



Due diligence on upstream production

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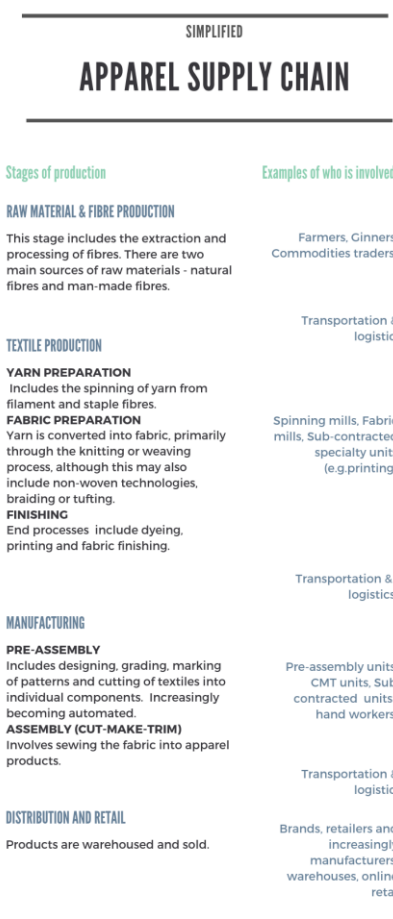
Partners

Know the Chain, Fair Labor Association (FLA), Nest, Yarn Ethically and Sustainably Sourced (YESS)

Objective

In recognition of the challenges to addressing risks beyond a company's immediate suppliers, this session will seek to identify practical approaches to carrying out due diligence along the supply chain with a specific focus on tier 2, sub-contracting to handworkers and cotton production. It will consider how the actions of companies along the supply chain can be mutually reinforcing.

Background



Structure of the garment and footwear supply chain and the actors involved

The garment and footwear supply chain is generally divided into stages (also referred to as tiers) which include: raw material and fibre production, textile production, manufacturing, distribution and retail. Differentiation in the supply chain is often fluid and a single tier may consist of one or many enterprises. For example, vertical integration, whereby a single enterprise owns and controls numerous processes within a single stage or across stages of the supply chain, is increasingly common in the apparel supply chain. The sector also includes a wide range of intermediaries operating at all stages of the supply chain, including buying agents, transporters, merchandisers and traders. Sub-contractors in the supply chain include both those with specialty skills, such as printers or hand workers or more standardised processes, such as assembly, in a response to fluctuations in orders. The variety of actors along the supply chain is diverse in terms of size and function. For example, an assembly manufacturer may be as small as 100 people or as large as 5,000+. Similarly cotton traders and merchandisers include both informal traders and large multinational merchandisers.

Supply chain due diligence beyond tier-one under the OECD Garment Guidance

Companies are recommended to carry out due diligence across their supply chain to identify and address labour, human rights and environmental impacts. See Box 1 for recommendations under the OECD Garment Guidance. In recognition of the complexity of the supply chain, a number of key principles guide due diligence:

- **Due diligence is risk based.** Companies prioritise the issues to address along the supply chain based on their severity in terms of scale, scope and irremediable character and on the likelihood of the potential impact. Furthermore, the measures that they take are commensurate to the likelihood and severity of the risk, meaning efforts to address severe issues should be more robust.
- **Due diligence is the responsibility of all actors in the supply chain.** All companies along the supply chain have a responsibility to carry out due diligence on their suppliers. In this way, due diligence is mutually reinforcing. For example, manufacturers may carry out due diligence on their suppliers and subcontractors or partner with their customers in doing so. Similarly, cotton merchandisers may
- **Due diligence can be carried out in collaboration.** Companies are encouraged to collaborate with peers and supply chain partners, for example, through industry initiatives or multi-stakeholder initiatives, to support full-supply chain solutions.

Even within the above context, full supply chain due diligence presents numerous challenges and is not yet common practice in the sector. This session will explore the role that brands and retailers, manufacturers, spinners and merchandisers can play in carrying out due diligence which is mutually reinforcing. It will likewise look at subcontracting to homeworkers which presents unique challenges and opportunities due its decentralised and often informal structure.

Box 1. Mechanisms to assess and address risks of harm beyond tier 2

**Excerpt from the OECD Garment Guidance*

It may be difficult for an enterprise to identify and assess individual suppliers operating upstream—for example at raw materials—due to a lack of visibility and leverage. This does not diminish the enterprise’s responsibility to identify harmful impacts upstream. Enterprises are encouraged to establish mechanisms that are fit-for-purpose. Establishing traceability and/or assessing ‘choke points’ are two example mechanisms that may be used to evaluate whether risks linked to harms upstream in an enterprise’s supply chain are being identified, prevented or mitigated. This is an area where collaborative approaches may be appropriate and are increasingly being used.

Traceability

Traceability is the process by which enterprises track materials and products and the conditions under which they were produced (in relation to matters covered by the OECD Guidelines) through the supply chain. It’s important to note that traceability as a tool may help an enterprise gain information on upstream actors, however, an enterprise cannot stop at traceability. The following subsequent steps in this Guidance—notably preventing and mitigating harm—are critical.

Engagement with ‘choke points’

‘Choke points’ may be identified using a number of considerations, such as:

- Key points of transformation in the supply chain
- Stages in the supply chain that generally include relatively few actors that process a majority of the commodity
- Stages in the supply chain with visibility and control over the circumstances of production and

trade upstream

By definition, an enterprise shares some of the same upstream suppliers as the enterprise operating at a choke point in its supply chain. However, the enterprise operating at the choke point likely holds greater visibility or leverage over those upstream suppliers. If an enterprise can reasonably determine that enterprises operating at choke points in its supply chain are conducting due diligence on their upstream suppliers, then the enterprise can likewise reasonably determine that risks of adverse impact linked to its own upstream suppliers have been identified, prevented and mitigated.

The enterprise may:

- identify suppliers operating at choke points in its supply chain for products that are linked to severe impacts upstream (i.e. beyond where the enterprise has visibility); and
- verify that enterprises operating at choke points are identifying, preventing and mitigating harms linked to their suppliers.

Example choke points in the garment and footwear supply chain may include:

- Global commodities merchandisers (e.g. for cotton and rubber)
- Exporters, processors, wholesalers (e.g. for fragmented supply chains)
- Chemical plants (e.g. for synthetic fibres)
- Smelter and refiners (e.g. for metals)

Cost sharing

Implementing traceability and engagement with choke points requires financial resources. The OECD Garment Guidance recommends that enterprises build into supplier contracts an obligation to support supply chain due diligence of risks linked to upstream production where appropriate (e.g. obligation to direct sourcing towards choke points that have demonstrated effective due diligence mechanisms). However, this Guidance does not recommend that enterprises mandate that suppliers engage in specific initiatives unless the enterprise is willing to support the cost of the supplier's participation and any associated premiums. Rather, enterprises should recognise a range of collaborative due diligence initiatives, tools, etc. that conform with this Guidance.

Collaboration

Enterprises are encouraged to collaborate, for example, through industry initiatives or multi-stakeholder initiatives, to implement the above. This is particularly important for the engagement of SMEs. The following are example steps that an enterprise or initiative may take to assess enterprises operating at choke points in the supply chain.

- Identification of actual or likely choke points in the supply chain
- Traceability to enterprises operating at choke points
- Verification (e.g. through management audits and random site-checks) that enterprises operating at choke points are applying due diligence on their upstream suppliers in accordance with the recommendations in this Guidance.
- Directed sourcing towards enterprises operating at choke points in the supply chain that are applying due diligence in accordance with this Guidance

Discussion questions

Tier 2

- What steps have buyers and first-tier suppliers undertaken to cascade labour standards (e.g. to manufacturers of fabrics / garments and subcontractors)?
- What is the role of buyers and first-tier suppliers in ensuring meaningful due diligence and capacity building on labour rights to second-tier suppliers?
- What are the challenges in implementing due diligence and capacity building at second-tier suppliers?
- What are the key strategies that could work at a tier 2 level for both data collection (on workforce demographics, working conditions, etc.) and remediation?

Subcontracting to handwork

- What is the context of handwork in the apparel supply chain?
- What are the biggest differences and challenges to ensure responsible sourcing from handworkers in the informal sector (subcontracted, small workshops, and homes) as opposed to factories and how can these be addressed?
- How can vendors be supported in facilitating these responsible practices with their subcontracted producer partners? What incentives exist for subcontractors to participate in the improvement of responsible sourcing practices?

Cotton production

- What does the supply chain for cotton look like? Who are the primary actors involved and what are their operating circumstances (e.g. Size, geographic location, market power, etc.)?
- Who are the choke-points in the cotton supply chain and how can choke-points be leveraged to support due diligence upstream?
- What incentives or relationships are necessary in order to engage with choke-points on due diligence upstream? In this regards, what processes will need to be put into place and what will be the corresponding roles of brands, retailers, manufacturers, spinners, ginners, traders, merchandisers and others alongside multi-stakeholder initiatives?

For more information

- The **KnowTheChain** benchmarks attempt to measure corporate efforts to address forced labour risks across different tiers of companies' supply chains. In 2018, the benchmarks found that, while many buyers require suppliers to cascade their supply chain labour standards, and some buyers take action to educate and work with second-tier suppliers, efforts of first-tier suppliers to address (forced) labour risks in their respective supply chains seem minimal or absent (or not disclosed).
- **The Fair Labor Association (FLA)** has been engaging with its affiliated companies and suppliers on extending work beyond tier one globally. In one such effort funded by the US State Department in Turkey, FLA is working with 6 international apparel and footwear companies, a group of tier 1 suppliers and tier 2 suppliers to explore useful strategies to mitigate child labour and forced labour risks at the tier 2 level.
- **Nest's** Standards for Homes and Small Workshops and Seal of Ethical Handcraft work together to promote industry-wide transparency and compliance for production taking place beyond the

four-walled factory. Measuring compliance across a matrix of 130 Standards, the training-first program is tailored to address the wide degree of variation in decentralised supply chains.

- The **YESS: Yarn Ethically & Sustainably Sourced** of the **Responsible Sourcing Network (RSN)** aims to support the due diligence of spinning mills on forced labour in cotton. Through its research, RSN determined that forced labour is a high risk in cotton production in nine countries which produce nearly 60% of the global cotton supply. YESS identifies the role of spinners and commodity traders as crucial for cascading effective due diligence prevention and mitigation of these risks.