

## Chapter Eight: Respect for Human Rights in Supplier and Service Provider Relationships

### Overview

#### *Brief overview of supplier and service provider relationships*

A supply contract is an agreement between a vendor and a customer for the procurement of goods. A service contract is an agreement for the provision of services. A “hybrid” contract includes elements of both. Contracts set out the specific goods and services to be provided, the costs and means of doing so, and allocate risks between the parties.

Supply and service relationships are often critical to the efficiency and effectiveness of a company’s operations. Many types of supply and service arrangement exist ranging from: purchasing a product or service directly from another business, to standard purchase contracts (sometimes conducted electronically) for commodities where there is never a direct relationship between the buyer and the seller, trader or producer, to outsourcing critical functions involving outside service providers who are privy to the intimate details of a company’s operations on a long-term basis. The terms of contracts also range widely, from standard form agreements, to complex documents with payments tied to performance criteria. Supply and service provider relationships can involve long chains of entities that may or may not be contractually linked.

Supply and service contracts are often agreed by two or more parties following the issue of a request for proposals. The request and subsequent contract frequently use similar language. Contracts are often tailored to meet the specific needs of the parties, clearly articulating their rights and obligations. Typically (though not always), the buyer can assert a degree of control over the supplier or service provider. In certain contracts (such as consigned manufacturing contracts), the buyer determines all terms and conditions, and selection criteria, and retains control for second and third tier suppliers.

The extent to which a company conducts up front due diligence on its suppliers and service providers typically depends on how many it has, the volume and value of contracts, and its perception of risk. Contracts tend to specify in detail the goods or services to be delivered and may contain incentives and provisions for monitoring the delivery and quality of particular goods or services, as well as penalties (including the possibility of termination) for non-performance. While monitoring production quality has a long history, it is only comparatively recently that monitoring of environmental, health, safety and labour has been regularly included in an increasing range of industries’ supplier and service provider contracts. When companies have long-term relationships with service providers or suppliers, they tend to work with them to improve practices rather than end relationships.

### *Human rights and suppliers and service providers*

Businesses may consider human rights impacts for a number of reasons when they work with suppliers and service providers. For example:

- Several of the early defining moments of the human rights and business movement were around supply chains – children making clothes, stitching footballs, weaving rugs. Media and NGO campaigns put human rights issues front and centre in some sectors. It is the business relationship category that has attracted the most consistent attention from the human rights community. There has been a particular focus on labour rights, starting in the apparel and sporting goods industries, working its way into the electronics and consumer goods industries, and increasingly into other sectors.
- Although labour rights are often the focus of human rights attention, supplier and service provider relationships can impact on a range of human rights. Problems have been associated *inter alia* with security provision, resettlement (e.g. due to factory expansion), air and soil pollution, and access to water resources. Though public attention has concentrated on working conditions in developing countries, recent cases in the agricultural, hospitality, and cleaning sectors have shown that human rights are equally relevant to supply chain relationships in developed countries.
- Advocacy on human rights abuses in supply chains focused initially on branded products in a few specific sectors. However, interest in improving social and economic development through improved conditions in global production networks has now spread to a wide range of products and services, from commodities to tourism. The number of initiatives addressing production conditions has exploded in recent years.<sup>85</sup>
- Companies are increasingly expected or required to be transparent about the origins and conditions of production of their products. This has implications for all their production relationships. Slowly, information about the origins of goods, and their conditions of production, are being standardised and becoming more widely available to consumers.
- Some governments use procurement incentives and disincentives to encourage companies to promote human rights and sustainability in their value chains. Though it is unclear how governments weight these factors alongside price in final award decisions, companies that have human rights due diligence systems in place will be in a better position to respond than companies that do not.

Many valuable initiatives promote and support business attention to human rights in supply chains. Frequent news reports and an extensive literature have examined human rights abuses in supply chains and service relationships. This chapter does not review that work but focuses on the relevance of the Guiding Principles to business relationships with suppliers and service providers based on information from respondents.

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<sup>85</sup> See for example, <http://www.standardsmap.org/>.

### What the Guiding Principles Bring to Supply Chain Relationships

Branded companies are increasingly requiring first tier (and sometimes second or third tier) suppliers to provide specified labour and working conditions that are in line with, or approximate to, internationally agreed standards. Approaches have often been 'audit led': brands at the top of the supply chain commission internal or external expert teams to verify that suppliers comply with codes of conduct set out in supplier agreements.

The Guiding Principles call into question some aspects of this traditional way of managing supplier relationships.

**First**, the Guiding Principles apply to all businesses, regardless of geography, size or sector. Therefore suppliers too have a responsibility to respect human rights, and take action to prevent their activities from causing or contributing to adverse human rights impacts. On these grounds, the Guiding Principles encourage companies to strengthen the management and leadership of their suppliers, so that they can conduct their own human rights due diligence. In effect, the capacity to manage takes precedence over successful audit results.

**Second**, the Guiding Principles require companies to prevent and mitigate negative human rights impacts (rather than merely complying with company standards). For example, the Guiding Principles encourage companies to proactively consider the adverse impacts of their purchasing behaviour, or the harm they might cause if they place supply chains in areas that have known human rights risks.

**Third**, the Guiding Principles require all businesses that are parties to a relationship to exercise due diligence with regard to *all* relevant human rights impacts, not just those relating to core labour standards. This might require companies to look at human rights issues within the workplace, which do not traditionally fall within labour relations (such as 'privacy'), and at impacts on workers and communities outside the workplace. (Relevant issues might include worker dormitories and accommodation, or mental health or family abuse issues associated with overwork or degrading conditions.)

As highlighted in this Report, the Guiding Principles are a new framework that is prompting companies to think carefully about its implications for their operations and their business relationships. Traditional approaches to supply chains may not be fully fit for purpose, suggesting that even familiar areas of corporate responsibility need to be reappraised.

## **Orienting and Embedding – Internal Company Management of Supplier and Service Provider Relationships**

### **Creating coherence between human rights policy commitments and procurement is a well-recognised challenge.**

Many of the companies in the research have specific and dedicated procurement departments to oversee supply chain relationships. These are backed up by procurement management systems that cover all phases of the business relationship, from identifying and evaluating suppliers, to selecting and negotiating contracts, monitoring and termination. Procurement departments and auditing functions are often managed by technical experts. Internal guidance developed by dedicated human rights staff or cross-departmental teams may be necessary to help these experts assess potential human rights issues. A number of companies have formed cross-departmental teams to make sure their environmental and human rights standards are fed into the procurement process.

The Guiding Principles note that procurement systems in particular need to be monitored for coherence. One well-known example involves a company's purchasing department issuing orders that undermined overtime pay, which conflicted with the company's supplier code of conduct requiring adherence to ILO standards for working hours and overtime pay

Respondents that are themselves suppliers highlighted the pressures suppliers face, especially in seasonal supply chains and when sudden demand peaks oblige their workforces to do extensive overtime. These pressures may force suppliers to balance their ability to fulfil signed contracts against their contractual obligations to maintain agreed working conditions, and price. Companies raised questions about the impact of end consumers' behaviour and expectations regarding price and lead-time demands and their own resultant human rights impacts.

Respondents identified a number of approaches they have taken to achieve coherence on human rights across company functions. Companies:

- Evaluate certain human rights requirements, and consider them, separately and alongside price, when they take decisions.
- Use pre-qualification systems to evaluate a supplier's ability to manage human rights issues.
- Train procurement staff to understand company codes of conduct and standards on appropriate workplace conditions and apply them in their procurement procedures.
- Explicitly monitor procurement orders against the company's human rights requirements, giving special consideration to the impact on suppliers and their staff of seasonal demand and demand peaks. Conduct periodic follow up and re-evaluation on an ongoing basis.

## The Business Relationship Cycle

### Selecting and Starting the Relationship

*Setting expectations and communicating them to business partners*

**Companies most frequently set and communicate their expectations for suppliers and service providers by developing company codes or policies.**

Respondents emphasised the importance of making clear to business partners what human rights standards they are expected to uphold, as purchasers of supplies and services and as suppliers and service providers themselves. Among the six business relationships covered in this Report, companies often have the most explicit human rights expectations of their suppliers. Respondents identified several approaches, usually articulated in a code of conduct. Companies:

- Apply the same expectations to suppliers that they apply to themselves in order to demonstrate that they can meet their own requirements.
- Develop codes of conduct specifically for their suppliers.
- Apply a graduated system, setting the strictest requirements for contractors who work on-site (akin to those applied to employees); less strict though still extensive expectations for strategic suppliers or service providers; and with fewer requirements for suppliers deemed less strategic.

Dedicated supplier codes of conduct usually focus on a defined set of labour rights, often the eight ILO core labour conventions. They often follow ILO definitions and standards (though not always fully), and refer to underlying ILO or other human rights standards (though not consistently). Respondents regularly mentioned child labour and forced labour when they discussed supply chain codes, with some treating breaches in these two areas as cause for termination in their standard contracts with suppliers. The codes of a few companies cover other labour rights, such as wages and benefits, and a few make reference to freedom of thought, conscience, religion, speech, or to community issues that implicitly or more explicitly integrate a wider range of human rights principles. Most codes expect companies to comply with national law. Industry-wide codes, like the Electronic Industry Code of Conduct, help to clarify expectations across a sector.

Supplier codes of conduct and detailed procurement requirements are evidently points of leverage. Suppliers or service providers meet or agree to meet them, and are not considered for partnership if they do not. Recognising that smaller suppliers or service providers may initially be unable to meet requirements, several respondents have capacity building programmes that assist such suppliers meet the requirements over time.

Companies that seek to ensure human rights are respected throughout their supply chain often find it difficult to communicate clear expectations and standards to business partners, as called for in the Guiding Principles, and at the same time act with the flexibility they require to deal with potential human rights issues in widely different and unpredictable circumstances. Particular human rights risks arise in certain countries

and sectors of a supply chain, new human rights issues appear that may not be covered in existing codes, and stakeholder expectations ceaselessly evolve and change. The Guiding Principles expect companies to assess their arrangements at regular intervals; periodically, they are also expected to undertake a more general review of their actual and potential impacts inside and outside supplier or service provider facilities, to capture broader trends and issues. Well-functioning operational-level grievance mechanisms offer a further way of identifying new human rights impacts requiring attention in the relationship. In response to these expectations, respondents said their companies had implicitly or explicitly adopted several approaches. Some:

- Undertake more detailed human rights due diligence on higher risk countries, sectors or partners.
- Add more detailed requirements to the procurement system (such as pre-qualification criteria that may not be public but are used to vet suppliers).
- Insert more detailed requirements in their contracts.

*Understanding the issues – Assessing human rights impacts in supplier and service provider relationships*

**Understanding the supplier or service provider is a key part of understanding potential human rights risks.**

Respondents highlighted the often-huge range of suppliers and service providers they deal with. They include other multinationals, small and medium sized enterprises, and companies in every form of jurisdiction. Some are based in the OECD, others in countries that have weak or contradictory laws and poor or non-existent law enforcement. Some partners set extremely high standards of conduct, while others have little or no awareness of their human rights obligations and have little internal capacity to assess or manage them. In some instances, suppliers and service providers may actively conceal their adverse impacts on human rights. The respondents noted that it is often impossible to undertake human rights due diligence on all partners. In such cases, they instead use a prioritisation system (see below).

Most of the companies involved in the research consider the assessment of potential business partners, particularly more strategic suppliers and service providers, to be of fundamental importance to the due diligence process. Many have extensive “know your customer” procedures they use with business partners, grounded in their experience of anti-corruption and anti-money laundering standards. They sometimes undertake a very extensive review of a business partner’s record and reputation. Several companies explicitly review any court cases involving human rights, as well as public sources that link the business partner to human rights issues. In this respect, respondents regretted that very little reliable information is publicly available.

Some companies in the extractive sector look explicitly at a supplier’s community commitments (for example, social investment plans, local hiring, training programmes for local communities, provision of services and local purchasing targets). In some

countries, government local content rules impose local hiring and purchase quotas. For specific types of service providers (notably private security forces) companies carry out specific background checks, often using specialised consultancy services. External benchmarks, such as membership in the Dow Jones Sustainability Index, also figure in some companies' initial assessment of partners.

A number of companies have pre-qualification systems, some of which address specific human rights (notably child labour, forced labour, health and safety and discrimination), as well as broader environmental and social issues. Inquiries may be supplemented by on-site inspection. Several companies explicitly review a supplier's management system and its ability to manage key procurement requirements, including human rights issues that are referenced in company codes of conduct and procurement rules. These checks provide some additional assurance that business partners have the capacity to address key performance challenges, rather than relying on contractual requirements alone. One company has developed a corporate responsibility self-assessment module specifically for suppliers, undertaken after pre-qualification, and when the supplier has agreed to abide by the company's code of conduct. In some companies, more detailed "key performance indicators" (KPIs) are further applied to track performance. These pre-qualification systems provide an interesting opportunity to put the analysis of the technical and management capabilities of supplier systems into the hands of human rights experts in companies (if such expertise exists). When suppliers are considered high risk, some companies also do post-award audits involving desktop due diligence followed by on-site inspection, leading to a detailed action plan.

**Assessing country risks often depends on where the supplier or service provider is located and the types of services provided.**

Many respondents undertake country assessments on a wide range of issues. Their first basic question is whether to do business in a country. Some then look more explicitly at human rights issues, using publicly available sources such as the Business and Human Rights Resource Centre or commercially available sources. The analysis that emerges is then applied to identify key risk areas, for example the heightened vulnerability of migrant workers in some countries, the prevalence of child labour, or the presence of indigenous peoples. On the basis of this work, companies prepare a broader risk analysis. Some companies do not conduct country risk analysis in OECD countries, judging that their domestic systems are sufficiently robust to protect human rights.

**Faced by complex supply chains, companies prioritise certain risks. Some are developing approaches to risk that explicitly consider human rights.**

Context matters when identifying human rights risks, which tend to be locality and sector specific. Given this, and the length and diversity of supply chains, human rights due diligence processes need also to be locality and sector specific in order to identify and prioritise these risks (see Chapter 2 for further discussion on prioritisation). The supplier screening systems of a few respondents explicitly prioritise in-depth reviews of regions, sectors or suppliers that present high human rights risk. This mirrors the Guiding Principles' pragmatic view that companies with large supply chains may find

it unworkable to assess human rights risks in each of their relationships. The Guiding Principles expect a company to adopt an approach that prioritises the most serious risks, focusing on risks to people (not just risks to the company). Respondents recognised that this new approach may generate “counterintuitive” results for procurement systems that have traditionally been driven by volume and price.

In deciding which suppliers to focus on, one company evaluates human rights risk by country and by industry and focuses on suppliers that score high in both categories. Other companies identify products and services that generically raise human rights concerns (for example, small and home-based producers who may employ child labour). Prioritised suppliers are then often targeted for site visits. One company is actively searching out suppliers and contractors who employ disabled workers. This illustrates how a business can promote suppliers who provide a non-discriminatory workplace. Other companies have not yet started to prioritise. As a first step, they are focusing on incorporating human rights issues in their procurement systems, in a manner they find manageable.

**As one respondent noted:**

“We are trying to get a more comprehensive picture of the impacts of our products and services and we are doing that in two principal ways. We are working with the Danish Institute for Human Rights to develop a grid that evaluates our suppliers on human rights issues, and we are mapping our own products and services in all regions around the world to look at the human rights and environmental risks and opportunities associated with those products and services.”

**Stakeholder consultations in supply chains often focus only on workers once the relationship has started.**

While companies consult stakeholders about the overall direction of their human rights policies, some take the view that it is the responsibility of their business partners in the supply chain to consult local stakeholders.

Once a business relationship has been established, companies do interact to an extent with workers when they audit through their supplier monitoring programmes. The Guiding Principles expect companies to integrate stakeholder input in their human rights due diligence, but give little guidance on how this is to be achieved in large supply chains.

Respondents whose projects have a large physical footprint, involving many suppliers and service providers, generally utilise a well-developed methodology around interactive, consultative environmental and social impact assessments. It is unclear however, how much and when businesses involve external stakeholders in their assessments of human rights impacts in other suppliers and service provider relationships, even the more significant ones.

**When supply chains consolidate, it is an opportunity to align shared values.**

Several companies participating in the research detected a growing trend to consolidate supply chains. Companies are creating deeper relationships with fewer suppliers, particularly strategic ones. In the process, purchasers focus on long-term value, grounded in expertise more than price. This implies closer and longer-term relationships, and sharing of standards and systems. It may be that this process will make it easier to integrate human rights, ethical values and good practices in supply chains.

**Companies do not yet know how to calculate the efficiency of their spending on supply chain compliance.**

None of the companies consulted could readily calculate how much their supplier monitoring system costs or whether the benefits justify its cost. One estimate carried out in Denmark calculated that Danish companies spend annually on their monitoring systems an amount equivalent to 40% of the Danish foreign aid budget.<sup>86</sup>

**Formalising the Relationship**

**Contractual references to human rights issues serve several purposes.**

Noting that it would be prohibitively expensive and burdensome for companies to conduct human rights due diligence across whole value chains, many respondents observed that standard contractual provisions that reference human rights serve several purposes:

- They codify expectations upfront and provide a means to raise questions and require corrective action when things go wrong, especially when coupled with contractual provisions on monitoring and auditing.
- They provide a contractual justification for termination if corrective action is not taken.
- They prompt suppliers and service providers to reflect on their responsibilities.

Respondents undertake a range of different approaches to contracting. Many companies require suppliers to adhere to their codes of conduct or other supplier standards, which contain (explicit or implicit) human rights requirements, rather than directly reference human rights issues in contracts. One company participant does not include requirements on supplier auditing and corrective action unless there is a realistic expectation that they will be implemented. It considers that contractual provisions alone, without the capacity to deliver or follow them up, risk presenting a façade of attention that may mask significant or underlying human rights risks.

Most companies have some kind of standard form agreement that can be adapted to local law and conditions, with varying levels of control by legal counsel in company headquarters. In many companies, the business team that holds overall responsibility for the supplier relationship is responsible for the contracts that relate to it.

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<sup>86</sup> *Changing Course – A study into Responsible Supply Chain Management*, Global CSR and Copenhagen Business School for the Danish Ministry of Foreign Affairs (2011), 13. At: [http://www.global-csr.com/fileadmin/Our\\_Approach/RSCM\\_MainReport\\_110111.pdf](http://www.global-csr.com/fileadmin/Our_Approach/RSCM_MainReport_110111.pdf).

**Given the wide range of their relationships, companies use an array of tools to generate leverage.**

It is often assumed that a large multinational will always be a large purchaser with leverage to impose conditions on its supply chain or service providers. In reality, the size of the contract varies widely and relationships are so diverse that companies need to actively adopt many techniques to create leverage over suppliers directly linked to their operations, products and services to respect human rights. This is especially true when supply chains are long and increasingly anonymous.

When discussing what causes suppliers to adopt shared values, respondents repeatedly emphasised the effectiveness of incentives and capacity. To secure change, several companies said they provide suppliers and service providers with incentives (repeat business, capacity building, opportunities to build their systems, offers of preferential treatment) rather than impose punitive approaches (contractual requirements, auditing systems). One company uses “supplier scorecards” (that include EHS issues), which it uses to assign new business and reward suppliers who perform well.

**Creating Leverage Beyond the First Tier**

When seeking to create leverage beyond first tier suppliers, different approaches were identified. Companies:

- Require suppliers to apply the company’s code of conduct or an industry-wide code of conduct in their contracts with their suppliers (sub-suppliers).
- Involve sub-suppliers in training and capacity building.
- Encourage first tier suppliers to promote key values among second tier suppliers, thereby engendering wider local buy in.
- Apply the same requirements to all contractors and sub-contractors who work on a site or in connection with a project.
- Make use of local content requirements to involve government departments and local NGOs in longer-term capacity building programmes.
- Simplify contract award procedures if standards are met and maintained.

**It is common to specify the consequences of non-compliance.**

Most companies stated that their contracts specify the consequences of non-compliance with contractual conditions or company codes of conduct. Where suppliers do not comply with legal and regulatory conditions, companies usually define the corrective action they must take, monitor their performance, and eventually terminate the relationship if non-compliance persists. Many companies emphasised that their objective is not termination but compliance, because termination can harm the interests of the company, the supplier and potentially the suppliers’ employees.

### **Graduated contractual provisions can provide flexibility.**

Though not a common practice, some companies use or are considering using graduated contractual requirements to address different levels of risk in their supplier relationships. These could potentially be adapted to address human rights risks. When a company identifies that a supplier relationship is high risk, it monitors the supplier more frequently and requires it to meet more stringent or more detailed conditions. A different approach may be taken for less sophisticated suppliers: the company includes more capacity building and training in the contract, and inserts higher penalty levels if “things really go wrong”.

### **Understanding and Managing Contracting Chains in the Oil and Gas Sector**

A recent report by the International Institute for Environment and Development (IIED), **Shared value, shared responsibility: A new approach to managing contracting chains in the oil and gas sector**,<sup>87</sup> highlights critical challenges for major companies. These include how to:

- Cultivate a sense of shared responsibility throughout the contracting chain and across stakeholder groups.
- Adequately implement systems and procedures to enforce standards and incentivise good performance.
- Operate across differing cultural and contextual landscapes.

The report identifies short and longer-term recommendations. These include:

- Collaborate on early-stage planning and assessments.
- Invest in capacity building in underdeveloped local markets.
- Encourage uptake of standards through procurement processes.
- Ensure that contracts incentivise good practice.
- Build capacities and trust on the job.
- Ensure excellent communication and oversight throughout the contracting chain.
- Build trust and accountability with external stakeholders.

### **Companies are asking partners to communicate the company’s requirements to their business partners.**

Several companies require or expect their suppliers or service providers to apply the company’s code of conduct to their own direct sub-contractors and potentially to further layers of the supply chain. Some also require suppliers or contractors to audit sub-contractors. These provisions serve to cascade human rights requirements down the supply chain and extend the company’s human rights influence. Some companies explicitly review a contractor’s application of provisions to sub-contractors, while

87 <http://pubs.iied.org/pdfs/16026IIED.pdf>.

others noted they see explicit legal problems with going more than one step down the supply chain. All the companies recognised that practical difficulties arise when they seek to exercise influence beyond the first layer of the supply chain. Several noted, nevertheless, that they are analysing their full supply chain, often in response to new US requirements on conflict minerals (see box above). On-site operations provide the exception. Several companies impose explicit requirements (typically health and safety rules) on all contractors, sub-contractors, and sub-sub contractors who enter their sites. These requirements are enforced by a strict system of visual, on-site inspection.

### **Reflecting MSI and industry initiative requirements in contracts is an approach to note.**

Earlier chapters have already observed that several MSIs explicitly or implicitly address human rights issues in the supply chain or with service providers. They include the Voluntary Principles on Security and Human Rights, the Roundtable on Sustainable Palm Oil, the Kimberley Process Certification Scheme, the Electronic Industry Code of Conduct, and the Fair Labour Association. Some of these initiatives have developed specific guidance on management of supply chains and service providers. Some MSIs explicitly require their provisions to be included in supply chain or service provider contracts (where they are usually referenced). Referencing all or part of their codes or guides within contracts with suppliers or service providers has several advantages. They:

- Provide a shorthand way to authoritatively define detailed expectations, because most have been carefully negotiated and discussed, often in a multistakeholder setting.
- Clarify the meaning and intention of certain contractual conditions.
- Provide for referral of disputes (where an MSI has created this function).

As with other clauses on human rights issues, more meaningful attention and leverage are possible if contractual requirements include compliance with these initiatives (or relevant parts of the initiatives), and are backed up by additional provisions providing for on-going tracking and communication, as called for in the Guiding Principles.

### **Due Diligence in Supply Chains around Conflict Minerals and Metals**

“Conflict” in company supply chains has been making headlines since the 1990s. Since the original controversy over ‘blood’ diamonds, the mining and supply of a range of minerals (tin, tungsten, tantalum, gold) has come under scrutiny, notably in the Democratic Republic of Congo (DRC). Numerous multistakeholder approaches to regulation of the production and use of minerals and metals have been created by states, civil society, trade unions and business.

- **The Kimberley Process and Certification Scheme (KPCS)** was the first of these joint initiatives. A tripartite government, industry and civil society initiative, formed to stem the flow of conflict diamonds, the KPCS is an import-export certification scheme that requires governments to certify that the origins of rough diamonds are conflict-free.

- The OECD organised a multistakeholder process with the eleven African countries of the International Conference of the Great Lakes Region, and with industry, civil society and the UN Group of Experts on the DRC. The group produced the **OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas**.<sup>88</sup> This document focuses on the supply of tin, tantalum and tungsten, while a **Supplement on Gold**<sup>89</sup> was published subsequently. These reports provide guidance to companies on their due diligence responsibilities at different phases of mineral and gold production and supply.
- The recently launched **Public-Private Alliance for Responsible Mineral Trade**<sup>90</sup> brings together the US government, twenty high-tech and automotive companies, four industry associations, six NGOs and the International Conference of the Great Lakes Region. It aims to establish fully traceable and validated supply chains that are credible to companies, civil society and governments, and to act as an information hub for those interested in taking action on responsible minerals trading.

Two additional industrial initiatives are looking at improving the traceability of products.

- **The Electronic Industry Citizenship Coalition (EICC) and the Global e-Sustainability Initiative (GeSI)**, two socially and environmentally focused electronics industry associations, have joined forces to address conflict minerals in the electronics supply chain.<sup>91</sup> Their joint working group will enable companies to source conflict-free minerals by: implementing their Conflict-Free Smelter and Due Diligence programmes; supporting in-region sourcing schemes to enable future legitimate trade from the DRC and surrounding countries; supporting the OECD's due diligence guidance; and engaging with stakeholders.
- **The Responsible Jewellery Council (RJC)**, a membership organisation of over 360 businesses and associations in the diamond, gold and platinum metals supply chain, has undertaken several multistakeholder initiatives. The most recent is the Chain-of-Custody Certification Standard,<sup>92</sup> which guarantees that materials are conflict-free and responsibly produced according to the human rights, labour, environmental and ethical standards outlined in the RJC Code of Practice.

88 At: <http://www.oecd.org/dataoecd/62/30/46740847.pdf>.

89 At: <http://www.oecd.org/dataoecd/54/39/49187571.pdf>.

90 At: <http://www.resolv.org/site-ppa/>.

91 At: [http://www.eicc.info/documents/EICC-GeSI\\_ConflictMineral\\_Overview\\_30May2011FINAL.pdf](http://www.eicc.info/documents/EICC-GeSI_ConflictMineral_Overview_30May2011FINAL.pdf).

92 At: <http://www.rjc-dev.logicspot.com/chain-of-custody-certification/>.

## Managing the Relationship

### **Monitoring (some) suppliers has become a routine part of supply chain relationships.**

Given the long history of attention to this issue, it is noteworthy that the basic approach to addressing human rights with suppliers has not evolved significantly since the early days of monitoring supply chains, nor as the system has migrated from industry to industry.<sup>93</sup> All the companies that participated in the discussion of supply chains employ a similar system for setting standards, monitoring, and correcting shortcomings of performance. Respondents implicitly or explicitly recognised the need to review their business relationships periodically because all have a form of risk-based monitoring for their suppliers. This often combines supplier self-assessment with company or independent third party assessment. Assessments determine which suppliers are audited, based on a range of factors (country risk, number of employees, type of labour, quality of relationship). Monitoring usually focuses on supplier compliance with the company's code of conduct for suppliers, or other contractual requirements.

Respondents raised questions about the extent to which companies' continuous monitoring of suppliers should employ KPIs that examine human rights performance vis-à-vis their code of conduct or other business principles (as well as more traditional indicators that focus on operational and financial performance and customer satisfaction). It was noted that a company's decision to use standardised performance indicators will be influenced by its position on human rights, and its size, sector, and operating context.

### **Companies are reducing the audit burden and identifying key concerns.**

If non-compliance is discovered, a company will usually prepare a corrective action plan that is monitored until the supplier or service provider completes the corrective action. Some companies have banded together with others in their sector to reduce the auditing burden on suppliers and shifted attention to corrective action, for example using the Supplier Ethical Data Exchange (SEDEX). Others, while recognising the trends noted above, have moved towards an incentive-based approach, away from one based solely on monitoring.

In addition to structured monitoring systems, several companies review human rights issues by "piggybacking" on other forms of audit or monitoring. One company participant used safety inspections to monitor child labour. Several companies referred to "eyes wide open" visits. Here, staff familiar with the company's standards and code of conduct are trained to keep their eyes open for breaches of human rights when they visit suppliers or service providers for an unrelated purpose.

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<sup>93</sup> See footnote 70, which assesses the current array of initiatives and considers the extent of their demonstrated impacts on working conditions.

**Non-compliance measures are often viewed by suppliers as punitive. Some companies find proactive and incentive-based systems more effective.**

When supply chains are very long, many respondents observed that it is not feasible to provide capacity-building support to all supply chain or service partners. Such programmes often focus on specific business needs (such as meeting local content regulations), particular risks to the company (such as security issues), or a more general approach to driving productivity. Their content ranges from sharing good practice, to detailed technical training, or induction into web-based tools. In some cases, companies have engaged local NGOs as trainers, or asked local suppliers to sub-contract this service. Capacity building is an important complement to contractual conditions to avoid situations where companies use contractual conditions to shift liability for human rights failures to partners who lack knowledge or capacity to seriously address the issues in question (as discussed in Chapter 2).

Some companies run capacity building programmes, often designed specifically for local SMEs, to meet their procurement standards (including those related to human rights). Other companies said they lacked the capacity to provide such outreach. In some cases, capacity building had purely business motives (to respond to increasing local content requirements, particularly in the infrastructure and extractives sectors). A number of companies wished to build or deepen local acceptance. Still others undertake capacity building because they understand it to be core to their social responsibility.

**Some reporting by suppliers and of audit results is occurring in select sectors.**

As noted above, considerable attention has been devoted to human rights problems in supply chains, particularly in certain industries. Several companies in sectors subject to stakeholder scrutiny report on their supply chain auditing programmes and results, and some report in detail (though they rarely disclose the identity of suppliers). Several companies in the retail sector transparently report on business relationships in their supply chain, but this is not yet a widespread trend.

**‘Whistle-blower lines’ are the most common form of grievance mechanism, but practices vary.**

Businesses in the sector have adopted different models of operational-level grievance mechanisms. One of the most common is a “whistle-blower line” or website on which individuals can report concerns confidentially. These procedures tend to focus on company policy or compliance with codes of conduct, supported by a process to assess and address issues that are reported. A few of the companies in the research allow complaints about business partners to be reported via their own whistle-blower line. Others require business partners to operate their own whistle-blower system. Some others have either not yet addressed the issue or consider it entirely the business partner’s responsibility.

Some companies whose projects have large physical footprints require their principal contractor to establish an operational level grievance mechanism for community relations issues. The contractor is required to report on grievances and their resolution.

### MSIs can assist companies to resolve disputes and prompt development of effective dispute mitigation.

MSIs can provide an obvious place to resolve disputes but experience here is a work in progress. Respondents noted a number of features of an effective MSI grievance process. It should encourage cooperation among the different tiers in the sector's supply chains and open dialogue between stakeholders. It should also encourage active mitigation of issues before escalation to the MSI. To provide accountability, the grievance process could include a membership termination option, if members do not adequately resolve 'serious grounds' of complaint against them.

### Innovations on Labour Standards Compliance

Much innovative research has recently been done on supply chain management.

- **The Capturing the Gains Programme.**<sup>94</sup> Based at the Brooks World Poverty Institute at the University of Manchester, this programme considers that "economic and social upgrading" contributes to more sustainable growth and development in global production networks. Economic upgrading stimulates innovation and competitiveness among firms, while social upgrading promotes employment based on decent work and respect for labour standards. The programme is investigating how private sector global production networks are changing the dynamics of trade, production and employment in developing countries.
- **The Commitment Approach.** An alternative to lean production and traditional labour standards compliance models has recently been developed by Richard Locke and others at the Massachusetts Institute of Technology (MIT).<sup>95</sup> While the concept of lean production is well established, the research applies it to supply chains to improve certain labour standards (wages, overtime and accident rates, though not freedom of association). Complementing traditional compliance-driven approaches to production, the 'commitment' model focuses on learning, capacity building, incentives, mutual respect and mutual gains for compliance officers and the suppliers they inspect. Finding that compliance programs have produced only modest and uneven improvements in working conditions and labour rights in most global supply chains, it seeks to address the 'root cause' of low standards through joint problem solving, information sharing and generation of trust – as laid out in Locke et al's comparative table below.

94 At: <http://www.capturingthegains.org/>.

95 See for example, Locke et al , *Virtue out of Necessity?: Compliance, Commitment and the Improvement of Labor Conditions in Global Supply Chains* (2009), 46. At: <http://www.princeton.edu/~smeunier/Locke>. See more generally: <http://web.mit.edu/polisci/people/faculty/richard-locke.html>.

Comparison of the Compliance vs. Commitment Approach		
	Compliance	Commitment
Approach:	Rules/Standards Focus "Meeting" Standards	Uncovering, Analyzing and Correcting "Root Causes" of Current Issues
Mechanisms:	Policing, Detailed Audit Protocols (checklists), Inspections, Documentation	Joint Problem Solving, Information-Sharing, Trust, Reciprocity
Dynamics:	"Us vs. Them" Functional Division of Labor Mixed Signals	Mentoring, Coaching, Diffusion of Best Practices, Integration of Standards with Operational Excellence
Drivers of Change:	Repeated Audits, Pressures from Above, (Negative) Incentives	Learning, Capacity-Building, (Positive) Incentives, Mutual Respect

### Ending or Renewing the Relationship

**Termination clauses are common in supplier contracts, but rarely applied in practice, in favour of corrective action.**

All contracts typically have some form of termination clause. Given the scrutiny of human rights conditions in supply chains, specialised contract clauses have been developed to permit termination on specific human rights grounds, typically for child labour and forced labour. Some companies have a no-tolerance policy on these issues, and require an immediate response from their business partners if these abuses are reported. A number of companies reported that their contracts include more general clauses for non-compliance with their code of conduct for suppliers (or similar company policies), requiring suppliers to carry out corrective action when failures of compliance are identified. Corrective action is subject to monitoring and reporting. Several companies reported that very rarely they terminated relationships on grounds of non-compliance, but their clear preference is to promote corrective action, maintain the relationship, and resolve the problems that have been identified.