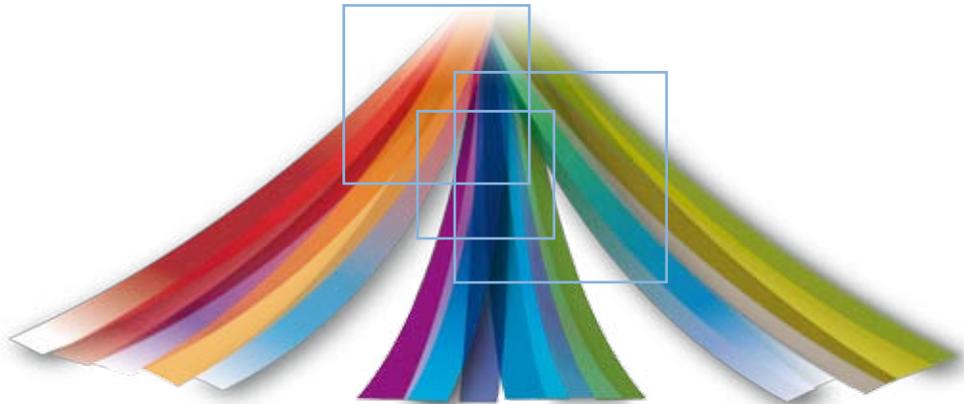


GLOBAL JOBS PACT POLICY BRIEFS



International
Labour
Organization



RESPONSIBLE PRACTICES IN SUPPLY CHAINS

1. Executive summary

The financial and economic crisis presents an enormous challenge to enterprises and has a profound effect on jobs and the well-being of people affected directly (who are losing their jobs) and indirectly (who are not losing their jobs, but whose conditions of work, including psychological ones, deteriorate). This challenge is particularly difficult for the smaller enterprises involved in the supply chains of larger enterprises.

At times of crisis the main challenges for enterprises,

and 'employers and workers' representatives at the enterprise level, is how to address the impact on the enterprise through, dialogue, information, consultation and negotiations, and minimize the social costs. The main challenge for the policy makers and social partners at national and sector levels is how to assist enterprises in achieving this goal. The ILO assists its constituents in addressing such challenges through upstream work (the development of manuals, handbooks, policy guidelines, etc.), and direct assistance at the country level through technical cooperation projects.

2. Description of the policy challenges

The financial crisis has introduced a set of profound issues, in a globalized economy, among which :

- National markets are integrating into global markets for products, services and factors of production, and becoming increasingly interdependent due to new patterns of trade, and flows of capital and technology. Since the mid 1980s this integration of markets has accelerated, fuelled by many governments adopting free-market economic systems and entering international trading agreements. Rapid technological advance, particularly in information and communication technology, transport and manufacturing has made possible large-scale systems of global production and distribution. With production systems being broken down into their component parts, corporate strategy is now based more on outsourcing, so that the production of intermediate goods are sourced internationally wherever the best deal can be found. The present

wave of globalization is characterized by increasing trade in manufactures, where the world share of the developed countries in manufacturing exports has declined. In contrast to the past, where trade from developing countries was mainly in raw materials and primary products, since the early 1980's trade between industrialized and developing countries has been increasingly in competing manufactured products. While in 1955 developed countries accounted for 85 percent of world exports of manufactured goods, in 2006 the share was only around 67 percent.¹ Developing country exports in manufacturing have increased: first in labour intensive products such as textiles and garments and subsequently in electronics, office and telecom equipment and automotives.

¹ WTO: Trade in the Globalizing World, (World Trade Organization, Geneva 2008)

The Global Jobs Pact policy brief series is intended to inform readers of the relevance of the ILO's technical areas of work in addressing economic downturns as well as assisting in sustainable economic recoveries. Each brief is an invitation to the reader to contact the ILO for additional information and support.

More briefs can be found and downloaded at <http://www.ilo.org/jobspact>



In broader political, social, cultural and environmental terms, globalization forms a series of “pushes” and “pulls” that act on enterprises and influences the way they are managed. Some of the results of this are seen as harmful and are expressed in two main streams of criticism.

- Labour critics point to the dangers of abuse of human rights in the workplace, in particular within the supply chains of multinational enterprises (MNEs).
- Environmental critics point to unrestrained economic activity accelerating global warming and depleting natural resources, such as forests in developing countries.

Concerns about the negative economic, social and ecological impacts of the present forms of globalization have been rising in both developing and industrialized countries. In developing countries, globalization is seen as leading to increased inequality, exploitation, environmental degradation and the breakdown of social cohesion. In industrialized economies the concerns are about job displacements, wage stagnation, the weakening of social protection, and rising inequality. These concerns threaten a backlash against further liberalization of trade and investment.²

Thus, some observers see the speed of globalization slowing down and its nature changing.³ On the one hand, they see that the technological revolution, e.g. in ICT, will continue to spur the internationalization of MNEs operations. On the other hand, they see the increasing reluctance of policy makers both in developed and developing countries to open up their borders any further partly because of their publics’ outcries at the perceived negative economic, social and environmental impacts of globalization. The breakdown on July 29, 2008 of the Doha trade negotiations and, the export restraints of some exporting countries in response to rising prices of food and commodities in the early part of 2008 are indicative of this trend. A more restrained globalization is therefore foreseen in some quarters. As early as 2004, The ILO World Commission on the Social Dimension of Globalization extensively examined the concern for the social impact of globalization. The Commission came with a number of observations and recommendations.⁴

a) Global supply chains in the context of globalization and the current crisis

In the context of globalization, a major development in the business environment is the rapid growth of global supply chains as production-distribution systems that are becoming increasingly disaggregated geographically. To be competitive,

flexible and agile, enterprises are outsourcing and off-shoring the components and services they need to other enterprises, whether located in the same locality or country or in other countries. Data from Massachusetts-based Forester Research estimates that around 1.5 million jobs in the services sector in Europe will be off-shored to lower-waged economies in the next 10 years. In particular, India and China are becoming the favoured offshore destinations for high-end telecommunications, software development and research and development work.⁵

On the other hand, of course, the number of new MNEs from emerging economies, such as China and India, but also Argentina, Brazil, and Russia is increasing, and are expected, just like their economies, to become more prominent in the future and move into industrialized countries’ markets. They are likely to play a more significant role in the post-recession global economy.

The production-distribution process becomes a chain, network or cluster of supplier-user enterprises, starting from the supply of basic raw materials to the selling to the end user, sometimes even to the final disposal of the end product.

At the same time, faced with increased competition in the globalized market, enterprises (in particular, small and medium-size enterprises, SMEs) form or are encouraged to form enterprise clusters. With sector and geographic concentration, the enterprises benefit from agglomeration advantages such as access to specialized suppliers of raw materials, components, machinery, skills and technology as well as supporting services. Their cooperative and competitive interactions and linkages result in better collective learning and innovation. Thus, many countries have adopted the promotion of industrial clusters as an industry development strategy.

² United Nations Conference on Trade and Development (UNCTAD): Globalization for Development: The international trade perspective, (UNCTAD, Geneva, 2008).

³ See for example: Abdelal, R.; Segal, A.: “Has globalization passed its peak” in Foreign Affairs, Vol 86, No.1, 2007. Available at: <http://www.foreignaffairs.com/articles/62273/rawi-abdelal-and-adam-segal/has-globalization-passed-its-peak>

⁴ ILO: A Fair Globalization: Creating Opportunities for All, Report of the ILO World Commission on Social dimension of globalization, (Geneva, ILO, 2004).

⁵ R. Ernsberger: “The Big Squeeze” in Newsweek, (2005, 30 May) pp.48-52



b) Cluster upgrading – an important strategy to improve the economic performance of enterprises

As the competitiveness and productivity of enterprises are now very much dependent on the efficient use of supply chains, such efficiency can be further enhanced by cluster dynamics. Supply-chain improvement and cluster upgrading has become an important strategy to improve the economic performance of enterprises. At the same time, the ecological impacts and the social impacts of an enterprise need to be examined from supply-chain and cluster perspectives.

Often, competitive pressures, in particular in the case of SMEs in developing countries, encourage firms to desist from making investments in human capital and improving working conditions. Guarding against a deterioration of wages and working conditions through the application of international labour standards and the national laws they inform consequently should acquire greater prominence as a policy objective.

The improvement of working conditions, providing opportunities and incentives for skills development or installing new equipment in the smaller sub/contracting enterprises are often perceived by entrepreneurs as costly propositions. Furthermore, the longer-term benefits of productivity and profitability are not always understood by micro and small enterprises operating in a cluster environment.

At the same time, it must be emphasized that the extent of enhancement of competitiveness and productivity of the 'lead firms' is often determined by the technology, skills, working conditions and business practices at the lower levels of hierarchy of the supply chain.

If the cluster predates the supply chain linkages to international sourcing firms, the old practices of operating under poor working conditions with outdated equipment are even more likely to be entrenched and will need change in entrepreneurial and work cultures. Policy makers and local government authorities, 'lead firms' and the private sector, stakeholder institutions and the local community, together with development agencies will need to develop an environment with mechanisms that encourage the SMEs - along the supply chain and in clusters - to improve job quality and so upgrade the cluster. This should include government initiatives to promote the presence and consultation of trade unions in SMEs, for instance, by reducing the threshold beneath which small firms in some countries are exempted from labour law provisions.

For enterprises to prosper in the supply chain, they have to

upgrade themselves through constant improvement in their products, in the efficiency of their operations and in moving up to more value adding activities in the chain. Moving up along the supply chain is a strategy that concerns not just enterprises themselves but also policy makers for the following reasons.⁶

- Various activities being located in different parts of the world make participation in the global supply chain a potent industrial development strategy.
- Some activities in the chain add more value and are more lucrative than others, with the share of overall returns shifting more and more to the upstream end of the chain; so the further you move up the chain the more opportunities there are for higher returns.
- Some actors have power over others in the chain, e.g. multinationals have more power, whether as the main buyers or leading producers in the chain. In case of crisis, such power of the multinationals might lead to additional costs imposed upon the suppliers due to the MNEs' intention to share risks and costs by distributing them all along the supply chain.

At the same time, one should not ignore the fact that SMEs and entrepreneurs play a significant role in all economies and are the key generators of employment and income, and drivers of innovation and growth. For example, in the OECD area, SMEs employ more than half of the labour force in the private sector. In the European Union, they account for over 99 % of all enterprises. Furthermore, 91 % of these enterprises are micro-firms with less than 10 workers. Given their importance in all economies, they are essential for economic recovery.⁷

The dramatic job losses in large enterprises potentially distract attention from the significant impact that the financial and economic crisis has on employment in the enterprises involved in their supply chains, which are mainly SMEs. Research evidence shows that the economic crisis dominates the supply chain agenda (see Box 1).

At the same time, SMEs have been especially hard hit by

⁶ United Nations Conference on Trade and Development (UNCTAD): Value chain issues, (UNCTAD, Geneva, Sep. 2007)

⁷ Organisation for Economic Cooperation and Development (OECD): The Impact of the Global Crisis on SME and Entrepreneurship Financing and Policy Responses, (OECD, Paris, 2009). Available at: <http://www.oecd.org/dataoecd/40/34/43183090.pdf>



Box 1. Economic crisis dominated the supply chain agenda in 2009

Capgemini Consulting carried out an international study which aimed at investigating the main factors influencing the supply chain agenda in 2009. The study was executed by means of a survey, which was completed by over 300 respondents in Europe (62 %), the United States and Canada (16 %), Asia (13 %) and Latin America (5 %). In addition to the survey, there were several interviews with Supply Chain Managers.

The study shows that the financial crisis led the list of most influencing factors for the supply chain agenda in 2009. Over 65 percent of the questioned managers engaged in logistics affairs, said that their strategy was affected by the crisis. Another striking finding is that 34 per cent of the managers mentioned “sustainability” as a topic on their agenda.

The financial crisis was the most important motive for 2009.

To the question “what are the most influencing factors on the supply chain agenda 2009”, 65 % of the respondents answered that the financial crisis was the most important topic. Next to that, meeting (changing) customer requirements and sustainability appeared to be important motives for the supply chain manager.

The focus of supply chain managers shifts towards short term-results.

Capgemini asked the respondents to list the projects that were on the supply chain agenda before the financial crisis, and the projects that were (still) on the agenda after the start of the financial crisis. The top ten of supply chain projects show a shift caused by the downturn. Projects that were aimed at the reduction of inventory and the renewal of contracts with current or new logistics service-providers, showed a clear increase. More ‘long-winded’ projects, such as network redesign and supply chain strategy projects had been removed from the agenda.⁸

in times of crisis for many reasons among which are:

- it is more difficult for them to downsize as they are already small;
- they are individually less diversified in their economic activities;
- they have a weaker financial structure (i.e. lower capitalization);
- they have a lower or no credit rating;
- they are heavily dependent on credit and,
- they have fewer financing options.

SMEs in global value chains are even more vulnerable as they often bear the brunt of the difficulties of the large firms.⁹

SMEs lack the capacity to analyze the economic effects that

Box 2. How are the SMEs hit by the crisis?

According to the Automated Access to Court Electronic Records, during the first five months of 2009 the total number of commercial bankruptcy filings in the United States increased by 52 % compared with the same period in the previous year (from 23,829 to 36,106). The vast majority of commercial bankruptcies, which are not separated by size of firm by data keepers, are filed by entrepreneurs and small-business owners.¹⁰

At the same time, the Confederation of Finnish Industries found in its January 2009 survey that among small firms (less than 50 employees) the incidence of solvency problems was more than 17 % compared to the usual 6-8 %. Furthermore, 51 % of the sample reported some increase in their clients' insolvency problems. A review by size indicated the most significant increase in insolvency problems was for medium-sized enterprises.¹¹

the global crisis (See Box 2). These firms are more vulnerable now for many reasons: not only has the traditional challenge of accessing finance continued to apply, but new, particularly supply-side difficulties are currently apparent. It is important to stress that SMEs are generally more vulnerable

⁸ http://www.at.capgemini.com/m/at/tl/Supply_Chain_Management-Studie_2009.pdf

⁹ OECD, 2009. <http://www.oecd.org/dataoecd/40/34/43183090.pdf> . Op. cit.

¹⁰ http://www.usatoday.com/money/smallbusiness/2009-06-30-small-businesses-bankruptcy_N.htm

¹¹ OECD, 2009. <http://www.oecd.org/dataoecd/40/34/43183090.pdf> . Op. cit.



a policy change or an economic incident can generate on the overall global economy, not to mention the impact on their businesses. This lack of experience of dealing with global (or even national) affairs, makes them unable to adjust internal management to suit the need of new or approaching situations (whereas larger firms can be both better prepared for a crisis, can adapt better, and take a longer-term perspective).

One emerging change from the crisis may be a shift away from global to more regional supply chains (changes are also being driven by the climatic change debate and possible

regulatory changes in this domain). This has major implications for the SME sector. It is likely that a more consolidated financial system will emerge from the crisis; competition may be weaker leading to higher costs of credit and other financial services. There may well be an increase in the real cost of capital. Enterprises, particularly small ones will need to prepare for this reality.¹²

¹² International Organization of Employers (IOE): SMEs and the crisis: Implications for employers' organisations. (IOE, Geneva, 2009)

3. Policy options to address the challenges

The short-term option for policy makers is to design and implement measures that protect entrepreneurs and workers in existing supply chain enterprises and support new firms, by strengthening their capacity to compete and take advantage of new economic opportunities, including those provided by expansionary public policies. These range from direct financial support to enterprises and the provision of business advisory services, through to policies to improve the enabling environment for enterprises. All these measures are to be developed in consultation with the representatives of workers and employers, who are often better informed than governments on the situation at the enterprise and sector levels.

In the current environment of the financial crisis there is a general response in terms of downward pressures on wages and job security. However there are significant long and short-term drivers pushing for more sustainable enterprises.

- An increasingly global public awareness for labour standards up the supply chain and the existence of examples of good practices are leading companies to establish good industrial relations, to pay attention to conditions of work and human resource development as well as the application of International Labour Standards.
- Changing consumer preferences and consumption patterns have put focus on the way goods and services are produced; civil society groups are playing an increasingly important role, both at the international and local levels to influence enterprises.
- Along supply chains, leading companies are addressing labour and social conditions, monitor these as part of their supply chain management and outsourcing practices, and put in place codes of conduct. There are examples of in-

ternational framework agreements between global unions and MNEs that have sought to cushion the impact of the crisis.¹³

- Pressure also comes from major lending institutions and investors, who are adopting performance standards on environmental and social issues.
- Government procurement policies are increasingly asking companies to look at improved health and safety, welfare and other standards in contracts.

A final driver and mandate for sustainable enterprise development comes from conclusions and recommendations at global summits and conferences. In this context, the 2007 International Labour Conference General Discussion on Sustainable Enterprises¹⁴ concluded that:

"Sustainable enterprises need to innovate, adopt environmentally friendly technologies, develop skills and human resources, and enhance productivity to remain competitive in national and international markets. They also need to apply workplace practices based on full respect for fundamental rights at work and international labour standards, and foster good labour-management relations as important means of raising productivity and creating decent work. These principles are applicable to all enterprises."

The ILO is involved in a number of projects/activities aimed at assisting governments and social partners and enterprises, in addressing the challenges of economic and financial crises. Such activities are based on the International Labour

¹³ <http://www.ilo.org/pls/apex/f?p=109:1:0>

¹⁴ ILO: The promotion of sustainable enterprises, Report VI, International Labour Conference, 96 th Session, Geneva, 2007.



Standards, the ILO Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy (MNE Declaration), the 2007 International Labour Conference Conclusions on Sustainable Enterprises, etc.

Some examples include the ILO Global Project on 'Sustaining Competitiveness and Responsible Enterprises' (SCORE) and the European Union Project on National Seminars on Socially Sensitive Restructuring (ARENAS). The lessons learned from these projects show that governments and social partners are playing an increasingly important role in:

- maintaining the competitiveness of national enterprises and ensuring the place for such enterprises in the global,

and regional, value chains through better legislation and capacity building activities;

- establishing partnerships with global social partners and the MNEs in ensuring decent working conditions up the supply chains;
- encouraging large companies to engage in a continuous social dialogue with the representatives of workers and governments in order to better anticipate and manage restructuring, and to avoid layoffs wherever such possibilities exist.

4. Conclusions and recommendations

While considering the policy dimensions highlighted above, policy makers should remember that a key response to the financial crisis lies in competitive supply chain enterprises being able to handle the pressures for improved productivity, and to mechanisms ensuring a fair distribution of productivity gains, contributing thereby to a wage-led recovery. Such enterprises can participate in the national and global economies, but to do so they need to put in place cost effective productivity improvement programmes and crisis response programmes. In this regard, productivity upgrading through better people management and workplace practices is comparatively cheaper and faster than capital intensive technology upgrading through plant and machinery.

Sustainable business practices also open the door to public tenders, which in most parts of the world today require a minimum of social compliance. In a time of government

stimulus packages, public tenders will play an increasingly important role for business activity.

In summary, this area of work is aimed to foster the adoption of responsible and thus sustainable workplace practices – economic, social and environmental – in supply chain enterprises to improve their productivity and competitiveness and, protect the quality and quantity of decent work in them. As such, it is a direct and contemporary contribution to the Decent Work Agenda. Such improvement can be achieved through the efforts of governments and social partners to create an enabling environment for enterprises, through the process of social dialogue and through the promotion of workplace cooperation and, through the efforts of the large enterprises (in particular, the MNEs) to promote decent work throughout their supply chains, based largely on the principles of the MNE Declaration.

5. Further reading and resources

- International Labour Organisation: *The ILO Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy*, Geneva, 2006 http://www.ilo.org/wcmsp5/groups/public/---ed_emp/---emp_ent/documents/publication/wcms_094386.pdf
- Rogovsky, N. et al, *Restructuring for Corporate Success: A Socially Sensitive Approach*, (Geneva, ILO) 2005.
- International Training Centre of the International Labour Organisation (ITC/ILO): *Sustainable Enterprise Development and Human Resource Management*, (ITC/ILO, Turin), forthcoming.
- Ulrich, S.; Rogovsky, N.; Lamotte, D: *Promoting Responsible and Sustainable Enterprise-Level Practices at Times of Crisis: A Guide for Policy-Makers and Social Partners*, (ILO, Geneva) 2009.