



International Chamber of Commerce
The world business organization

Policy statement

ICC guidance on supply chain responsibility

Prepared by the Commission on Business in Society

Executive summary

In this paper, ICC offers a global business perspective on the policy implications that companies have to consider when defining their approach to supply chain responsibility, and presents various mechanisms that companies can use to help their suppliers improve their social and environmental performance.

A basic principle for all companies is to deal with suppliers who comply with all applicable laws and regulations in their business activities. While monitoring compliance with the law is a matter of law enforcement, and the ownership of this function properly rests with government, the environment for doing business in some countries can be especially challenging due to the lack of government oversight.

As a result, companies find themselves having to address social and environmental issues that lie outside their remit as private institutions, but which they are increasingly expected to address in their supply chain operations. In this context, a number of initiatives have been taken by individual companies and sector associations to assist suppliers in complying with their legal obligations.

Based on the experience of ICC member companies across a broad range of sectors and geographies, this paper seeks to establish a policy framework which defines the respective roles of business and government in this area, and encourages companies to adopt a risk-based approach by concentrating efforts where they are most needed, and most likely to bring about change.

Within this policy framework, ICC suggests a set of practical recommendations to help companies manage their relationships with suppliers in a responsible way. These recommendations stress the importance of the supplier-selection phase, the need for companies to integrate supply chain responsibility considerations into their regular purchasing practices and overall business model, and the value of developing a long-term collaborative approach between companies and their suppliers, by involving local management and employees in the shaping of social and environmental performance objectives.

Introduction

The purpose of this paper is to present ICC views on supply chain responsibility from a global and multi-sectoral perspective. These views are based on the extensive and diverse experience of ICC member companies across a broad range of sectors and geographies. Building on this experience, ICC offers practical recommendations to help companies build effective supplier relationships that will lead to good business practices across their supply chains. This document is also intended to help the public at large, including governments, intergovernmental and non-governmental organizations, gain a better understanding of the policy implications that companies have to consider when managing supply chain issues.

What is supply chain responsibility?

Supply chain responsibility, also referred to as responsible sourcing, can be broadly defined as a voluntary commitment by companies to manage their relationships with suppliers in a responsible way. As a result of their purchasing activities, companies may have some opportunities to influence constructively their suppliers' social and environmental performance. This can be done using several incentives, including information and training, as well as audits of suppliers' practices. Whatever mechanism is used, the most effective way to achieve sustained improvement over time is through the development of a long-term collaborative relation between corporate buyers and their suppliers, through which suppliers can internalize change by participating in the shaping of social and environmental performance objectives, based on their own perception of their business capacity and needs.

A corporate commitment

Supply chain responsibility is an area of growing importance for business, particularly in sectors where production is largely outsourced (for example clothing and footwear, electronic and food products) and often takes place in developing countries where the enforcement of social and environmental legislation may be weak or ineffective. In these countries, sometimes characterized by the absence of key elements of sound public governance, companies may not be able to rely on government oversight to ensure that local working conditions and production processes meet acceptable standards.

A number of initiatives have been taken by individual companies and sector associations to assist suppliers in complying with their legal obligations. While these initiatives should not be considered as a substitute for governments' primary responsibility to enact and implement national legislation, they can play a helpful role in the improvement of social and environmental practices, notably in export-oriented sectors, which employ a large and growing share of the workforce of many developing countries.

An integral part of supply chain management

With rising raw material costs and competitive pressures on prices to consumers, it is understandable that companies seek greater efficiencies in their supply chains. But cost cannot be the only factor to be taken into consideration when negotiating business relationships with suppliers. In order to develop sourcing strategies that will support brands over the long term, it is in a company's interest to consider a comprehensive

range of supply chain issues including product quality and safety, continuity of supply and delivery, and the protection of intellectual property.

As part of this process, a growing number of companies have chosen to address working conditions and ethical, environmental, health and safety, and human rights issues as an integral component of their procurement strategy, since good practice in these areas can make a significant contribution towards the ultimate goal of supply chain continuity and long-term efficiency.

Companies with brand exposure and consumer visibility have become particularly alert to the strategic importance of supply chain responsibility. As experience has shown, notably in these sectors, one incident with one supplier can cause a disproportionate amount of adverse publicity and damage to a company's reputation and brand image¹. More generally, a company's overall efforts to manage its activities in a responsible way can be seriously discredited if low standards of business conduct persist in the supply chain.

Policy implications

For companies, a commitment to supply chain responsibility has important implications both from a policy standpoint and in terms of the resources necessary to discharge this responsibility. These will vary depending on the particular circumstances of individual companies, including the commercial environment in which they operate and the nature of their supplier relationships.

The primary role of government

A basic principle for all companies is to deal with suppliers who comply with the local law in their business activities. Monitoring compliance with the law is a matter of law enforcement and the ownership of this function properly rests with government. In many parts of the world, however, the lack of government involvement in enforcing social and environmental standards makes it difficult for companies to ensure that good business practices prevail across their global supply chains. As a result, corporate buyers find themselves having to address issues that lie outside their core competencies and remit as private institutions, but which they have to shoulder to ensure business continuity and competitiveness.

While companies can help fill this gap through voluntary initiatives, it is clear that no effective long-term progress will be made without greater involvement of governments to ensure that local laws are respected and that domestic working conditions meet acceptable standards. A World Bank study showed a clear consensus among corporate buyers and suppliers that the absence of local government action presented the most significant barrier to the achievement of better social and environmental performance among suppliers.²

¹"Assurance for a Sustainable Supply Chain", Discussion Paper by the Fédération des Experts Comptables Européens, June 2005

² Strengthening implementation of corporate social responsibility in global supply chains, The World Bank Group, October 2003.

Governments should be reminded that there are significant economic and social benefits that flow from effective regulation and enforcement in this area. The drive for higher social and environmental standards can lead to increased productivity and country competitiveness, which in turn attract investment (including foreign direct investment) and help local businesses move up the value chain. Government action also captures entire economies, since national social and environmental regulations are not confined to export-oriented sectors, thereby contributing to broad economic development and the achievement of higher living standards.

A shared responsibility

Many companies have literally thousands of suppliers across the globe. It would be inappropriate from a legal standpoint, and simply impossible from a practical point of view, to expect them to be responsible for the actions of all suppliers and sub-suppliers in their supply chain. However, as a result of their purchasing activities, companies may have leverage to influence and monitor their suppliers' business conduct.

What companies can reasonably be expected to do to manage their supply chain responsibly is to work with their suppliers on a collaborative basis towards improving their social and environmental performance. This can best be achieved by using a combination of approaches and tools such as:

- providing information and training to suppliers on the development of management systems;
- organizing on-site visits and worker interviews;
- using a global supplier code as a benchmark for compliance;
- incorporating supplier requirements into commercial contracts, and
- carrying out assessments of suppliers' facilities and practices, including through independent monitoring where appropriate.

Measuring suppliers' social and environmental performance raises the question of which standards should be used as a benchmark. A minimum requirement should be compliance with applicable national legislation, including relevant labour and environmental laws. Some companies also decide to promote standards reflecting various international conventions and declarations on social and environmental issues, which may sometimes go beyond local legislation.

A useful point of reference in this respect is the Global Compact and its "ten principles" covering human rights, labour standards, the environment and anti-corruption³. These principles, which are derived from relevant intergovernmental instruments such as the ILO Declaration on Fundamental Principles and Rights at Work and the Universal Declaration of Human Rights, are specifically addressed to companies and have enjoyed increased recognition as a benchmark for good business practice.

The variety of supplier relationships

The expectations of the public with regard to responsible sourcing have been largely influenced by the experiences of sectors in which supply chain relationships are

³ See www.unglobalcompact.org

characterized by large multinational companies being able to exert strong influence on small suppliers. But it is important to note that the nature of supply chain relations can vary greatly across economic sectors and from company to company.

A company's supply chain is constituted by all those involved, through upstream and downstream linkages, in processes and activities delivering value in the form of products or services to the user. Companies have many different types of suppliers: suppliers that provide components, parts and services for the company's products, and suppliers that provide services, resources or products that enable a company to carry out its business. In many ways, the nature of a company's business relationships with its suppliers will determine its ability to promote and influence change.

For example, some companies account for only a small percentage of their supplier's output and turnover, making it difficult for them to have an influence on their behaviour. Companies may also deal with monopolistic suppliers of specialty products, leaving them with very little leverage to impose additional requirements of any kind. In the manufacturing sector, large-scale suppliers of resource inputs (e.g. supplies from the oil industry) are often larger and able to exert more influence than their customers. In other cases, companies might engage with suppliers on short-term contracts or one-off orders, making it difficult to plan and implement long-term responsible sourcing strategies. The agricultural sector presents its own challenges as the suppliers in question are often smallholder farmers, using only their families and some casual labour to assist them. In these cases, promoting and ensuring responsible practices can become a difficult exercise as they are not employees or suppliers in the normal sense and are widely dispersed geographically.

The merits of a risk-based approach

For companies dealing with large numbers of suppliers, monitoring social and environmental compliance across the supply base may lead to logistical and financial challenges that far exceed their capacity. In this context, a risk-based approach can lead to positive results by helping companies to allocate resources more efficiently and to concentrate efforts where they are most needed, and most likely to bring about change.

An essential dimension of this approach for companies is to treat the supplier-selection phase as a key step in the process of integrating supply chain responsibility considerations into their commercial purchasing and risk management systems. When considering sourcing from low-cost countries, companies should envisage undertaking risk analysis at the outset, so that labour and environmental issues that could arise are known early on and accounted for as part of the cost-benefits analysis for such sourcing.

Because not all suppliers present risks, and many of them will have good business practices already in place, companies should focus attention and resources on high risk areas and avoid the implementation of supply chain monitoring systems that apply "across the board". For example, a leading mobile telecommunications company has developed a system to identify high-risk suppliers with which it decides to conduct more detailed evaluations and engage in corrective action in areas falling below requirements. Such an approach requires that companies weigh the costs of training their suppliers

against their broader commercial interests, which could sometimes lead them to favour terminating high-risk supplier relationships.

Another matter for companies to consider is how far down the supply chain should their involvement extend. A practicable approach would be to focus on suppliers responsible for the main steps in the production process, for example, in textile and footwear production, the cutting, sewing and assembly of clothing and footwear, since this is where the greatest incidence of poor labour and environmental performance is likely to be found.

In other sectors, where risks may be more diffused down the supply chain, companies may find it most effective to work with their direct suppliers to ensure that social and environmental considerations in turn play a role in their direct suppliers' relations with second and third tier suppliers. But this approach may not be practicable for sectors that operate through middle markets, where hundreds or thousands of small producers feed into, and for which it is virtually impossible to identify the supply chain.

Practical recommendations

The following practical recommendations are intended to help companies implement their approach to supply chain responsibility in a spirit of continuous improvement and mutual engagement with their suppliers. It should be reminded from the outset that supplier selection is a critically important step in this process and that supply chain responsibility considerations can be effectively built into it.

1. Integrate supply chain responsibility into commercial purchasing and risk management systems

Most companies working with a large supply base have established purchasing procedures to manage their relations with suppliers. To avoid the creation of unnecessary administrative layers within companies and to adopt a long-term and effective management approach based on a clear business focus, supply chain responsibility elements should be integrated into regular commercial purchasing and risk management systems.

An objective of integrating corporate responsibility elements into a company's purchasing procedures is to raise awareness among purchasing teams on the impact that their decisions might have at a factory level. The purpose is to help ensure that conditions imposed by corporate buyers, such as low pricing policies or tight deadlines, do not undermine the capacity of suppliers to comply with relevant social and environmental standards.

For example, recognizing that its own business practices can have an impact on its suppliers' compliance, a clothing retailer has developed a system to ensure its production calendars consistently reflect garment manufacturers' capabilities before orders are placed with them. Companies should also strive to avoid inefficient purchasing practices such as rush orders and last-minute changes, which often lead to excessive overtime and other compliance violations.

In order to better focus resources on areas where problems are most likely to occur, a helpful approach for companies could be an initial classification of suppliers in two broad categories: “low risk” and “high risk”. Such a risk-based approach could usefully keep in check the “inflation of requests” in supplier relationships, and devote attention and resources to where these are most needed and most likely to generate improvements.

2. *Clearly set out expectations*

It is essential that companies clearly set out what their expectations are to all their suppliers. At a minimum, companies should make clear to their business partners that they expect them to comply with all national and other applicable laws and regulations and, as appropriate, to take into account principles contained in relevant international instruments.

A further step is the development of a “supplier code of conduct” which governs the behaviour of supply chain partners, notably on social and environmental matters. Supplier codes of conduct typically include guidelines based on relevant international instruments relating to workplace issues, such as wages, health and safety, working hours, disciplinary practices, freedom of association and child labour. Where relevant, they also include provisions relating to the environmental impact of suppliers’ activities.

The decision to adopt of a supplier code of conduct should be carefully weighed in light of the practical challenges that its implementation may raise. In particular, the proliferation of supplier codes of conduct and the resulting multiplicity of requirements imposed on suppliers may pose very real difficulties for them to comply. Furthermore, dilemma situations can occur in cases where the provisions of supplier codes of conduct may conflict with national laws, for example on issues such as freedom of association in certain countries, or equal employment opportunities in others.

3. *Help suppliers live up to their commitments and internalize change*

In order to achieve continuous improvement over time, companies should approach supply chain responsibility from a capacity building perspective rather than exclusively from a compliance point of view. Companies should encourage their suppliers to define their own management policies and practices, taking into account national regulations and international instruments, thereby raising performance by involving local management into the shaping of responsible business conduct, rather than simply prescribing what they think is best for them (e.g. imposing their own code of conduct on suppliers).

The most effective way for companies to encourage suppliers to improve their performance on social and environmental issues over time is to establish requirements in these areas in a “business critical” perspective, i.e. highlighting the commercial benefits to the supplier of sound business practices.

Such an approach should not only stress the primary benefit of maintaining or winning new contracts, but also additional strategic gains in terms of higher productivity, innovation, and quality as well as declining employee turnover.

This approach can make a significant contribution to building strong supplier relations on a long-term basis, by helping suppliers to internalize and interpret responsible business conduct for themselves, based on their own perception of their business capacities and needs. If helpful or requested, companies can provide support and training to their suppliers to help them improve their management practices and performance. Such support should be considered as an integral element of the knowledge transfer that comes with sourcing, and could include for instance better awareness of health and safety practices, and the implementation or transfer of management and supervisory skills. Companies working with the same suppliers may also seek to pull together their resources and cooperate in the organization of training seminars for management and employees.

4. Track supplier performance

In order to assess compliance with their supplier code of conduct, corporate buyers increasingly request their suppliers to provide comprehensive social and environmental information on their activities. This information can be complemented by the organization of on-site visits, which provide a useful way to effectively monitor suppliers' progress, or lack of progress, in implementing responsible business practices.

Suppliers' environmental and social performance can also be evaluated as part of regular assessments of business requirements (including key commercial considerations such as ensuring continuity, quality, etc), and may be supplemented, where needed, by more in-depth or specific assessments.

But monitoring should only be considered as one of the steps of a wider and more inclusive process in which corporate buyers and their suppliers work together to identify and resolve non-compliance issues that may occur. In the experience of several companies, there are indeed limitations in the outcomes that can be achieved through the use of supplier assessments alone. Those companies that have conducted such assessments of their supplier base, report that the challenges vary according to the country and industry.

The following shortcomings have been identified as being particularly problematic⁴:

- not all social and environmental issues have consistent, easily identifiable and measurable performance indicators, which makes it difficult to evaluate performance on a comprehensive basis;
- factory audits only provide a snapshot of conditions at a specific point in time, which help expose problem areas but do little to identify root causes and bring about actual improvements; and
- inconsistent or flawed methodology in factory audits may cause bias or limit the integrity of the results.

Another problematic development is the growing incidence of fictitious worker time cards and payroll documents provided by factory managers and aimed at deceiving social auditors. For example, maintaining a redundant payroll list is a way for suppliers to

⁴ "Meaningful Change: Raising the Bar in Supply Chain Workplace Standards", John Ruggie and Roseann Casey, June 2006

appear, on paper, as if they meet the demands for minimum wage or other employment rights.

To enhance the effectiveness of internal monitoring programmes, companies are increasingly involving factory management and workers in the monitoring process, providing them with the training and tools to develop and integrate compliance systems in their own operations⁵.

Some companies may also require of their suppliers independent certification of conformity with standards of social and environmental responsibility. In these instances, companies can alleviate the burden on suppliers, which oftentimes are small and medium-sized enterprises with limited resources, by accepting certification by others that is similar, but perhaps not identical, to their own requirements. Companies may collaborate to adopt common principles and practices for auditing their suppliers, in order to alleviate the costs and burden on themselves and their suppliers.

Some sectors have sought to minimize the compliance burden on suppliers by bringing together, through their sector associations, the main actors in their supply chain including suppliers, manufacturers of branded goods, retailers and customers, in order to develop common tools and approaches to harmonize supply chain responsibility requirements. This commonality and consistency of approach between all actors in the supply chain can contribute to the achievement of long-term, sustainable and affordable solutions for all.⁶

Alongside such industry initiatives, which provide useful platforms for exchanging information about good practice and the experiences of companies in a particular sector, multi-stakeholder efforts have also emerged as a way to engage other significant players, such as non-governmental organizations and trade unions, in companies' efforts to manage their supply chain responsibility. While participation in multi-stakeholder initiatives comes with important benefits in terms of fostering dialogue and building overall confidence, companies should be aware that these initiatives may have different operating procedures and operational objectives than those that are entirely business-based.

5. Manage stakeholder expectations

Promoting good performance throughout the supply chain requires all stakeholders to take responsibility. Companies work with their first tier suppliers to ensure they are, in turn, promoting supply chain responsibility among their own supplier base. Companies are also in continuous dialogue with their customers and take part in initiatives with other companies in their own sectors to benchmark good practices, and to help promote consistent and complementary approaches within these sectors.

⁵ "Internal Monitoring", Issue Brief, Business for Social Responsibility

⁶ Examples of such business-led initiatives include: the Business Social Compliance Initiative (www.bsci-eu.org), the Electronics Industry Code of Conduct (www.eicc.info), and the International Council of Toy Industries Code of Business Practice (www.toy-icti.org).

For some companies, for example retailers, their customers may expect them to validate their first or second party monitoring practices by third parties. First party monitoring refers to monitoring conducted by the company itself. Second party monitoring is conducted by another organization on behalf of the company, and third party monitoring is conducted by independent bodies certified to conduct such monitoring in the context of a monitoring scheme adhered to by the company.

Another way for companies to build trust among their customers on their approach to supply chain issues is to collect information about supplier performance across markets and to report this information as part of their annual reports and other public communications. This effort can also serve as a management tool to measure the effectiveness of supply chain management practices and systems and to identify areas for improvement.

Companies should lead by example and have a positive influence on their supply base by implementing their own codes of conduct, undertaking assessments of economic, environmental and social conditions in their own operations and driving continuous improvement and transparency by reporting on their performance. This contributes to the alignment of a company's approach to supply chain responsibility with its overall corporate values as expressed in its business principles.

Another related and emerging challenge facing a growing number of companies is the issue of "customer responsibility". This concept can best be described in the form of a question: "how far does a company's responsibility extend with regard to the final use of its products or services by the end-customer"? This issue has arisen from the recent experience of companies whose responsibility in this regard has been called into question by some non-governmental organizations, socially responsible investment funds, and the media.

Companies are responsible for ensuring the quality and safety of their products, and for minimizing the negative environmental impact of these products especially when they reach the end of their life-cycle. A number of sectors have already voluntarily integrated this aspect of "customer responsibility" in their approach to product design and management, such as white goods manufacturers and car manufacturers, while in some jurisdictions these requirements are even mandated by law.

6. How to deal with non-performance?

In order to minimize the risk of non-performance by suppliers, again it is essential to emphasize the crucial importance of a thorough supplier selection phase, which integrates supply chain responsibility dimensions with regular commercial purchasing and risk management considerations.

When confronted with supplier non-performance, a radical option would be for companies to immediately terminate their business relationship with suppliers that are found to be in violation of a company's requirements. However, such an approach could ultimately be counterproductive, because termination of a supplier relationship would

deprive the supplier of the economic resources necessary to improve its business practices, and may lead to worsening conditions among suppliers. It is also in the interest of sourcing companies to encourage the viability of a multiplicity of suppliers as a way to increase choice among suppliers and foster competition.

Where suppliers do not meet requirements, a constructive initial approach would be to work with them and agree on time-bound improvement measures to achieve the desired level of performance. If suitable solutions cannot be found and performance does not improve over a reasonable and realistic timeframe, termination of business relations may regrettably have to be seriously considered.

Conclusion

While supply chain responsibility may not have the same degree of relevance for all business sectors, the issue has become an important element of corporate responsibility. The diversity of supply chain relationships requires companies to consider a range of approaches and instruments to be tailored to their own specific circumstances. The development of a long-term collaborative relation between companies and their suppliers, through which companies help their suppliers reach a level of performance consistent with their own management principles and practices is the most effective way to improve supplier performance. However, it is essential to remember that voluntary initiatives by companies in the area of supply chain responsibility can only be a complement but not a substitute to the necessary role of government in enacting and enforcing appropriate legislation. *A checklist of key issues to assist small and medium sized enterprises in managing their supply chain relationships is provided as an annex to this policy statement.*

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About ICC

ICC is the world business organization, a representative body that speaks with authority on behalf of enterprises from all sectors in every part of the world. ICC promotes an open international trade and investment system and the market economy, and helps business corporations meet the challenges and opportunities of globalization. Business leaders and experts drawn from ICC's global membership establish the business stance on broad issues of trade and investment policy as well as on vital technical subjects. ICC was founded in 1919 and today it groups thousands of member companies and associations in 130 countries.

Annex

A checklist for small and medium-sized companies engaged in supply chain relationships

ICC recognizes that small and medium-sized enterprises (SMEs) may not have all the necessary financial and managerial capacities to implement the practical recommendations set forth in this document. However, the public expectations with regard to supply chain issues such as working conditions and respect for the environment tend to be the same for large companies and smaller ones.

Because SMEs have limited resources to track supplier performance and to engage in capacity building efforts towards their suppliers, the supplier-selection phase should become the focus of attention to minimize risks and prevent incidents which can have costly consequences. The following checklist presents some of the elementary steps that SMEs should take when entering supply chain relationships:

- ☒ Apply due diligence and check basic facts about the social and environmental legislation in the countries of production of prospective suppliers. Find out about the level of enforcement in these countries to assess production risks⁷.
- ☒ Check whether prospective suppliers qualify for independent certification of conformity with recognized social and environmental standards.
- ☒ Clearly define your expectations to your suppliers. Make clear that compliance with all applicable laws is a minimum. Explore potential risk areas with suppliers and agree on the desired level of performance.
- ☒ Find out about relevant sectoral initiatives to monitor suppliers' social and environmental compliance and to assist them in improving their business practices.
- ☒ In case of inappropriate behaviour by suppliers, agree on time-bound improvement measures, and if remediation cannot be envisaged, consider termination of business relationship.

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⁷ Cal Safety Compliance Corporation's website (<http://www.csc-online.com>) provides a good source of information, which includes "country profiles" assessing production risks for 110 countries.