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# Benchmarking Corporate Policies on Labor and Human Rights in Global Supply Chains

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## Executive Summary

*Despite investors' commonly expressed concern for so-called environmental, social and governance (ESG) risks, there is little benchmarking of social factors such as labor and human rights (LHR). As a result, the analysis of social factor investment risk remains an underdeveloped field. Investors and corporate managers have few if any guidelines about what constitutes best--or even standard--practices in these areas, and few methods for comparing company approaches or learning which might be more effective in reducing long-term reputational or operational risk. This paper offers an initial building block required for the development of social factor investment analysis. Using ASSET4 data on 2,508 global corporations, we benchmark public LHR policies relating to global supply chains. We find a significant minority of companies with broadly stated policies in this area, but far fewer with detailed standards or follow-up procedures. Twenty-eight percent say they have such a supplier policy, and 15 percent have issued an explicit LHR code of conduct for their suppliers. However, less than 6 percent of companies endorse specific labor standards such as the eight core conventions of the International Labor Organization. Only 6 percent say they monitor suppliers for policy or code compliance or set LHR improvement targets; and only 7 percent describe enforcement procedures. Near majorities of large companies and those based in Europe have LHR policies and codes, as do majorities of firms in some industries more subject to public criticism about LHR abuses. These market-wide benchmarks of what firms profess to do provide a starting point for investors to compare the potential investment risks of the different approaches.*

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## Introduction

This paper benchmarks corporate policies on labor and human rights (LHR) as they are applied to global supply chains. The goal is to build tools to help investors analyze the long-term investment risks of LHR factors. The effort is part of a broader undertaking by investment analysts to assess so-called environmental, social and governance (ESG) risks, with LHR factors typically falling into the social category.

Over the past decade or so, a diverse array of entities around the world has published benchmarks and guidelines on corporate governance.<sup>1</sup> The purpose has been to set standards or best practices for how companies should be governed. These efforts have been both reinforced and informed by dozens of studies correlating various governance standards to measures of corporate performance such as higher total shareholder returns and greater profitability. Increasingly, shareholders use these standards to judge a company's investment potential, in the belief that those with good corporate governance will perform better and deliver superior long-term returns.

More recently, similar corporate benchmarking efforts have emerged regarding corporate environmental policies and practices. Groups such as the Carbon Disclosure Project, the Investor Network on Climate Risk and the Global Reporting Initiative have issued guidelines and standards on corporate greenhouse gas emissions and other factors relating to climate and environmental risks.<sup>3</sup> For example, in 2007 several investor groups released a report called *Climate Risk Disclosure by the S&P 500*, which in turn built on a study published the year before entitled *Global Framework for Climate Risk Disclosure*.<sup>4</sup> The motivation of much of this work stems from a view that environmental factors pose long-term risks that companies must manage to enhance their profitability and stock performance. As is the case with corporate governance, institutional investors are increasingly attempting to use corporate best practices on the environment as part of their investment decision-making. They engage in often elaborate discussions with companies to encourage them to pay more attention to these risks and to adhere to the standards of behavior emerging in these fields.<sup>5</sup>

However, very little benchmarking has been initiated regarding social factors such as LHR or human capital, despite investors' commonly expressed concern for ESG risks.<sup>6</sup> Corporations have long faced both national and international laws and regulations covering

many social factors, including the conventions issued by the International Labor Organization (ILO).<sup>7</sup> But these are usually enforced unevenly or not at all. They also typically have been issued for normative purposes, to govern what societies consider to be fair and just treatment of employees and citizens. None have been developed to help companies or investors assess potential operational or investment risks that social factors may present. So far, few entities setting corporate standards on governance and the environment from an investment risk perspective have attempted to do the same thing for social factors.

As a result, social factor analysis from the standpoint of investment risk remains an underdeveloped field of inquiry. While many studies have correlated a variety of human capital factors such as employee skills to better corporate and portfolio performance, insufficient data inhibits attempts to assess factors such as LHR, despite prima facie indications of their materiality. Heated controversies over sweatshop conditions in Western companies' overseas supply chains have erupted regularly since the mid 1990s, affecting companies such as Nike, Wal-Mart, and The Gap, to name just a few. A growing number of investors and analysts believe that such public criticism inflicts reputational damage on companies that can undermine share prices. A handful of studies also suggest that better supply-chain labor conditions can improve factory operations by reducing employee turnover, lifting employee morale and productivity, and cutting order turnaround time.<sup>8</sup>

Investors and corporate managers have few effective methods for comparing companies' LHR policies against each other or learning which approaches might be more effective in reducing any long-term reputational or operational risk. In fact, the field is so immature that there are no commonly accepted definitions of basic concepts such as what is meant by child labor or freedom of association. Some companies define the LHR standards they set for their employees and suppliers in general terms that can be interpreted differently, while other use more detailed definitions prescribed by the ILO or multi-stakeholder associations (MSAs). Although private investment research firms increasingly benchmark and assess corporate policies and practices in these areas, little of their work enters the public domain while the breadth of coverage and analytical rigor is uneven.

Supply chain LHR issues have become increasingly important for investors over the past decade as the expansion of global telecommunications and the Internet has accelerated Western corporations' outsourcing of manufacturing, information technology and back-office operations. The heightened transparency of companies in the Internet era also has

made consumers, companies and investors more aware of LHR abuses in the supply chain. Advocacy groups, academics and nonprofits have heightened the risk to corporate reputations by issuing reports and studies on abusive conditions in supplier factories.

This paper provides one important initial building block required for the development of social factor investment analysis. Using ASSET4 data on 2,508 global corporations, we benchmark LHR policies and practices relating to global supply chains.<sup>9</sup> The broadest finding is that a significant minority of companies have such policies, although fewer describe follow-up monitoring and enforcement mechanisms that would suggest a serious program. We find that 28 percent say they have a supplier policy covering at least one major LHR issue, and 15 percent have issued an explicit LHR code of conduct for their suppliers. But the specifics are often vague. For example, less than 6 percent of companies say they endorse the eight core conventions of the ILO. Follow-up is weak as well: only 6 percent say they monitor their suppliers for policy or code compliance or set LHR improvement targets; and only 7 percent describe enforcement procedures. LHR policies are more common among large companies (45 percent), among those based in Europe (43 percent), and in industries that have been subject to public criticism about LHR abuses (65 percent in household and personal products).

Our findings are based solely on descriptions provided by each company in public documents such as annual reports and corporate social responsibility reports. They do not reflect any external verification or assessment of how well companies actually implement their stated policies and procedures, or whether they even carry them out at all. However, publicly disclosed policies represent the primary basis upon which investors can evaluate LHR risk across a wide range of companies. By examining both the specificity and degree of explanation of corporate statements, it is possible to begin to formulate objective benchmarks of LHR supply-chain policies, as well as to better understand where the most significant challenges lie.

This analysis offers investors, corporate officials and other interested parties a starting point from which to construct more elaborate assessment frameworks. The fact that 45 percent of large global companies have adopted a supply-chain LHR policy of some sort, and 25 percent have published a specific supplier code of conduct, suggests that such approaches may be an emerging best practice which others would be prudent to emulate. For investors, market-wide benchmarks can provide a basis by which to compare the in-

vestment risks posed by the varying approaches companies take to mitigating LHR risk. Doing so would allow them to move beyond the negative screens often used to restrict portfolio investments in companies found to be in violation of LHR norms. The exclusion approach has limitations, since it only allows investors to address investment problems after they have occurred and offers no means to proactively manage LHR or other portfolio risks. Investors and others also can use these benchmarks to develop objective rankings of companies based on their LHR supply-chain policies relative to industry and sector peers.

## Section One: Literature Review

Only a handful of other available studies have attempted market-wide descriptions of corporate LHR policies in supply chains. None have employed a sample size as large as ours or examined the distinction between broadly worded policies and more specific standards and follow-up procedures. Most involve selective publications by private-sector research companies that draw on data and analytic frameworks they have developed for paying clients. On their face, the conclusions of most of the studies appear to be broadly in line with those of this paper, finding significant percentages of companies with broadly worded policies and much smaller shares with detailed standards and follow-up procedures. However, comparisons with prior studies are difficult because they do not always spell out the details of how they define corporate policies. This is particularly important because companies themselves often describe their policies in vague or general terms. The problem is compounded by the lack of standardized definitions of basic concepts. As a result, companies may have different definitions of say, child labor, and other studies may categorize those descriptions in different ways.

The closest parallel to the findings in this paper can be found in a proprietary benchmark series created by RiskMetrics Group that was described in a 2008 client newsletter.<sup>10</sup> It found that a fifth of 1,800 global companies said they had supplier codes of conduct on LHR issues in 2007. The companies included those in the S&P 500, the Toronto Stock Exchange 300 and the Morgan Stanley Europe, Australasia, and Far East index, excluding Japan. Child and forced labor and workplace discrimination were the issues most commonly addressed, with at least 15 percent of the companies saying they set standards in these areas. Freedom of association was the next most common, addressed by 12 percent of firms, while 10 percent described standards for harassment, health and safety

and wages. However, lower percentages specified that their standards followed the corresponding core conventions of the International Labor Organization (ILO).

RiskMetrics found fairly significant geographic differences. Companies based in the European Union were the most likely to have adopted a supplier code, with 35 percent having one in 2007. Twenty-two percent had one in the rest of Europe, 17 percent in the United States, 10 percent in Austral-Asia, and 8 percent in the rest of the Americas. RiskMetrics also reported that it had collected three years of data for U.S. companies (i.e., those in the S&P 500), which showed a clear trend toward code adoption. Thirteen percent had a code in 2005, 16 percent in 2006, and 22 percent in 2007.

EIRIS Ltd. has published similar LHR benchmarks on smaller samples of companies as part of an annual study called *The State of Responsible Business*.<sup>11</sup> It assessed 280 companies selected from the 2007 FTSE All-World Developed Index that EIRIS identified as being at high or medium risk for supply-chain labor standard violations. (The risk levels describe companies that have the greatest concentration of activities involving global supply chains.) The study then grouped each company's policies in this area into three categories: basic, advanced, and residual. Basic meant that the firm "demonstrate(d) commitment to one of the core ILO (International Labor Organization) conventions areas, and make the policy publicly available." Advanced meant that it "also demonstrate(d) integration of its policy with the company's procurement process and membership of a relevant initiative dealing with labour standards, such as the Ethical Trading Initiative, Fair Labour Association or Social Accountability International." Residual, defined companies with "no evidence of reporting publicly on their supply chain labour standards policy and systems." The results were reported by geographic regions: Europe, Australia/New Zealand, North America, Japan, and Asia ex-Japan.

EIRIS did not provide numbers for all 280 firms in its sample but instead reported its findings by geographic region. The results broadly paralleled those of RiskMetrics. Less than 20 percent of companies in all regions other than Europe had a LHR supply-chain policy. More than half of those based in Europe had either a basic or an advanced policy, and a third met the advanced criteria. EIRIS found comparable rates for management systems designed to implement these policies and for reporting publicly on their actions. (The fact that EIRIS selected companies with higher risks of supply-chain violations may in part explain why it found more policies than RiskMetrics. However, EIRIS also used a differ-

ent measurement standard. It ranked companies by their stated commitment to core ILO conventions, by “other key labour standards identified by EIRIS,” and by membership in relevant MSAs.)

Other ESG research firms provide clients with similar LHR supply-chain benchmarks or incorporate them into proprietary rankings that rate companies on their ESG policies and performance. For example, KLD Research & Analytics, Incorporated has provided ESG rankings since 1988.<sup>12</sup> It scores companies on 200 performance indicators, including policies and systems that encompass “the protection of supply chain workers’ rights, including freedom of association, freedom from forced labor and child labor, safe working environments and other rights described by the International Labor Organization (ILO) Conventions and other applicable standards.” However, KLD benchmarks and ratings are for the most part available only to clients, as is the case with EIRIS and other ESG research houses.

A study by the Roberts Environmental Center at Claremont McKenna College focused on 100 companies randomly selected from those that issue sustainability reports using guidelines published by the Global Reporting Initiative.<sup>14</sup> Its purpose was not to benchmark LHR supplier codes but to assess the quality of corporate reporting on human rights that is done under the GRI rubric. Like RiskMetrics, the researchers examined what companies said about their actions in public documents released in 2007 such as GRI reports, sustainability or corporate social responsibility reports, and annual reports.

It found much higher rates of general reporting on key LHR factors (although the study didn’t distinguish between reports that focus on a company’s own workforce as compared to those that discuss its global supply chain). For example, 79 percent discussed freedom of association, 97 percent discussed non-discrimination, 71 percent discussed child labor, and 67 percent discussed forced labor. These robust rates likely reflected selection bias, since companies with no policies on these issues would have little reason to use GRI reporting guidelines.

However, the study also found major deficiencies in the depth of reporting on LHR issues. The GRI guidelines require companies to describe their policies regarding each specific right, as well as the actions they have taken and the performance they have achieved on each. But only 9 percent of the 100 companies reported on all three aspects regarding

non-discrimination, while 11 percent did so with respect to child labor, nine percent to freedom of association, and six percent to forced labor.

Another organization, the Business and Human Rights Resource Centre, has created an extensive database that could be used as the raw material to create a supplier LHR benchmark.<sup>15</sup> The center attempts to identify and link to all corporate statements that refer to human rights, although it offers no further attempt to categorize the statements.

Other studies have employed surveys of companies to assess LHR policies. A 2006 survey of the 500 largest global companies taken for the United Nations found that nearly 93 percent said they had policies on human rights which covered their supply chains.<sup>16</sup> Almost 90 percent said they had internal reporting and compliance systems in place, while nearly 75 percent said they engaged in some form of external reporting. Nearly 96 percent of respondents said their policies covered health and safety, 87 percent covered freedom of association, and 80 percent covered forced and child labor.<sup>17</sup> These findings are considerably higher than those reported by RiskMetrics and EIRIS. Selection bias undoubtedly played a role in these differences, since the UN received only 102 responses from the 500 corporations. As the study said: "... (I)t may well be the case that companies with human rights policies and management practices responded to the survey at a higher rate than those that don't." Another possibility is that some firms have LHR supplier standards but don't report on them publicly, in which case the RiskMetrics and EIRIS studies would not have uncovered them.

The UN undertook a companion study of publicly reported LHR policies, analogous to the RiskMetrics one.<sup>18</sup> It looked at the public statements issued in 2006 by 314 companies, including the 102 that had responded to the initial survey questionnaire; those listed on the Business and Human Rights Resource Centre's website as having publicly reported human rights policies; and companies that had submitted a Communication on Progress for 2005 or later as required by the Global Compact.<sup>19</sup> It found stated LHR policies at levels that were closer to those found by its survey questionnaire than to the lower rates reported by RiskMetrics. For example, 54 percent of companies had supply-chain management policies that included LHR; 87 percent had policies covering non-discrimination; 65 percent covered freedom of association; and 60 percent covered forced and child labor. These rates also are much higher than the market-wide RiskMetrics and EIRIS studies, again most likely due at least in part to the selection bias of the companion study, which

focused exclusively on firms already known to have LHR policies.

A third UN study examined the reported LHR policies of 25 Chinese firms.<sup>20</sup> It found much lower percentages of companies with such policies.

The variations among all these studies stem from their differing sample sizes and methodologies. Alternate or imprecise definitions of LHR policies may be a factor as well. The following section outlines our effort to specify the definitions we developed to capture the often dissimilar descriptions companies use to report their supply-chain LHR policies. A clear understanding of corporate reporting on these issues is necessary for the development of benchmarking strategies that can be used for meaningful analyses of any investment risks they may pose across industries and markets.

## **Section Two: Data and Methodology**

The benchmarks constructed for this paper are drawn from ASSET4's database, which contains more than 85 individual data points on LHR and employment quality issues. Forty-two of these are related to supply chain policies and performance. The sample consists of 2,508 publicly listed companies that comprise the MSCI World, MSCI Europe, Standard & Poor's 500, FTSE 350 and Dow Jones STOXX 600 Indexes.<sup>21</sup> Collectively, these firms comprise more than 85 percent of the total market capitalization of the 23 stock markets of the developed world. Thirty-five percent of these companies were based in Europe; 29 percent in the United States, 26 percent in Asia/Pacific markets (including Australia) and the remaining 10 percent were from Canada, Latin America and the Middle East.

Their size breaks down as follows: 26 percent have market capitalizations between \$200 million and \$2 billion, which we define as small companies; 47 percent are mid-sized firms with market caps between \$2 billion and \$10 billion, and 27 percent are large firms with market caps greater than \$10 billion.<sup>22</sup>

To ensure consistency and a common standard for analyzing performance, ASSET4 obtained the data from information made public by the companies through annual reports, sustainability or corporate social responsibility reports, and corporate websites. Because there are no legal or commonly accepted definitions of supply-chain LHR policies, we defined categories designed to capture key aspects of corporate behavior in this arena. We

identify a company as having an LHR policy if it specifically claims to be committed to upholding human rights standards, broadly defined, among its suppliers (some companies have such policies but do not specify that they apply to their supply chain).

Some companies issue more detailed versions of LHR policies typically called codes of conduct. We categorize firms as having a supply-chain code if they describe a specific code of conduct for suppliers that includes LHR factors, or if they describe a broader company code that has a section devoted to suppliers. Statements of business principles or business ethics were included as supply chain codes of conduct, provided that they incorporated LHR policies for suppliers.<sup>23</sup>

We deem companies to have a policy on individual LHR standards if they specify that they require suppliers to respect rights or norms in a particular area. While there are numerous topics covered in some corporate policies, we restricted our research to four of the most common: health and safety; child labor; forced labor; and freedom of association.

Some companies employ ILO definitions for their LHR standards, which generally provide more detailed explanations about meaning. We count them in this category if they specifically state that they require adherence to the relevant ILO core conventions.<sup>24</sup> (Although the ILO also has conventions relating to health and safety, it has not designated those as core, so we have excluded those from the ILO tabulations.)

Many companies say they have set up a variety of procedures to ensure that suppliers adhere to their LHR policies. However, the extent of reporting on the specificity of these procedures varies widely. In addition, there may be even less commonality here than there is for the definition of policies and standards. As a result, we categorized different levels of policy implementation, ranging from very general to more specific. At the broadest level, we consider a company to have a “process” if it characterizes any program or plan for implementing its LHR policies, or if it describes the ways that its policies are applicable to suppliers. More specifically, companies are considered to have a monitoring program if they provide concrete evidence that audits or surveys of LHR performance occur with any regularity. Companies are considered to have LHR improvement targets if they provide qualitative or quantitative goals for improving performance over time. Finally, companies are considered to have enforcement procedures if they provide concrete evidence that they are willing to terminate relations with their suppliers if their LHR standards are not met.

For the purposes of this study, we have considered policy statements made by companies in their annual reporting for the fiscal years 2007 and 2008. Two fiscal years of data were used given the relatively slower and irregular nature of company sustainability/corporate responsibility reporting compared to financial reporting.

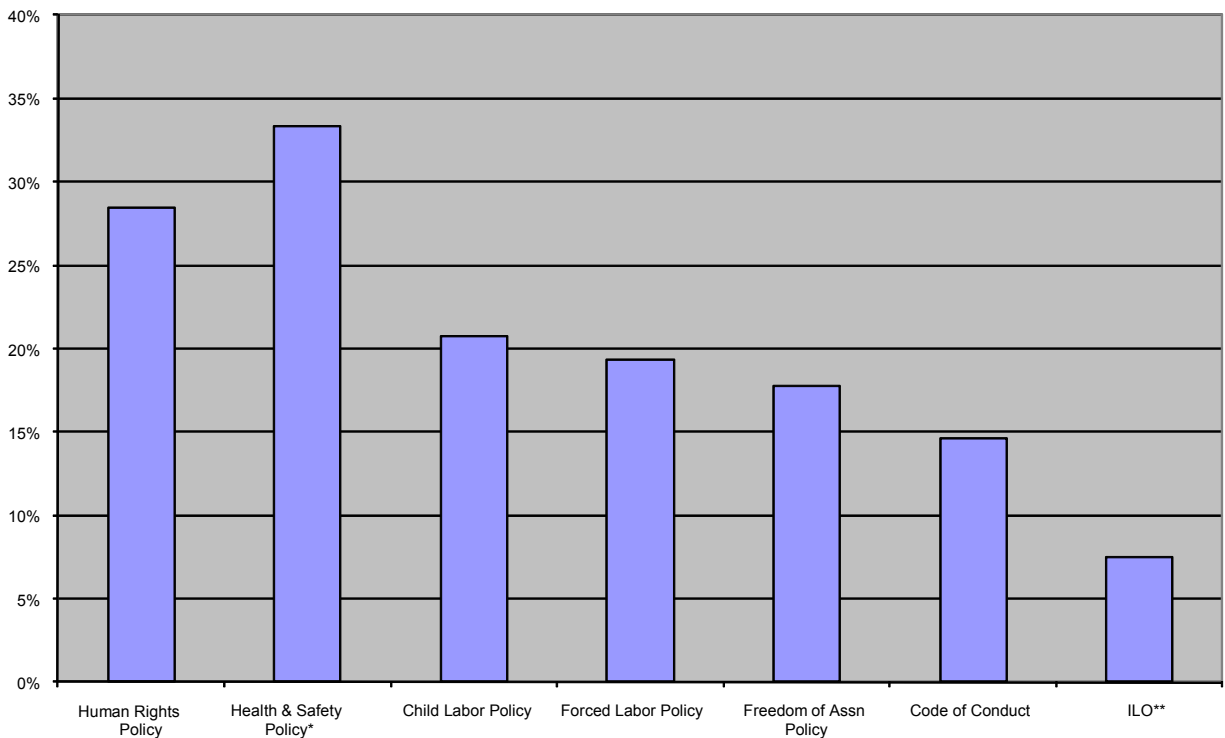
## Section Three: Results

### Policies and Implementation Overview

The most general question about supply chain LHR policies is whether a company has one. We find that 28 percent of the 2,508 companies in our sample describe a human rights policy that applies to the supply chain, while the remaining 72 percent do not (Chart 1).<sup>25</sup> These policies range from general statements to more explicit and detailed standards and expectations suppliers must meet. The 28 percent figure encompasses the entire spectrum. For example, Duke Energy Corporation issues a code of conduct for suppliers that covers a variety of issues including the use of company resources, giving and receiving gifts, and maintaining financial records. However, it contains only one sentence about employment standards, which reads: “Suppliers must conduct all their operations in a socially responsible, non-discriminatory manner and in full compliance with applicable laws including, but not limited to, those associated with Equal Opportunity, Child Labor, Forced or Compulsory Labor, Working Hours, Wages and Benefits, Freedom of Association, and Harassment-Free Work Environment.”<sup>26</sup> An example of a more developed supply-chain policy would be that of Associated British Foods (ABF), which says: “All our suppliers are required to comply with a strict code of conduct which lays down, amongst other things, minimum standards of health and safety, welfare, human rights and wages that we are prepared to accept in relation to the treatment of their employees. We employ our own in-region ethical managers as well as third-party auditors to check that our suppliers meet their contractual obligations and that proper standards are being maintained.”<sup>27</sup> Similarly, ABF subsidiaries such as Primark, a large retailer, have elaborate codes of conduct backed up by independent audits of factory audits as called for by the Ethical Trading initiative, an MSA to which the company belongs.<sup>28</sup>

The more detailed policies codified in a code of conduct typically list a set of LHR standards the company expects its suppliers to meet. The goal is usually both greater specificity and greater reach, since codes by definition cover more than one LHR issue. Overall,

**Chart 1 Supply Chain Policies**



\*The number of companies with health and safety policies is higher than the overall number of those with human rights policies because some firms consider the two to be unrelated issues.

\*\*International Labor Organization conventions.

15 percent of the company policies we examined used the term code of conduct to describe their supplier LHR policies.

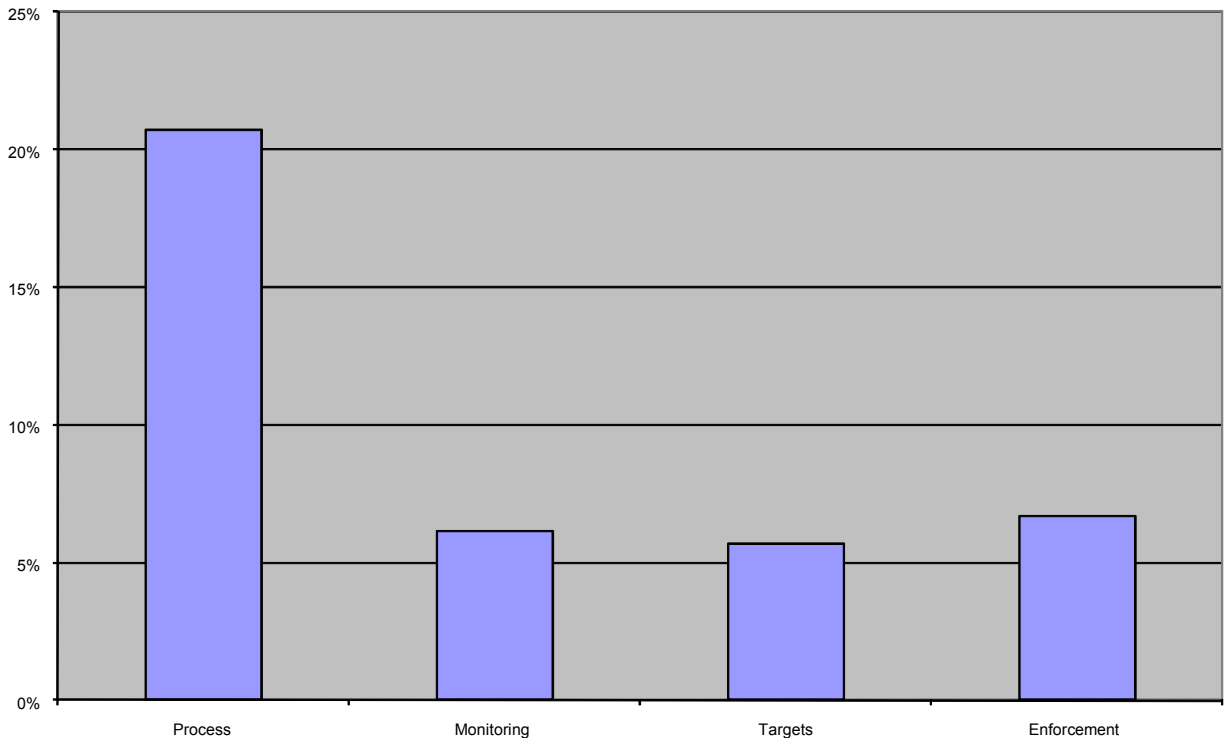
Another question is which rights are covered by a company’s policy or code. Despite the absence of legal requirements or widely accepted standards, there appears to be a rough consensus that several basic issues should be included. Health and safety is the most common, found at 33 percent of companies. (The figure is larger than the 28 percent of firms with an overall supply-chain human rights policy, presumably because some companies consider health and safety not to be a matter of human rights. In other words, some firms do not issue an overall human rights policy but nonetheless have one concerning health and safety.)

The other three standards we include are child labor, forced labor and freedom of association. Twenty-one percent of companies say they have a policy against child labor, 19 percent cover forced labor, and 18 percent address freedom of association.

A statement or code that specifies a particular right can leave significant room for interpretation, depending on how broadly worded it is. Corporations frequently have been criticized for adopting vague LHR policies that lack specifics sufficient to make them meaningful. Even companies such as Williams-Sonoma Incorporated that are widely respected for their LHR commitments do not always provide detailed definitions of issues. For example, it says: “We seek to use only vendors who meet the highest standards for safe, healthful working conditions and follow employment practices that conform to local law, best industry practices and our company standards. This includes, among other things, a prohibition against child labor, prison or forced labor, unsafe working conditions or payment of below minimum wage. All of our vendors and suppliers are required to sign and abide by our Code of Conduct.”<sup>29</sup> However, the company’s code does not mention any of these employment issues.<sup>30</sup> Such statements, while positive, fail to define forced or child labor with the specificity sufficient to allow investors to compare Williams-Sonoma’s policies to those of other companies.

Such a policy can be applied in many ways, particularly since national laws and social norms vary on issues such as the appropriate age at which children should enter the work-

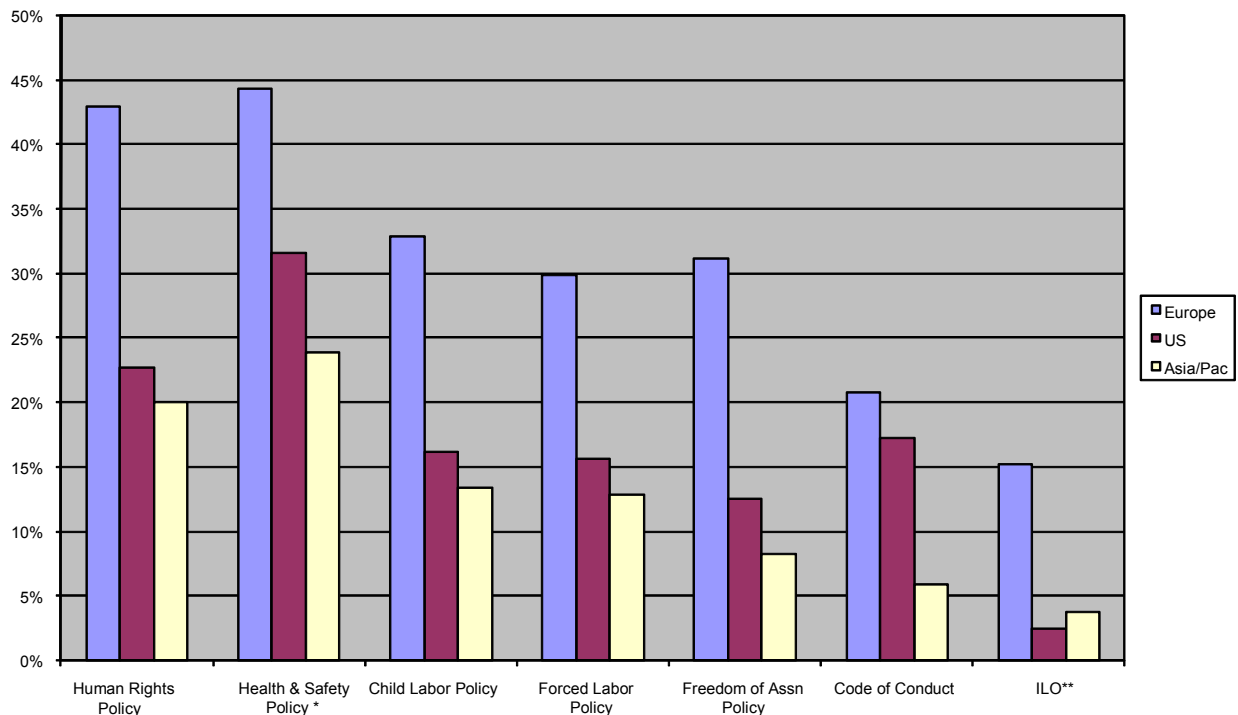
**Chart 2 Supply Chain Policy Implementation**



force and how many hours per week and day they should be allowed to work. One way some companies have dealt with this issue is to use the definitions developed by the ILO. However, only 7.5 percent mentioned any of the eight core ILO conventions.

A second range of issues about LHR supplier policies is whether they are enforced in any way. Just as critics argue that policies without sufficient specifics lack efficacy, so too have many said that it is unrealistic to expect suppliers to simply stop abuses just because a company it supplies says they must. Over the years, leading global corporations and MSAs such as Social Accountability International and the Fair Labor Association have built increasingly elaborate processes and procedures to ensure compliance with their LHR codes. But most companies have not yet put in place specific compliance mechanisms. Overall, 21 percent of companies describe some sort of process for implementing their LHR supplier policies (Chart 2). However, only 6 percent say they monitor their suppliers for compliance or set targets for them to improve their behavior. And only 7 percent say they have an actual enforcement system.<sup>31</sup>

**Chart 3 Supply Chain Policies by Geography**



\*The number of companies with health and safety policies is higher than the overall number of those with human rights policies because some firms consider the two to be unrelated issues.

\*\*International Labor Organization conventions.

## Geography

We find significantly more LHR supplier policies among European corporations, despite the fact that public controversies over sweatshops have regularly affected highly visible U.S. corporations as well. Forty-three percent of firms based in Europe profess an LHR policy, versus 23 percent in the United States and 20 percent in Asia (Chart 3). The number for Asia is somewhat surprising in light of the findings by RiskMetrics and EIRIS, which both found significantly lower LHR supplier concerns there compared to Europe and the United States. However, this could reflect the different measurement standards employed in those studies. RiskMetrics focused not on broad policies but on the narrower category of companies with supply-chain codes of conduct. There our findings are similar: We find 21 percent of European companies with a code, compared to 17 percent in the United States and just 6 percent in Asia. Similarly, EIRIS’s lower results for Asian companies may reflect the fact that its geographic analysis focused on policies that meet all the core ILO conventions, which is a more specific standard than simply stating a general policy. The higher levels of general supply-chain LHR policies in Europe carry through to the other aspects as well. Corporations there are roughly twice as likely to specify particular rights, such as child and forced labor.

Chart 4 Policy Implementation by Geography

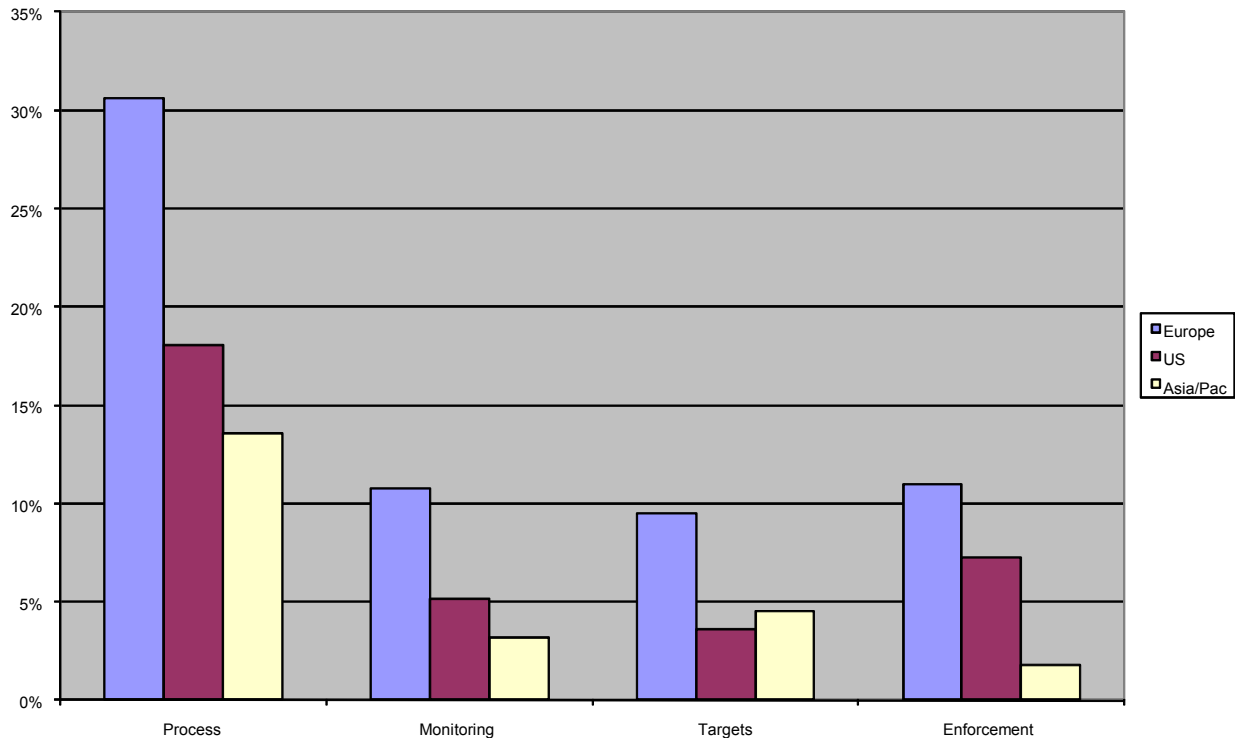
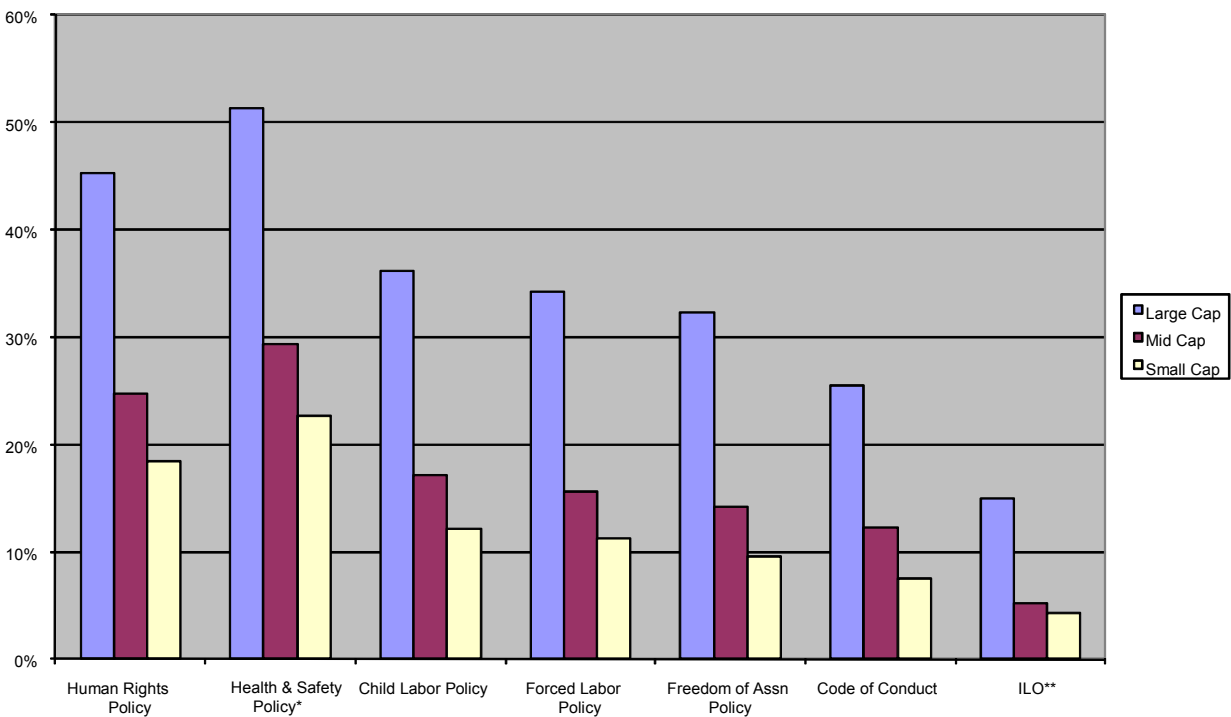


Chart 5 Supply Chain Policies by Market Capitalization



\*The number of companies with health and safety policies is higher than the overall number of those with human rights policies because some firms consider the two to be unrelated issues.

\*\* International Labor Organization conventions

European companies are also more likely to describe monitoring, improvement targets and enforcement mechanisms for their policies and codes than U.S. and Asian companies (Chart 4). Enforcement is particularly low in Asia, with just 2 percent of companies saying they have any policy in this area. European companies show an even more disproportionate focus on the core ILO conventions, with 15 percent addressing at least one compared to 4 percent of U.S. firms and 2 percent of Asian ones. This may partly reflect the fact that the ILO is based in Geneva and has long had significant participation by Europeans.

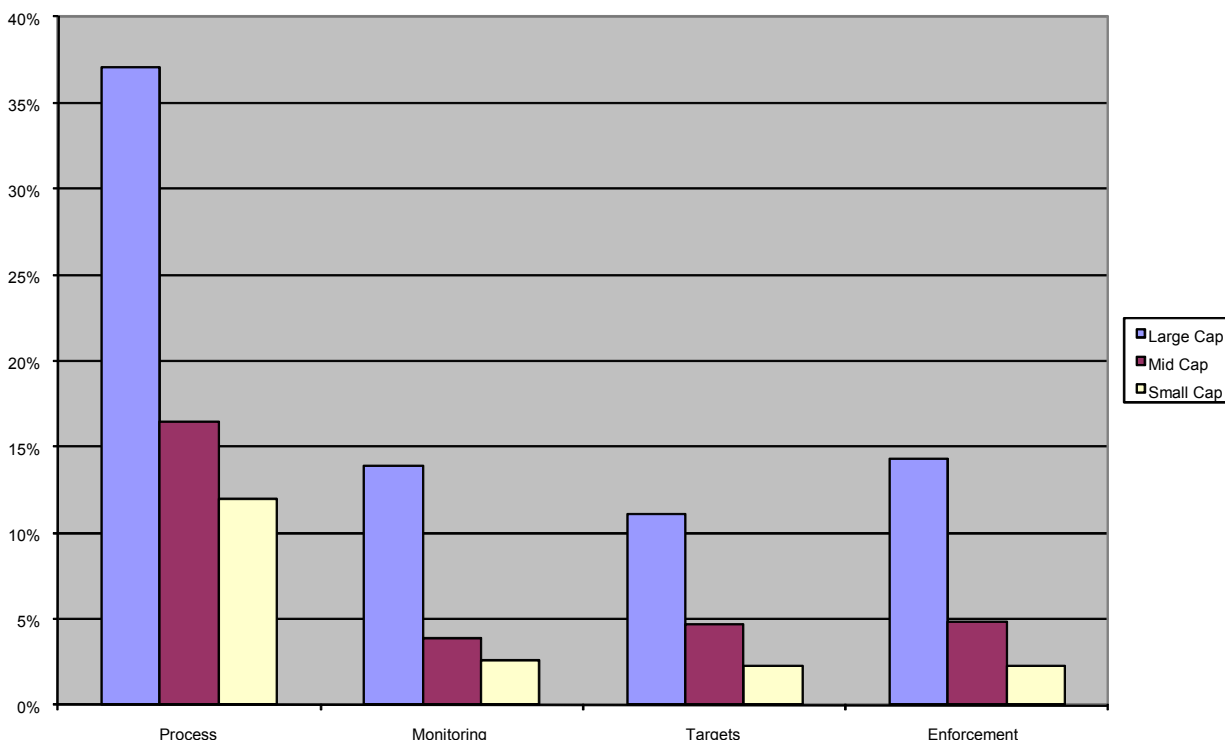
## Company Size

It would be expected that large corporations would be more likely to address LHR supply-chain issues, since they have extensive global supply chains and tend to be subject to greater public scrutiny. Still, it is striking that 45 percent of the 657 firms in our sample with \$10 billion or more in market capitalization have an enunciated LHR policy, and equally so that 25 percent of them publish an explicit supplier code (Chart 5). The implication is that

such concerns are close to the norm for large global corporations, suggesting that those lacking LHR policies may come under pressure to adopt them. The fact that 18 percent of smaller companies describe an LHR policy is something of a surprise, given that most operate below the public radar and presumably face less of a public relations imperative to adopt such a policy. The relatively large proportion may indicate that LHR supply-chain policies are starting to become an expected part of corporate behavior, at least among those with extensive supply chains or in some markets or industries.

The public visibility of large companies also may help to explain why they are so much more likely to adopt follow-up procedures, with 14 percent describing monitoring and enforcement processes and 11 percent saying they have targets (Chart 6). The disproportionately low levels of follow-up among smaller firms may indicate that many of their policies lack substance. Only 3 percent of small companies describe any monitoring effort, while just 2 percent say they have improvement targets or enforcement mechanisms. Follow-up processes are also expensive to learn about, set up, and administer, so these low levels also may reflect the fewer resources typically available to smaller companies. MSAs designed to assist companies on LHR supply-chain issues do have small-company members, as does the Global Reporting Initiative<sup>32</sup>. But it may be that many smaller firms

Chart 6 Policy Implementation by Market Capitalization

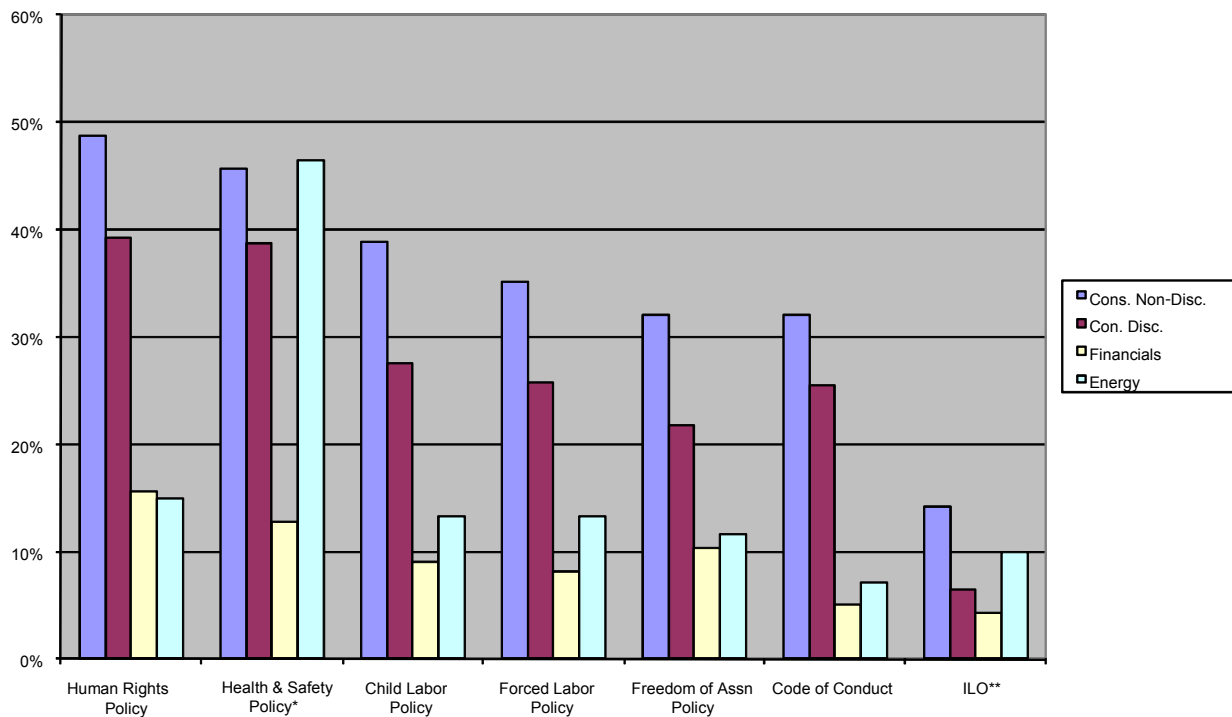


with LHR policies are not aware of their existence. It is also possible that smaller companies might be less likely to report publicly on these subjects, since that task can require scarce resources as well.

## Sectors

LHR policies are more likely in sectors of the economy that have been subject to the most exposes of LHR abuse.<sup>33</sup> They are most prevalent in the consumer sector, which include industries such as apparel and personal products. Forty-nine percent of firms in this sector have a policy, and 32 percent have published a code of conduct (Chart 7). By contrast, policies are found in only 15 percent of financial firms. Just 7 percent have a code, most likely because they typically are not involved in the manufacture of goods, which is the area that has received the most scrutiny in terms of global supply chains and LHR issues. The energy sector is the least likely to have supply-chain LHR policies, at 14 percent, although a much higher percentage of companies have broad human rights poli-

Chart 7 Supply Chain Policies by Selected Sectors

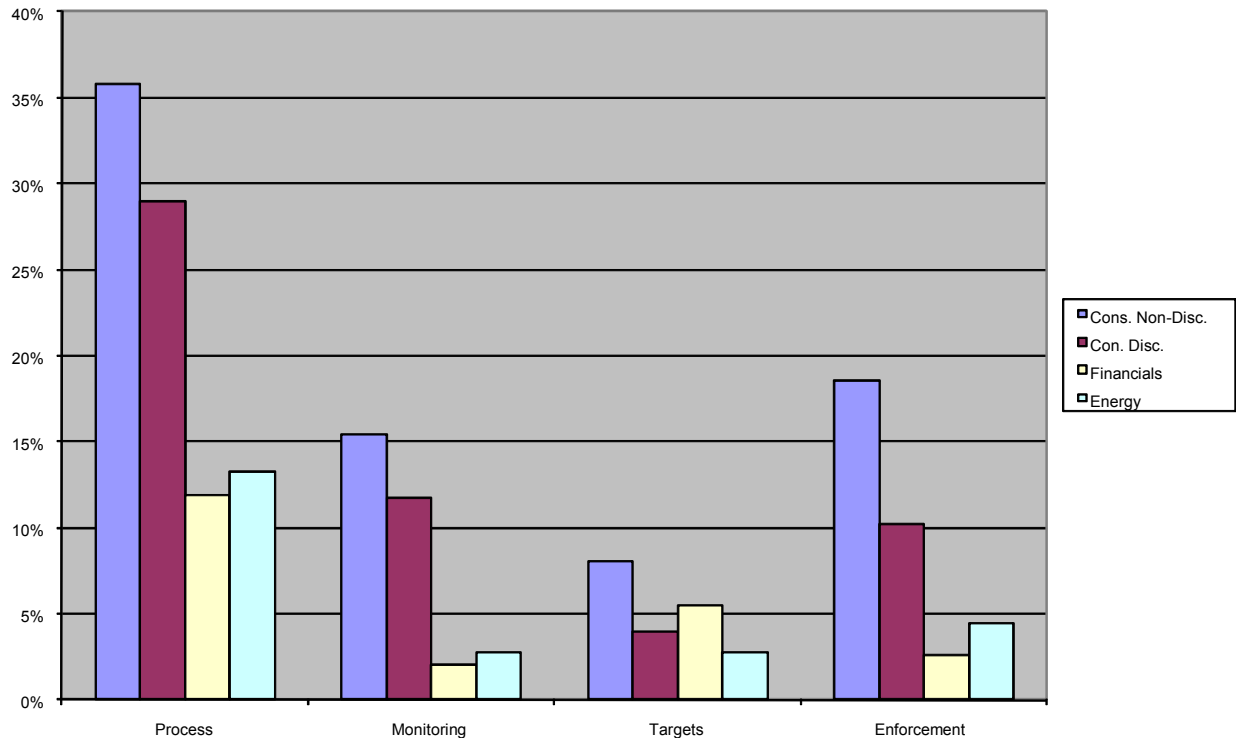


\*The number of companies with health and safety policies is higher than the overall number of those with human rights policies because some firms consider the two to be unrelated issues.

\*\* International Labor Organization conventions.

cies that do not address supply chain issues specifically. This probably reflects the more integrated nature of energy companies, which tend to rely less on suppliers than firms in other sectors. It also may reflect the fact that many operate in politically unstable countries with pervasive LHR challenges.

**Chart 8 Policy Implementation by Selected Sectors**

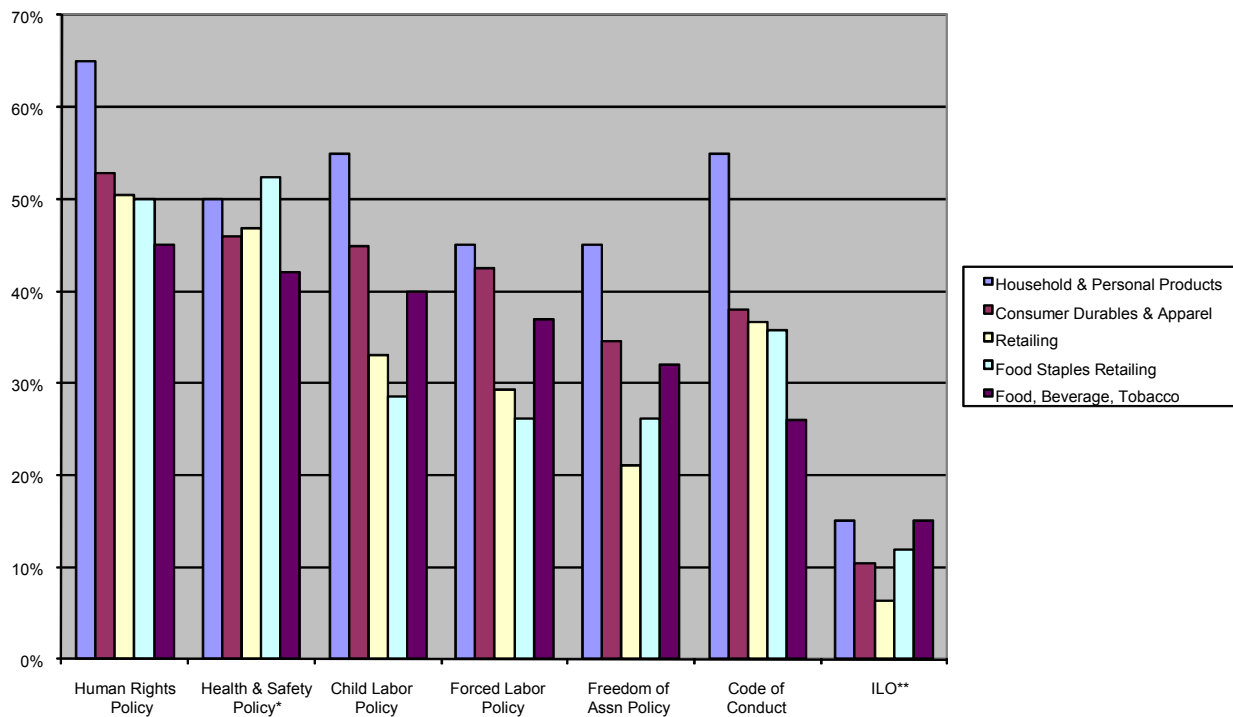


The story is the same regarding policy implementation. The consumer sectors report greater activity, with 19 percent of companies in the consumer non-discretionary sector describing enforcement procedures and 10 percent in the consumer discretionary sector (Chart 8). By contrast, only 3 percent of financial firms and 4 percent of energy companies say they do enforcement of some sort.

## Industries

A more detailed look at specific industries reveals several in which LHR policies already are the norm. Again, such policies are most frequently found in industries that produce brand-name goods purchased directly by consumers. The five industries with the highest prevalence of corporate policies are all part of the consumer discretionary or consumer

Chart 9 Supply Chain Policies by Selected industries



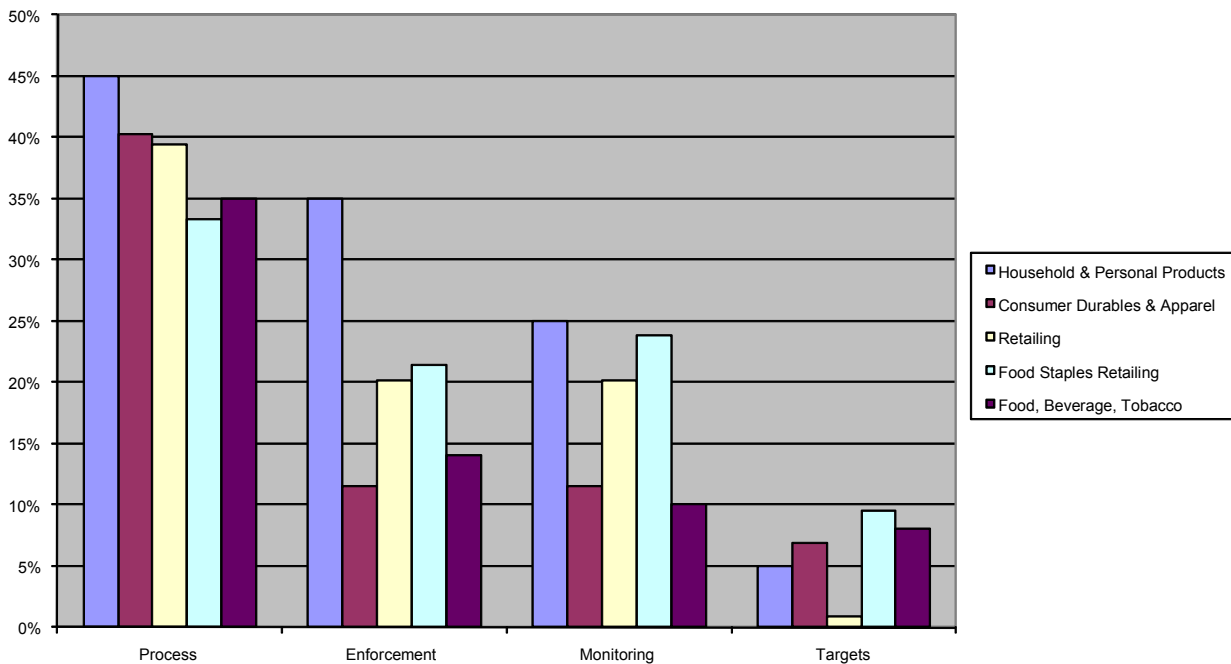
\*The number of companies with health and safety policies is higher than the overall number of those with human rights policies because some firms consider the two to be unrelated issues.

\*\* International Labor Organization conventions.

staples sectors, which include many well-known companies that have experienced negative LHR supplier publicity. These include firms such as Wal-Mart Stores Incorporated, Nike Incorporated and Tesco PLC. Fully 65 percent of household and personal products firms have policies and 55 percent have a code (Chart 9). In three other industries, a majority of companies have policies as well: Consumer durables and apparel; Retailing; and food staples retailing.

Somewhat surprisingly, enforcement mechanisms are less prevalent in consumer durables and apparel manufacturing than in retailing, where only 11 percent describe enforcement systems despite the attention LHR issues have had in these industries over the past decade (Chart 10). One possible explanation is that retailers may have more flexibility than manufacturing companies to change suppliers when confronted with LHR abuses.

Chart 10 Policy Implementation by Selected Industries



## Conclusion

The benchmarks reported in this study offer a starting point for an analysis of the investment risks posed by supply-chain LHR factors. They add to the scant literature in the field by providing a basic understanding of how global corporations are dealing with these issues, which enables investors to compare and contrast individual companies against emerging regional, sectoral, and industry norms. Our findings also deepen the understanding of corporate activity in this arena by quantifying the significant gap between general policies against LHR abuse, which many companies have issued, and the more detailed standards and enforcement mechanism required to carry them out, which are less prevalent. One implication may be that investors need to examine not simply whether a company has a policy, but also the extent to which it is given substance by monitoring, improvement targets and enforcement mechanisms. Only by examining the depth of policy implementation in greater detail can investors understand the significantly differing levels of company performance on LHR supply-chain issues.

Our findings show that LHR supply-chain policies vary significantly by sector and industry. These variations probably reflect the extent to which supply-chain LHR issues affect sectors and particular industries, since some outsource business activities more than others.

Consequently, investment analysis is likely to be more fruitful if it compares company performance relative to sector and industry performance levels. For example, our data indicate that reporting on LHR supply chain policies is rare in sectors such as energy and financials but common among consumer discretionary, retail and food and beverage companies. Our study also reveals significant variations by region, which may be driven to some degree by the more advanced level of corporate responsibility reporting in Europe compared to the United States and Asia. Public reporting varies widely by company size as well, with larger companies much more likely to disclose policies than smaller ones. Investor efforts to identify best-in-class approaches that adjust for these differences may provide a useful means of evaluating the relative performance of companies.

Another conclusion to emerge from our study is the lack of corporate reporting on factory monitoring and other policy enforcement measures, which are required for more robust portfolio analysis. If the field of social factor analysis is to advance, standardized definitions are needed. At this stage, it can be difficult to draw informative distinctions among those companies that simply state a policy against child labor or any other LHR factor, with no elaboration as to what exactly that means. Even though our benchmarks group all of these policies together, a firm with a rigorous definition might do a better job of reducing risky supplier practices than one with a vague description. The small minority of companies that cite ILO conventions offers one way to move toward a standardized classification system. However, even the conventions leave significant room for varying interpretation.<sup>34</sup> Investors could make more effective LHR risk assessments if more precise common definitions were developed and widely adopted by companies

Such a need may be even more necessary with regard to corporate descriptions of monitoring and enforcement mechanisms. Our categories include all companies that state they have activities in these areas. A more finely drawn approach could distinguish between programs that might be better at detecting and mitigating LHR abuse and those less capable of dealing with problems that both suppliers and their workers have many reasons to cover up. For example, some companies use their own staff to monitor suppliers, while others rely mostly or completely on third-party inspection services. Some hire and control the external inspectors, while others allow independent factory audits. Some companies adopt a policing model of compliance while others are moving toward a collaborative approach that involves training suppliers to set up their own internal compliance systems. These types of distinctions are rarely elaborated in corporate descriptions. Investors and

regulators may need to request more of this information to enable development of better market-wide benchmarks.

Our study also suggests a need for better corporate reporting on the efficacy of LHR supplier policies. Only a relatively small number of companies report any level of detail about the outcomes produced by their efforts. Ultimately, such reporting will be required for investors to identify policies and practices that do a better job of reducing reputational and/or operational risk. In the same vein, there are few independent sources by which to verify corporate statements relating to LHR policies. Our data is based solely on what companies describe in public documents. As a result, it contains no evidence about whether and how the policies are carried out. Our benchmarks suggest that LHR supplier policies are becoming the norm in some industries. Yet there are virtually no independent assessments of whether they achieve their goals or even have made any measurable progress toward meeting them. The relatively large differences between the fraction of companies with policies and codes and those with follow-up monitoring and enforcement efforts suggests that some of what is captured here may largely reflect public relations efforts mounted by companies to deflect criticism. One way to strengthen the analysis would be to attempt more detailed benchmarking of the types of monitoring and enforcement mechanisms companies employ. Various MSA and companies have experimented with different approaches and studies have found some to be more promising than others.<sup>35</sup> A closer examination that differentiates these efforts could shed more light on such issues.

A further challenge is to ensure that the publicly available data reflects the full extent of LHR policies regarding supply chains. The higher response rates to the survey questionnaires done for the United Nations suggests the possibility that some firms may have policies but choose not to make them public.

Despite these challenges, public disclosure remains the primary basis upon which investors can develop benchmarks of LHR supply chain policies. Benchmarking of the kind produced for this paper can provide investors with more choices for dealing with perceived risks posed by LHR supply-chain policies. For years, socially responsible investing (SRI) funds have employed negative screens to exclude investments in companies perceived to be engaged in risky or morally objectionable behavior such as tolerating supply-chain LHR abuse. But screens can be blunt instruments applied only after abuses are identified. That is a cumbersome approach at best, and one ill-suited to large investors like

pension funds or insurers that typically rely heavily on holding market-wide baskets of stocks for decades. Benchmarks can help investors develop alternative investment strategies like those aimed at corporate governance issues, such as over-weighting leaders and under-weighting laggards or using various corporate engagement and dialogue approaches (which are frequently aimed at more explicit disclosure). Identifying leaders in supply-chain LHR policy and implementation also can help investors to spot companies with innovative risk management practices in general. Such firms represent a select group that exhibits an awareness of systemic extra-financial risk factors in areas that extend beyond their immediate sphere of control. Positive benchmarking offers investors a way to identify such leading companies and thereby address the growing recognition that environmental and social performance may provide an important proxy for analyzing the quality of a company's management more generally.<sup>36</sup>

The ultimate goal of long-term investment risk analysis is to assess potential impacts on sustainable performance measures such as profitability or stock price. The benchmarks supplied here provide the starting point for such an undertaking, at least on a preliminary basis. If LHR concerns primarily pose threats to a company's reputation and brand value, it is conceivable that simply having a clear policy might positively affect risk perception and performance. However, the more detailed data we supply will allow investors to investigate whether follow-up monitoring and enforcement make a difference as well. Such data also can further analyses of potential impacts that may stem from operational risks and rewards that LHR factors may pose.

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## Endnotes

1 See, for example: The International Corporate Governance Network's Statement On Global Corporate Governance Principles, accessed August 19, 2009 at [http://www.icgn.org/files/icgn\\_main/pdfs/best\\_practice/global\\_principles/2005\\_global\\_corporate\\_governance\\_principles.pdf](http://www.icgn.org/files/icgn_main/pdfs/best_practice/global_principles/2005_global_corporate_governance_principles.pdf); the Council of Institutional Investors Corporate Governance Policies, accessed August 19, 2009 at [http://www.icgn.org/files/icgn\\_main/pdfs/best\\_practice/global\\_principles/2005\\_global\\_corporate\\_governance\\_principles.pdf](http://www.icgn.org/files/icgn_main/pdfs/best_practice/global_principles/2005_global_corporate_governance_principles.pdf)<http://cii.org/UserFiles/file/council%20policies/CII%20Full%20Corp%20Gov%20Policies%205-7-09.pdf>; and the OECD Principles of Corporate Governance, accessed August 19, 2009 at <http://www.oecd.org/dataoecd/32/18/31557724.pdf>.

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3 The Carbon Disclosure Project can be found at: <http://www.cdproject.net/>. The Investor Network on Climate Risk is at <http://www.incr.com/Page.aspx?pid=198>. The Global Reporting Initiative is at <http://www.globalreporting.org/Home>.

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6 For a summary of investor concerns about ESG risk, see: Bernstein, Aaron, "Incorporating Labor and Human Rights Risk into Investment Decisions," Harvard Labor and Worklife Program, Occasional Paper Series No.2, September, 2008, available at [http://www.law.harvard.edu/programs/lwp/pensions/publications/occasional\\_paper2.pdf](http://www.law.harvard.edu/programs/lwp/pensions/publications/occasional_paper2.pdf); and Bernstein, Aaron, "Quantifying Labor and Human Rights Portfolio Risk," Occasional Paper Series No. 4, June, 2009, available at <http://www.law.harvard.edu/programs/lwp/pensions/publications/occpapers/occasionalpapers4.pdf>.

7 The ILO, which was created in 1919, has over the years adopted 184 "conventions" on labor standards, which are international treaties that may be ratified by member states. The organization, an agency of the United Nations, has designated eight conventions as fundamental or core: Freedom of Association (No. 87); Right to Organise (No. 98); Forced Labour (No. 29); Abolition of Forced Labour (No. 105); Minimum Age (No. 138); Worst Forms of Child Labour (No. 182); Equal Remuneration (No. 100); and Discrimination (No. 111). See "Conventions and Recommendations," International Labour Organization, undated web page accessed September 1, 2009 at [http://www.ilo.org/global/What\\_we\\_do/InternationalLabourStandards/Introduction/ConventionsandRecommendations/lang--en/index.htm](http://www.ilo.org/global/What_we_do/InternationalLabourStandards/Introduction/ConventionsandRecommendations/lang--en/index.htm). A description of the ILO's labor standards and its eight core conventions also can be found at <http://www.ilo.org/declaration/lang--en/index.htm>.

8 Bernstein, Aaron, "Quantifying Labor and Human Rights Portfolio Risk," Harvard Labor and Worklife Program, Occasional Paper Series No. 4, June, 2009, available at <http://www.law.harvard.edu/programs/lwp/pensions/publications/occpapers/occasionalpapers4.pdf>.

9 Our data reflects corporate policies regarding suppliers, which typically do not distinguish between first-tier suppliers and second- or third-tier ones.

10 "One in Five Large Firms Set Labor Supplier Standards," RiskMetrics Corporate Social Issues Reporter, April, 2008.

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16 Ruggie, John G. “Human Rights Policies and Management Practices of Fortune Global 500 Firms: Results of a Survey,” Corporate Social Responsibility Initiative, Working Paper No. 28, John F. Kennedy School of Government, Harvard University, September 1, 2006.

17 The survey included forced and child labor in one question, even though each is typically dealt with separately by standard-setting bodies such as the International Labor Organization.

18 United Nations, “Report of the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises,” Addendum, Business recognition of human rights: Global patterns, regional and sectoral variations, February 8, 2007. Accessed August 6, 2009 at <http://daccessdds.un.org/doc/UNDOC/GEN/G07/111/64/PDF/G0711164.pdf?OpenElement>.

19 The second UN report says that 103 companies had responded to the initial survey, although the survey itself says 102 had done so.

20 Ruggie, John G. “Human Rights Policies of Chinese Companies: Results From a Survey,” John F. Kennedy School of Government, Harvard University, September 2007. Accessed August 6, 2009 at <http://www.business-humanrights.org/Documents/Ruggie-China-survey-Sep-2007.pdf>. This study was taken because of the low response rate of Chinese and other emerging-market companies to the questionnaire survey, and because the companion study of reported policies was restricted to those reported in English. The study of Chinese firms included reports published in Mandarin.

21 Descriptions of the MSCI World and Europe indices can be found at <http://www.msccbarra.com/index.jsp>. A description of the S&P 500 Index can be found at [http://www2.standardandpoors.com/portal/site/sp/en/us/page.siteselection/site\\_selection/0,0,0,0,1,0,0,0,0,0,0,0,0,0,0,0.html](http://www2.standardandpoors.com/portal/site/sp/en/us/page.siteselection/site_selection/0,0,0,0,1,0,0,0,0,0,0,0,0,0,0,0.html). A description of the FTSE 350 Index can be found at <http://www.ftse.com/index.jsp>. A description of the Dow Jones 600 can be found at [http://www.stoxx.com/indices/index\\_information.html?symbol=SXXP](http://www.stoxx.com/indices/index_information.html?symbol=SXXP).

22 The market capitalization numbers here and in the charts and tables are based on 2,472 companies due to delistings and mergers. All others are based on the full sample of 2,508 companies.

23 This study focuses on supplier codes of conduct that deal with LHR factors. A larger number of firms issue supplier codes, with others covering subjects such as ethics. For example, a 2008 survey by KPMG found that nearly a third of the 100 largest companies in each of 22 countries published a supplier code of some sort: “KPMG International Survey of Corporate Responsibility Reporting 2008,” KPMG, October, 2008, accessed August 19, 2009 at [http://www.kpmg.com/SiteCollectionDocuments/International-corporate-responsibility-survey-2008\\_v2.pdf](http://www.kpmg.com/SiteCollectionDocuments/International-corporate-responsibility-survey-2008_v2.pdf).

24 The ILO conventions are defined in endnote 7 above.

25 The detailed data underlying each chart is available in the Appendix.

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29 “Corporate Value,” Williams-Sonoma Incorporated, undated web page accessed September 29, 2009 at <http://www.williams-sonomainc.com/careers/corporate-values.html>.

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31 Although it seems logical that enforcement procedures would be dependent on monitoring and/or improvement targets, some companies describe the former but not the latter.

32 The Global Reporting Initiative has a program aimed at small and medium enterprise, available on its website at <http://www.globalreporting.org/WhoAreYou/SME/>, accessed October 20, 2009.

33 We define sectors and industries according to the Global Industry Classification Standard (GICS) developed by Standard and Poor’s Corporation and Morgan Stanley Capital International. See “GICS Direct from Standard & Poor’s and MSCI,” undated web page accessed September 1, 2009 at <http://www2.standardandpoors.com/spf/pdf/products/MK-GICS4-05.pdf>. Findings for the remaining GICS sectors can be found in the appendix tables.

34 For example, see the discussion of half a dozen MSAs to arrive at a common definition of a living wage and other LHR standards in: Bernstein, Aaron, “Quantifying Labor and Human Rights Portfolio Risk,” Occasional Paper Series No. 4, June, 2009, available at <http://www.law.harvard.edu/programs/lwp/pensions/publications/occpapers/occasionalpapers4.pdf>.

35 See the discussion in Bernstein, Aaron, “Quantifying Labor and Human Rights Portfolio Risk,” Occasional Paper Series No. 4, June, 2009, available at <http://www.law.harvard.edu/programs/lwp/pensions/publications/occpapers/occasionalpapers4.pdf>.

36 See, for example: “McKinsey Global Survey Results: Valuing corporate social responsibility,” The McKinsey Quarterly p 5. February 2009, accessed September 29, 2009 at [http://www.mckinseyquarterly.com/Surveys/Valuing\\_corporate\\_social\\_responsibility\\_McKinsey\\_Global\\_Survey\\_Results\\_2309](http://www.mckinseyquarterly.com/Surveys/Valuing_corporate_social_responsibility_McKinsey_Global_Survey_Results_2309).

## Appendix

Data tables for charts

**Table 1 Supply Chain Policies**

Human Rights Policy	28%
Health & Safety Policy*	33
Child Labor Policy	21
Forced Labor Policy	19
Freedom of Assn Policy	18
Code of Conduct	15
ILO**	8

\*The number of companies with health and safety policies is higher than the overall number of those with human rights policies because some firms consider the two to be unrelated issues

\*\*International Labor Organization conventions

**Table 2 Supply Chain Policy Implementation**

Process	21%
Monitoring	11
Targets	6
Enforcement	7

**Table 3 Supply Chain Policies by Geography**

	Europe	United States	Asia
Human Rights Policy	43%	23%	20%
Health & and Safety Policy*	44	32	24
Child Labor Policy	33	16	13
Forced Labor Policy	30	16	13
Freedom of Assn Policy	31	13	8
Code of Conduct	21	17	6
ILO**	15	4	2

\*The number of companies with health and safety policies is higher than the overall number of those with human rights policies because some firms consider the two to be unrelated issues

\*\*International Labor Organization conventions

**Table 4 Policy Implementation by Geography**

	Europe	United States	Asia
Process	31%	18%	14%
Monitoring	11	5	3
Targets	10	4	5
Enforcement	11	7	2

**Table 5 Supply Chain Policies by Market Capitalization**

	Small cap	Mid cap	Large cap
Human Rights Policy	18%	25%	45%
Health Safety Policy*	23	29	51
Child Labor Policy	12	17	36
Forced Labor Policy	11	16	34
Freedom of Assn Policy	10	14	32
Code of Conduct	8	12	25
ILO**	4	5	15

\*The number of companies with health and safety policies is higher than the overall number of those with human rights policies because some firms consider the two to be unrelated issues

\*\*International Labor Organization conventions

**Table 6 Policy Implementation by Market Capitalization**

	Small cap	Mid cap	Large cap
Process	12%	17%	37%
Monitoring	3	4	14
Targets	2	5	11
Enforcement	2	5	14

**Table 7 Supply Chain Policies by Selected Sectors**

	Consumer non-disc	Consumer disc.	Financials	Energy
Human Rights Policy	49%	39%	16%	15%
Health & Safety Policy*	46	39	13	46
Child Labor Policy	39	28	9	13
Forced Labor Policy	35	26	8	13
Freedom of Assn Policy	32	22	10	12
Code of Conduct	32	26	5	7
ILO**	14	7	4	10

\*The number of companies with health and safety policies is higher than the overall number of those with human rights policies because some firms consider the two to be unrelated issues

\*\*International Labor Organization conventions

**Table 8 Policy Implementation by Selected Sectors**

	Consumer non-disc.	Consumer disc.	Financials	Energy
Process	36%	29%	12%	13%
Monitoring	15	12	2	3
Targets	8	4	5	3
Enforcement	19	10	3	4

**Table 9 Supply Chain Policies by Select Industries**

	Household & Personal Products	Consumer Durables & Apparel	Retailing	Food Staples Retailing	Food Beverage & Tobacco
Human Rights Policy	65%	53%	50%	50%	45%
Health & Safety Policy*	50	46	47	52	42
Child Labor Policy	55	45	33	29	40
Forced Labor Policy	45	43	29	26	37
Freedom of Assn Policy	45	34	21	26	32
Code of Conduct	55	38	37	36	26
ILO**	15	10	6	12	15

\*The number of companies with health and safety policies is higher than the overall number of those with human rights policies because some firms consider the two to be unrelated issues

\*\*International Labor Organization conventions

**Table 10 Policy Implementation by Select Industries**

	Household & Personal Products	Consumer Durables & Apparel	Retailing	Food Staples Retailing	Food Beverage & Tobacco
Process	45%	40%	39%	33%	35%
Monitoring	25	11	20	24	10
Targets	5	7	1	10	8
Enforcement	35	11	20	21	14





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