



# Ethical Trading Initiative

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**For workers' rights. For better business.**

## **Enhance supply chain traceability and tackle unauthorized sub-contracting (UAS) to improve worker wellbeing**

### **EXECUTIVE SUMMARY**

This project was launched in China in May 2019  
It is funded by the Foreign and Commonwealth Office

#### **Project aims**

To bring together multi-stakeholders in China supply chains to assess the extent of unauthorized sub-contracting (UAS), explore barriers to monitoring and capacity-building, review existing solutions, hear new trends of advocacy and identify good practice.

#### **Methodology**

ETI adopted various survey methods including: desk reviews; buyer and brand surveys involving 50 companies sourcing from China; stakeholder interviews of almost 20 representatives from NGOs, academic research, local experts and third parties; and a roundtable discussion involving 40 field practitioners. This briefing note integrates the findings from all these activities.

#### **Summary findings**

- Subcontracting (UAS) is very common in China supply chains, especially in the garment, jewellery, accessories, handicrafts and footwear sectors
- There is a common impression that UAS is more common in North China than in South China

- 76%-82% of the companies surveyed cited cost, production flexibility and coping with delivery pressures as the top causes of UAS by suppliers
- The key risks of UAS identified in Chinese supply chains were: dangerous working conditions; excessive working hours; wage under-paid and/or detained; child labour; and the high prevalence of homeworkers
- 72% of companies have developed a clear UAS policy. But only 30% incorporate worker remediation
- 64% of companies have mapped the lower tiers of their supply chain
- Companies are using a range of methods to assess UAS risks in their supply chains: their suppliers' production capacity assessment; in-depth worker interviews; reviews of reports by NGO and CSOs; and off-site audits
- Industrial initiatives tend to be general and lack detailed specifics or guidelines on UAS
- 80% of companies communicate regularly with suppliers about UAS policy, but only 2% consult workers and representatives to develop remedy mechanisms.

## Recommendations

- Brands should review their internal sourcing models and take relevant corrective actions as there is a link between buying practices and UAS
- 84% of companies believe open conversation between buyers and suppliers is the most effective way of building trust and tackling UAS in the long term
- Capacity building is more effective than penalties. Brands could start by working with Tier 1 suppliers to gradually develop a clearer picture of lower tiers suppliers
- 56% of companies believe open conversation with suppliers about key sourcing terms, including price, is effective in tackling UAS
- 56% of companies believe advances tracing technology can improve supply chain transparency
- Stakeholders should collaborate to develop practical guidance for local suppliers in managing lower tier suppliers
- Buyers should address supply chain homeworker issues using the “acknowledge, engage and empower” principle
- Workers need to be trained to better understand the risks of UAS and should be involved in its identification, prevention and remediation.

# Section 1: Introduction

## 1.1 Project background

There is growing pressure on businesses to be more transparent in their supply chain management and to exercise due diligence regarding the protection of workers' rights.

Studies have found that unauthorized subcontracting is a factor in as much as 36% of production. In China, multiple challenges – increased production costs, a shrinking workforce, competition and an unpredictable environment for global trade – have contributed to a rise in UAS and home working.

Widespread UAS and an increasingly fragmented supply chain create significant challenges for brands and buyers seeking to monitor social compliance and protect workers' rights. Lack of visibility and oversight of the lower tiers of the supply chain, where UAS tends to be found, make it difficult to monitor worker safety, and incidences of child labour or forced labour. While production line workers are beginning to benefit from new technologies which allow them to be consulted in order to improve transparency and supply chain traceability, tackling UAS and homeworking remains controversial.

This ETI project was launched in China in May 2019, funded by the Foreign and Commonwealth Office. It brings together multiple stakeholders in China supply chains to assess the seriousness and difficulties encountered in both monitoring of and capacity-building of UAS, review existing solutions, hear new advocacy trends, and identify good practices.

## 1.2 Methodologies

ETI adopted various methods including desk reviews, surveys, stakeholder interviews and a roundtable discussion to conduct this survey.

### **Desk Research**

Existing studies of workers' protection issues as related to UAS were reviewed to identify knowledge gaps, corporate policies, advocacy and operational trends

### **Survey** (100% voluntary and anonymous)

Companies were approached and asked about perspectives and awareness of UAS to report on any internal policy, procedure, preventive strategy and remedy frameworks in place. 50 companies responded, covering a range of sectors including garment, apparel, footwear, toys, retail, accessories, gifts etc

### **Stakeholder consultation and interview**

In-depth individual consultations/interviews with almost 20 stakeholders from industrial initiatives, brands, third parties, researchers, NGOs, and individual experts (see Appendix for project participants list)

### Roundtable workshop

On 31 July 2019, ETI organized a workshop with around 40 participants from brands, third parties, technology initiatives, academic researchers, suppliers and NGOs, examining research results, exploring consolidated solutions, and making suggestions and recommendations.

## Limitations

These included budget, timeline, resource constraints and sensitivities and difficulties in relation to speaking to key players (subcontracted workers, homeworkers, individual brokers, lower tier suppliers). However, many field practitioners interviewed shared their observations of these groups and provided examples of real situations in the field. This briefing note is developed by integrating all the findings and summaries from all these activities.

## Section 2

### What is UAS, and what are the key risks?

- **72% of companies have developed a clear UAS policy**
- **18% of companies are in the process of doing so**

Subcontracting is the practice of assigning, or outsourcing, part of the obligations and/or tasks you are required to deliver under a contract to another party known as a subcontractor.

It includes bringing in an outside company or individuals to perform specific parts of a contract or project which cannot be produced internally.

In manufacturing supply chains, subcontracting production to other factories/parties requires prior approval and advance notice by the buyers/brands/agents. Otherwise it is defined as **unauthorized subcontracting (UAS)**. There are two types of UAS in practice: one is where an entire order is subcontracted to external parties, the other is where part of the order and/or a certain process is subcontracted without formal agreement.

Most of the companies we surveyed (72%) have developed a clear policy with very strict rules against unauthorized subcontracting. However 10% of companies still have no UAS policy, placing them at risk, and increasing the potential for grey areas and confusion in their supply chain due diligence management.

For many buyers/companies, violation of UAS policy will commonly incur a penalty and/or cancellation of the order. Sometimes, it can even lead to the termination of the business

relationship. Below are examples of the penalties incurred by two separate companies found to have been using unauthorized subcontractors.

Company A	Company B
<ul style="list-style-type: none"> <li>• 1<sup>st</sup> time: immediate deduction of £25,000</li> <li>• 2<sup>nd</sup> time: immediate deduction of £50,000 and/or</li> <li>• Suspend all orders until issues are resolved</li> <li>• Cancel orders; and/or</li> <li>• Terminating business relationship</li> </ul>	<ul style="list-style-type: none"> <li>• 1<sup>st</sup> time: immediate deduction of \$15,000</li> <li>• 2<sup>nd</sup> time: immediate deduction of \$20,000</li> <li>• 3<sup>rd</sup> time: remove from supply chain</li> </ul>

## What should a UAS policy include?

An effective company subcontracting policy should cover all the key elements listed in the table below. The percentage scores in the right hand column show how many companies surveyed by ETI which already have a UAS policy in place have included these key elements within the document:

Key policy elements	%
Clear definition of UAS	<b>78%</b>
Subcontracting approval procedures	76%
Roles and responsibilities of suppliers	68%
Due diligence procedures	60%
Consequences of violation	<b>80%</b>
Reporting requirements	52%
Correction plan and worker remediation	<b>30%</b>

The result shows that majority of companies have developed quite comprehensive internal UAS policies which cover many of the key elements, especially the definition of UAS and consequences of violation. However, only 30% included a correction plan and work remediation.

## 2.2 Examples of UAS in local supply chains

- 8% of companies have identified working conditions in UAS workplace are worse
- 56% of companies have no evidence identified to support this

All the surveyed parties reflected that overall, subcontracting was becoming more and more common in the local, labour-intensive manufacturing industries due to trends including increasing operational costs, shorter delivery times and responses cycles, sophisticated patterns and requirements, and squeezed profit margins.

However, one big third party company said they had identified fewer UAS cases in China in 2019 compared with 2018. They thought the key reason behind was production moving significantly outside of China to other countries in SEA (South East Asia), mainly Vietnam and Myanmar as a result of the US-China trade war in 2018-2019. A lot of local factories received fewer orders than in previous years.

The ETI survey found no strong link between the size of a factory and the likelihood of UAS – which was found in both large and small factories. However, the more serious cases tended to be found in the smaller factories.

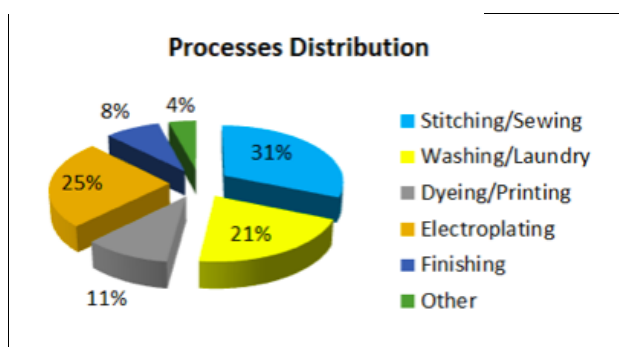
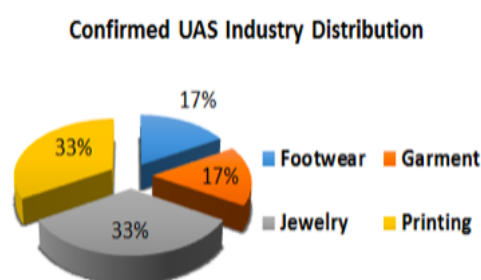
However the survey did reveal some sectorial and geographical characteristics of UAS practices in local supply chains.

### **Sectorial characteristics**

According to recent statistics from TAOS Network, nearly 10% of the total of 500 audited Chinese factories have identified subcontracting practices, among which 12% were confirmed UAS cases, covering sectors such as jewellery, printing, footwear and garments.

More UAS cases were also identified in the accessories industry, including glasses, belts, gifts, straw hats, baskets, embroidery, crafts etc where relatively intensive handwork and finishing tends to be required. In terms of production process, more UAS cases were identified in sewing/stitching, washing/laundry, electroplating and printing.

CCRCSP conducted a survey of around 600 homeworkers in 7 Asian countries including China in 2018. The result indicated that 45% of the surveyed homeworkers worked in handicrafts (baskets, wooden objects), nearly 46% in textile sectors (embroidery, spinning), with the others working in jewellery, labelling etc.

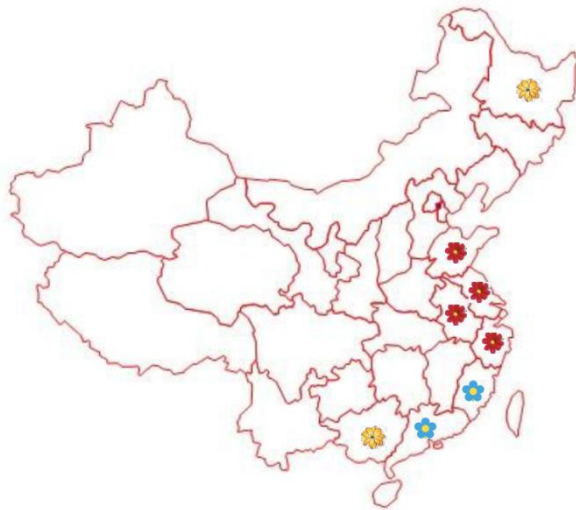


*Graphs: Breakdown of incidence of UAS cases by industry and process distribution (developed by TAOS).*

Generally, the more complex the technology and machinery required during manufacturing, the fewer possibilities for subcontracting. In some areas in China, such as the Jiangsu and Zhejiang provinces, local government departments have passed strict environmental laws defining manufacturing process such as washing, printing, electroplating as heavily polluted processes, making it difficult to acquire permits and licences. Suppliers are forced to have to subcontract these procedures to external parties, sometimes without notice to the buyers.

## Geographical characteristics

The map below marks the regions on the Chinese provincial map where UAS is most prevalent with different coloured flowers. Those marked with red flowers are Jiangsu, Zhejiang, Anhui and Shandong provinces, where ETI project parties shared a common impression that UAS cases are more common compared with southern regions such as Guangdong and Fujian (marked with blue flowers).



The possible reasons may include:

- There are a larger number of smaller sized factories and workshops with between 10 and 20 workers in Zhejiang and Jiangsu regions. Some small workshops only have 7-8 sewing machines and get sewing and hand works from larger factories around
- Suppliers in Guangdong regions have relatively better awareness about clients' ethical requirements as they have established and operated for longer, and have often been set up by an owner from Hong Kong or Taiwan
- The supplier workforce in Guangdong is made up of migrant labour from all over the country but in Zhejiang, Jiangsu and Shandong provinces, workers tend to come from the rural areas within the same province or from neighboring provinces.

The researchers found homework practices to be more prevalent in Fujian and some regions in Guangdong, mainly Chaozhou and Shantou cities. In recent years, in Guangxi, Heilongjiang provinces (marked with yellow flowers) cases have emerged of suppliers subcontracting to foreign migrant workers, mainly from north Korea, Vietnam and Myanmar.

## Suppliers' attitudes and approaches towards UAS

Local suppliers have two different attitudes and approaches towards UAS:

- One group use UAS reactively and occasionally to cope with cost, urgent order delivery pressures, production capacity etc. Some have lower awareness about UAS and poor internal production planning and operational efficiency. Below are some common quotes from this group of factory managers:

*"Sometimes we have to receive the orders with extremely low price in order to keep business relationships with buyer or agent. Then we have to subcontract part or whole order to others, otherwise we will lose money."*



*“Some clients come to us with very urgent orders and sometimes complicated requirements, which we don’t have facilities and workers to produce, so we have to subcontract to others.”*

*“We don’t know too much about UAS, our agent never communicated this with us and we only focus on good quality and on-time delivery.”*

- Another group uses UAS more actively or intentionally as a business model to maximize profit. These suppliers may have a good understanding and awareness about a client’s UAS standards. Some have relatively good production management system, some don’t. They think the procedures for clients to formally approve new subcontractors will be costly, complicated and strict, and impossible for their lower tier subcontractors to get approved. Some of these suppliers use “model factories” to get clients’ approval and attract more orders. But actually quite a lot of production is done by other unapproved subcontractors.

## Different UAS Practices

The cases below were shared by project parties and demonstrate the complex issue of UAS in local supply chains.

Case 1: Garment Factory A is located in Shandong province. It employs only 10 permanent workers, who are the owner’s relatives and friends and working as QC/QA. The factory relies on individual brokers to bring temporary workers in to produce a third of orders and subcontracts two thirds to external workshops via 1-2 agents. The buyer knows nothing about this as it has no local team to manage suppliers and they only visit the factory every 1-2 years. They are using a local agent who is very clear about Factory A’s capacity and subcontracting practices, however this agent only sets the bottom line with Factory A as not subcontracting production to prison labour. Factory A’s other non-compliances relate to working hours, wages and use of homeworkers, but they do little to address them.

Case 2: A footwear factory subcontracts orders to prisons in Guizhou and Yunan provinces. The finished products are sent back to do final packing. During previous audits, the factory hired an “external experienced consultant” to act as factory “HR staff” and support factory to “pass the audits”. The UAS practices have never been identified.

Case 3: Factory B is in Zhejiang province, and produces seasonal products, including Christmas gifts and summer water guns for western small retailers. The order volume is small, but each order is quite urgent, with various patterns, and low prices being paid. Factory B only produces certain parts and subcontracts others to smaller workshops nearby. The agent will send QC to check quality but never monitors closely the compliance status in the factory.

Case 4: A small buyer relies on an agent to reach out to the local supplier in the lower tiers of its supply chain. One agent subcontracts the orders into rural village factories/workshops. The agent asks the village factories to put buyers' CoC on the workplace. When there is supplier training about fire safety and quality issues, the agent will ask the village head to attend. But the agent will not list these village factories on the buyers' supplier lists. The buyer has little leverage to insist on factory audits.

Case 5: Factory C subcontracts part of its orders to another supplier D, who is approved by the buyer. C has no resources to monitor and check D's compliance status, and they believe D understands the client's ethical requirements. In fact, D has subcontracted some aspects of production to external parties through a broker, without informing C.

Case 6: Brand A is sourcing straw baskets from local agent B. But A has no clear idea how B finds and distributes the orders among lower tier suppliers. In fact, B doesn't know either as he is using sub-agencies who subcontract all the orders to local villagers to produce at home. The villagers enjoy the flexibility of earning money in their own homes, while having the freedom and time to take care of their families. Nobody cares about how the piece-wage has been confirmed and settled, or if there is any child labour or bonded labour going on.

## 2.3 Key risks

92% of the companies surveyed responded that even if they were unable to identify any concrete evidence of UAS, they take it very seriously as a compliance and supply chain management issue. 8% reported identifying worse working conditions in UAS workplaces.

*"In UAS cases we have identified, there were extremely high EHS risks, mainly lack of fire exits, no firefighting equipment and PPEs, very poor machines and the workshop had mixed functions of dormitory and production. In addition, there was excessive overtime and child labour."*

*— Andy Du, Audit Program Manager, ESTS*



Over 60% responded that the biggest concern in relation to UAS was the fact that the risk was unknown, as the supply chain becomes invisible. Brands and buyers sometimes lack awareness of where exactly the order is produced, especially for lower tier production. There was one particular report of a well-known brand placing an order in a factory in Fujian province, which was then subcontracted to a local prison as the factory had no capacity to fulfill the orders. This was picked up by the media who undertook an investigation which traced the production back the prison, and then published a detailed report which caused huge reputational damage to the brand.

*“From our perspective, even one UAS case is more than enough because it will damage the whole compliance program as well as company reputation. We should pay high attention to prevent and fix loopholes in our supply chain. “*

*— Regional ethical trade manager from one brand*

ETI asked surveyed companies to tick top 3 risks from UAS practices in China local supply chains. They were:

1. dangerous working conditions
2. excessive working hours
3. wages low or withheld,

followed by child labour and homeworkers.

Health and safety in UAS workplaces such as homes and small workshops is commonly poor, especially in relation to fire safety and injuries. In some village factories, the owners don't want to invest in safety equipment and if the agent or individual broker insists, they will choose abandoned or second hand ones from other formal factories, which do not work.

Those small workshops never do fire drills, nor do they have knowledge of fire safety. Due to lack of PPE or proper tools, workers frequently cut or injure themselves, but rarely do they consider this as work-related injury, and are not entitled to compensation anyway as they are not contributing to social insurance programmes or covered by any incident insurance.

Wage calculation and payment would be a concern in some subcontracted village factories and small workshops, where they have their own ways and schedules to calculate and settle payment which may not be compliant with ethical standards and legal requirements but are agreed by all relevant parties.

Agents are usually powerful figures in the villages and communities and monopolize the control of the workforce. Suppliers rely on these agents and brokers for a steady supply of materials, and therefore have less leverage to push for improvements in labour conditions. Working relationships in UAS workplaces are not necessarily poor. In some small workshops, the owner and workers are working together, and can negotiate piece-rate and workload more openly. They are more like partners than employer and employee.

Subcontracting and UAS was also found to impact negatively on permanent workers' morale, satisfaction and efficiency. One knitting factory located in Dongguan Guangdong invited external temporary workers to use its machines to produce urgent knitting orders in peak season. In order to attract these skilled subcontracted workers, it paid higher piece rates, around 1.5 times the rate they paid permanent workers. This caused huge dissatisfaction among the existing workforce and some of them quit during the peak season and worked as temporary subcontracted workers.

Where factories bring in subcontracted workers, the existing workers only tend to be adversely affected if the factory sets different piece rates. Normally the temporary subcontracted workers have higher production skills and can produce complicated patterns, and they don't have any social insurance, therefore they can earn higher piece wage even than permanent workers.

## **Section 3: Company practices and root causes**

### **3.1 Company practices**

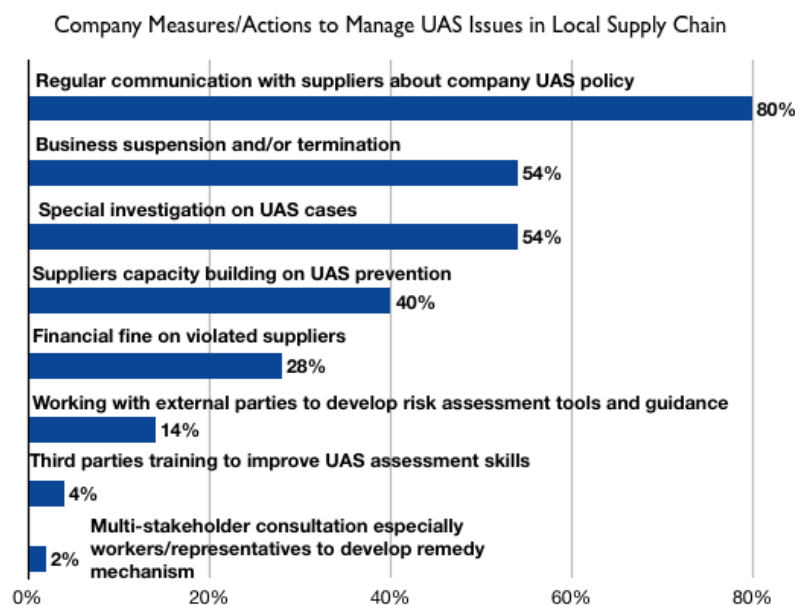
**80 % of companies do regular communication with suppliers about UAS policy**

**2% of companies consult workers and representatives to develop remedy mechanism**

In addition to developing internal policies, companies commonly take a range of measures to manage UAS issues in their local supply chains, including: communicating with suppliers; building capacity within the supply chain; carrying out special investigations; issuing financial fines and business suspensions/terminations; developing assessment tools and guidance; collaborating with external parties such as third party auditors; training; and consulting workers and workers' representatives.

The ETI survey found that of these, the vast majority of surveyed companies prioritise policy communication, risks and consequences to the business, and investigation of the issues. Some areas seem extremely weak and are neglected. For example, only 2% of companies will consult with external parties and workers to develop remedy mechanisms, while only 4% emphasize working with third parties to improve UAS assessment skills.

Some brands reflected that “UAS cases are highly sensitive for our company, so we will conduct investigations by own team rather than commission any external parties to handle”. Third party companies interviewed reflected that while most of the brands and buyers they have worked with have relatively clear policies about UAS, very few have comprehensive guidance/tools for third party companies to use when they are commissioned to conduct UAS investigations or audits. Brands and buyers mainly rely on third party companies’ experiences to identify the UAS risks. It is very rare for third party companies to be trained on UAS investigation skills by the clients, but nearly all of those we surveyed have developed skills and toolkits to conduct UAS-focused audits and investigations. Section 4.1 has detailed information on these.



## Business models

The examples below reflect how some brands fail to integrate ethical trade into overall business model.

- Not taking supply chain labour risks, especially hidden risks into consideration when making sourcing decisions
- KPIs for internal sourcing teams that focus too heavily on cost control. Rewarding cost cutting via annual bonuses
- Unrealistically low sourcing prices, making it impossible for suppliers to fulfill orders under ethical conditions, cover social insurance for workers or meet environmental and legal obligations.

The table below shows Better Buying purchasing practices scores from the last 2 ratings cycles (0 to 5 stars).

Hundreds of local suppliers were invited to rate their buyers on the seven categories of purchasing practices. The main areas of concern and dissatisfaction among suppliers are order planning, forecasting and placement. As many suppliers shared, the lack of order forecasting and unpredictable order placement places huge pressures on their capacity and ability to plan.

Better Buying™ Score	Spring'18 report: Average All Approved Ratings (n=218)	Fall'18 report: Average All Approved Ratings (n=363)	Spring'19 report: Average All Approved Ratings (n=656)
Overall	★★★★ (2.5)	★★ (2)	★★ (2)
Planning and Forecasting	★★ (1.5)	★★ (1.5)	★ (1)
Design and Development	★★★★ (2.5)	★★★★ (2.5)	★★★★ (2.5)
Cost and Cost Negotiation	★★★★★ (3.5)	★★★★ (2.5)	★★★★ (2.5)
Sourcing and Order Placement	★ (0)	★ (0.5)	★ (0.5)
Payment and Terms	★★★★★ (4.5)	★★ (2)	★★ (2)
Management of the Purchasing Process	★★★★★ (3.5)	★★★★★ (4.5)	★★★★★ (4.5)
Win-Win Sustainable Partnership	★★★★★ (3.5)	★★★★ (2.5)	★★★★ (2.5)

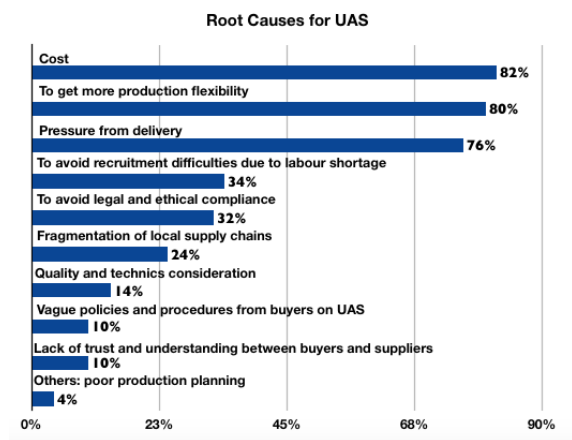
## 3.2 Root causes of UAS

**82%** of companies believe **cost** is the top reason for UAS practices

**32%** of companies believe the reason is to avoid legal and ethical compliance

76%-82% companies cited the root causes of UAS as cost, a lack of production flexibility and delivery pressures.

24%-34% cited labour shortage and evasion of legal and ethical compliance standards. 10%-14% cited unclear policy, coping with quality and technical requirements, and a lack of openness, trust and understanding between suppliers and buyers. Only 4% cited suppliers' poor production planning is a reason for UAS. See below chart for details.



Previous research by ETI found that the average age of a migrant worker in China is 39, with over 150million migrant workers aged over 65. By examining the two charts below, which show age pyramid data for 1978 and 2018 in China, we see a significant increase in average age of the whole population and a drop in the number of working-age people. In traditional manufacturing sectors such as garments, toys, printing, metal hardware etc, there is a labour shortage due to working and employment conditions which are not attractive to younger workers. In knitting and finishing departments, it is not unusual to see workers typically aged over 40, and even over 50.



From 2006 to 2015, real wages for Chinese manufacturing workers increased by nearly 100%. A survey result show that in year 2015, China's average monthly labour cost is about \$635, and the number is even higher in coastal areas. ( Data source: <http://www.cngold.com.cn/20170621d1970n157456324.html>).

To more accurately compare labour costs, see the table below for a comparison of legal minimum wages of three SEA countries from 2016-2018. To reduce production costs, and avoid employers' obligations including social insurance, labour contract termination,

environment control and enforcement, some suppliers are taking UAS practices to small workshops and even homework and prisons. Data from a third party company shows the cost of producing one shirt, which is RMB16 in formal factories, RMB12 in subcontracted small workshops and RMB8 in prison.

	2018	2017	2016
Vietnam	\$123-175	\$113-165	\$105-154
Cambodia	\$170	\$153	\$140
Myanmar	\$86	\$68	\$68

The ETI survey also found a connection between UAS issues and companies' sourcing practices and supply chain management models. The buyers who have below characteristics tend to have higher potential UAS risks in local supply chains.

- Frequent changes of supplier without established long term relationships
- Extremely unstable orders, small volume but complex patterns, poor order forecast
- Lack of local resources and heavy reliance on agents/business team to monitor suppliers
- Price-driven sourcing decisions (supplier bidding model)
- No or little investment in compliance capacity building for suppliers
- No subcontracting policies and/or unclear definition/procedures on UAS
- Insufficient/informal communication with suppliers on UAS policy
- Subcontracting not included in regular auditing programme
- Lack of open communication
- Walking away when UAS issues identified

## Section 4: ways of identifying the risks

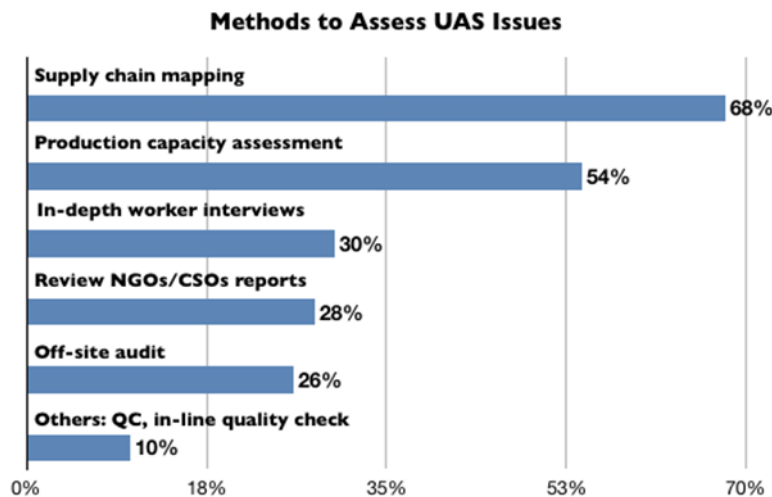
**68% of companies adopt supply chain mapping strategy to assess UAS issues**

**54% of companies are using production capacity assessment to detect UAS.**

UAS practices have very high potentials risks, however it is very challenging to collect hard evidence of UAS due to invisible and fragmented supply chains, and sensitivity.

The ETI survey found that that in addition to normal audit programmes, brands are using methods including supply chain mapping, production capacity assessment, in-depth worker interviews, review of NGO/CSOs reports, off-site audits and in-line QC quality checks to identify UAS in supply chains.





Most of the companies surveyed have a supply chain mapping strategy, which is a basic step towards building and improving supply chain transparency. In order to do this, brands' internal ethical teams should work with business/sourcing teams as well as external agents and suppliers to develop supply chain maps.

## 4.1 Audit and Special Investigations

Most brands/buyers will need to check UAS issues during supplier audits. According to TAOS Network, around 65% of clients will require them to check UAS risks, while 34% will rate UAS as a zero tolerance issue, 33% as critical issue, with the remainder handle the UAS cases directly once the hard evidence is identified.

In many cases, social auditors are not equipped with detailed information to detect UAS activities during regular audits, and very few brands will provide third party auditors with practical guidance and tools, so in many cases UAS is identified by chance.

If brands commission third party companies to conduct independent special investigations when there is suspected UAS practices, they will provide more detailed background information about the order and business relationships, and sometimes train dedicated third party auditors. The common UAS assessment methods include onsite observation, documents review, and worker and management interviews.

<b>On site observation</b> <ul style="list-style-type: none"> <li>• On-site workforce vs. claimed production capacity</li> <li>• Missing production processes, machinery, semi-finished goods</li> <li>• Warehouse goods, inventory vs. WIPs</li> <li>• Workforce with different uniforms and badges</li> <li>• Suspicious facilities, equipments, vehicles etc</li> </ul>	<b>Document Review</b> <ul style="list-style-type: none"> <li>• Production records</li> <li>• Shipment records</li> <li>• Warehouse goods, inventory records</li> <li>• Working hours and wage records</li> <li>• Production bonus records</li> <li>• Factory gate vehicles entry and leaving records</li> </ul>
<b>Worker Interview</b> <ul style="list-style-type: none"> <li>• Production line workers, worker committee, union representatives and warehouse staff</li> <li>• Line helpers, in-direct production workers, including driver, security, cleaner, canteen staff</li> <li>• Piece wage and bonus calculation</li> <li>• Working hours and seasonal works arrangements</li> <li>• Discipline and workplace grievances</li> </ul>	<b>Management Interview</b> <ul style="list-style-type: none"> <li>• Line leaders, production managers, ethical trade team and business staff</li> <li>• Order planning and forecast</li> <li>• Production arrangement, especially for urgent orders and in peak seasons</li> <li>• Subcontract process and risk prevention</li> <li>• Lower tiers suppliers management procedures</li> </ul>

## 4.2 Capacity assessment and verification

This method is used to calculate a factory's existing maximum production capacity, and to compare with order pieces to determine whether there is capacity to produce the order. See below example of PCA model from Impactt.

### PCA (Production Capacity Analysis) Model from Impactt

Assess the whole manufacturing process, through production input till output procedures.

Impactt first calculates the standard time, cycle time of each process under existed facilities, production lines, working hours and manpower to determine the maximized production capacity for each certain period of time.

Impactt then compares the maximized production capacity with buyers' order pieces to check if there are any significant gaps in capacity. If yes, a frank conversation with the factory will be conducted to identify if there any subcontracting from the factory and, if so, whether it was approved by the clients, what prevention measures are in place for potential critical issues and what the remedy plans are.

Many third party companies have dedicated internal teams, tools and methods to conduct factory capacity analysis to identify if there is any UAS risk. This method can be very effective to detect subcontracting if the buyer/brand fully owns the factory or occupies a dominant portion of factory's production.

It will not work if:

- The factory produces for multiple brands, and the individual brand's order is just a small portion of the overall production, making it hard to see the whole picture of factory's production.
- The supplier's production documents and files are inaccurate, incomplete, missing, inconsistent and/or faked, which add challenges to verify.

## 4.3 Worker hotline or APP-based reporting channel

*“There was approximately 5% of total calls we received from hotlines in year 2018 were in relation to subcontracting issues, while after follow up and investigation, less than 1% cases were confirmed as UAS practices.”*

— Yan Leung, Senior Project Manager, INNO

Some brands have adopted a worker hotline programme in supply chains to support getting workers' voices heard. INNO is a local NGO which has collaborated with brands and buyers and operated the worker hotline programme in more than 800 Chinese factories across sectors for 12 years.

Their hotline provides grievances support and follow-up, legal consultation and simple counseling to workers. According to Mrs Yan Leung, senior project manager in charge of the worker hotline, it was rare for workers to report directly about the factory subcontracting practices. This is because workers generally lack awareness on the topic, and it is not easy for them to get information about sensitive or confidential subcontracting practices which are normally decided by middle or senior production managers. In addition, workers don't have any motivation to report if the subcontracting and UAS practices have no impact on their welfare. Here were some typical UAS related cases reported by workers via hotlines.

### **Case 1: workers work excessive overtime due to factory's producing subcontracted orders**

One worker in Factory A reported that the factory received a lot of subcontracted orders from Factory B because B couldn't work too much overtime. Workers in A had to work very long hours and only got 2-3 days of rest each month. Workers felt very tired but many of them had to stay as it was not easy for them to find other jobs.

### **Case 2: worker not paid after working for small workshops**

One worker reported he worked in a small workshop nearby during low season when their factory had few orders. The small workshop produced subcontracted orders for other factories. He didn't sign any contract and when he left, the workshop took back his uniform and card, but didn't pay him all the wages he was owed.

### **Case 3: worker's monthly income dropped due to factory subcontract orders**

One worker reported factory managers subcontracted orders to external workshops owned by their relatives or friends, and some of these workshops may not have legal licenses. Workers'

wage dropped significantly and they felt pressure about monthly family expenditures as living cost increased a lot.

#### **Case 4: factory treated existing workers and temporary workers differently in relation to wages and benefits**

One worker called to complain that the factory brought into some subcontracted workers to produce orders in peak season, which reduced the existing workers' workloads. The factory paid subcontracted workers a higher food subsidy and also shared piece-rates with them, which they never shared with permanent workers.

In cases 3 and 4, after follow up investigations, there were no UAS issues but mis-understanding and lack of communications between factory management and the workforce were identified. In reality, it is common for factories to do little to communicate with or explain to existing workers about production arrangements, piece-wage and benefits policies. In addition, factories never train workers about basic subcontracting policies and procedures, which sometimes leads to complaints.

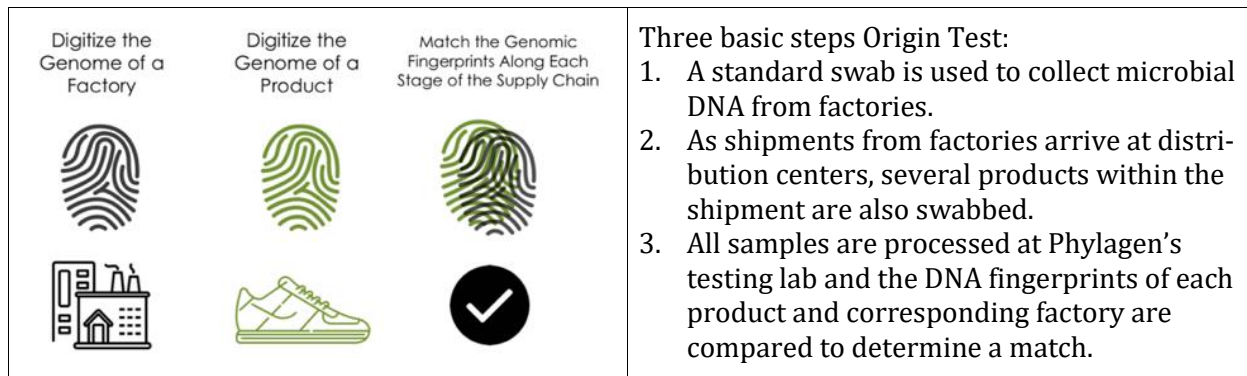
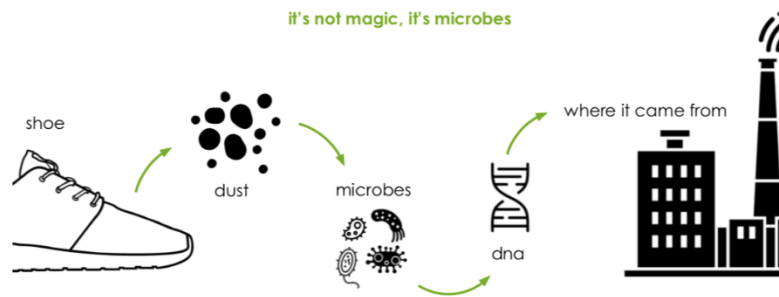
The ETI survey found that relying solely on the worker hotline is ineffective and unreliable in terms of identifying UAS risks due to the reasons mentioned above. However, it is still a practical channel to disclose potential and hidden risks/issues inside the workplace. Based on INNO's experiences, three key factors are key to mobilize worker engagement in monitoring and tackling UAS risks:

- Factory has set up relevant rules and trained to all workforce
- The provision and safeguard of environments that tolerate worker voices
- Effective follow-up verification and handling mechanism

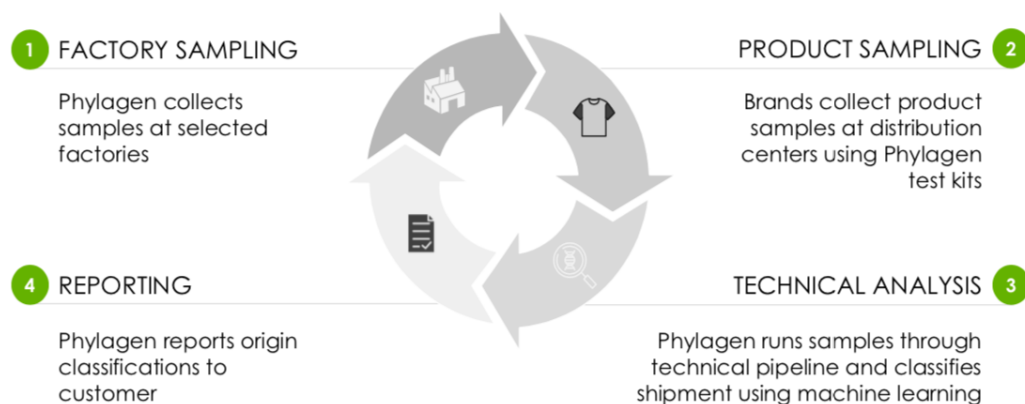
Some latest practices include receiving grievances and follow up via an App designed for that purpose, with some being able to track workers' feedback and analyse their daily work satisfaction, and others connecting supply chain origin with consumers who have an awareness of ethical consumption.

## **4.4 New technology to trace production sites**

Phylagen ([www.phylagen.com](http://www.phylagen.com)) is a San Francisco-based venture-backed microbiome and data analytics company which provides microbes testing methods to verify the origin of products in global supply chains. They believe every location has a unique DNA fingerprint, and in each location there are thousands of genetic features that can be identified, and that by matching the genomic fingerprints along each stage of the supply chain can tell people where the products came from.



Below is the workflow of the testing and analysis.



## Section 5: Examples of good practice and effective remedy strategies

### 5.1 Company preventive measures

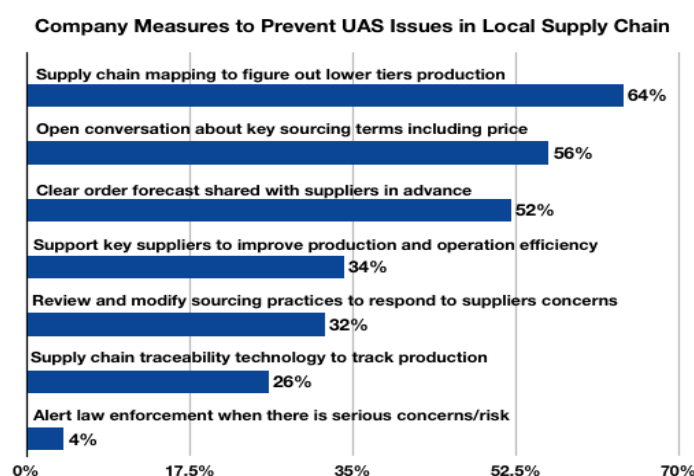
**64%** of companies develop supply chain mapping to figure out lower tier suppliers

## 56% of companies will have open conversation with suppliers about key sourcing terms including price

When brands and buyers simply cut off orders or penalise suppliers when UAS is detected, not only does it become impossible to bring about positive and sustained improvements, but workers' wellbeing suffers.

The ETI survey identified various measures being taken by companies to prevent UAS. These included mapping the lower tiers of the supply chain, having open dialogue with suppliers on sourcing terms including price, sharing order forecasts with suppliers to enable them to better arrange production and manpower, reviewing sourcing practices and supporting suppliers in their efforts to improve efficiency and capacity.

Below chart is the detailed results of the survey.



Among these, supply chain mapping is the most common measure. It is the first step in establishing a strong foundation for managing UAS issues in the supply chain. According to Jane Liu, SAI China representative, SAI requires its members to audit three tiers of their supply chain, although few members are able to achieve this in reality. Most brands disclose certain information about tiers 1 and 2 but not beyond. In reality, some companies start supply mapping by asking tier 1 suppliers to develop their own supplier lists, and then gradually move this practice to tier 2 and tier 3 suppliers. Some brands conduct training workshops for lower tier suppliers or ask tier 1 suppliers to invite their lower tier suppliers to annual supplier conferences.

These survey results are in line with observations and experiences from ETI and other project third parties, which have found that buyers/brands who incorporate the features of supply

chain management practice highlighted below tend to have fewer UAS risks:



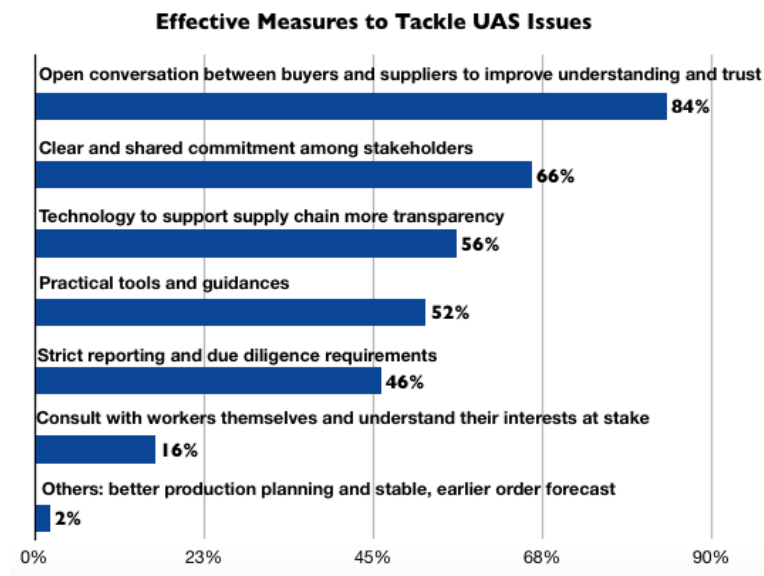
## 5.2 Stakeholder perspectives on effective approaches

### 5.2.1. Perspectives from brands

The ETI survey found that the top 3 measures most companies believe to be effective in preventing UAS risks include:

1. Open conversation between buyers and suppliers to improve understanding and trust
2. Clear and shared commitment among stakeholders
3. Technology support to improve supply chain transparency and traceability

According to the experiences from project third parties, a factory will tend to provide accurate information on the use of subcontractors if the buyer has a clear policy and guidelines on UAS and the process for approving subcontractors and, most importantly, is willing to listen and to understand the issues and challenges faced by the factory. Suspending production immediately or simply giving a deadline for remediating the issue without providing any support or motivation may encourage factories to keep non-transparency practices.



Other effective measures include developing practical tools and guidance, strict reporting and due diligence requirements, consulting workers themselves and understanding their interests. Around 2% of the companies surveyed also reflected that better production planning and more stable order forecasting also helped to reduce UAS issues. See the chart for the details.

**84% of companies believe open conversation between buyers and suppliers to improve understanding and trust is the most effective measure to tackle the UAS issues in long run**

**56% of companies believe technology support to improve supply chain transparency and traceability**

Only 16% of surveyed companies considered worker consultation an effective means of tackling UAS issues. More consensus is needed among brands both on the importance of placing workers' interests and rights at the centre of remediation, and of finding ways for suppliers to motivating workers to continuously monitor factory's high risks practices, for example by offering awareness training to workers on UAS, and grievance and remedy channels.

### 5.2.2. Perspectives from other stakeholders

Other (non brand) project stakeholders raised suggestions and recommendations to better prevent UAS issues:

#### More collaborations and consensus building:

The stakeholders reported that the multi stakeholder collaborations, including research, seminars and discussions were rare due to the sensitivity and complexity of the topic. The lack of baseline information, practical guidelines and consensus among stakeholders made it challenging for individual buyers and brands to tackle this issue.



*“We believe a capacity building approach is more effective in addressing complex issues like UAS in local supply chains. Brands could start from training and working with suppliers to gradually develop clear pictures of lower tiers suppliers.”*

— Ines Kaempfer, Executive Director, CCRCSR

#### Reflecting on purchasing practices and business model:

The ETI Better Buying survey found a link between sourcing models and buying practices and suppliers’ ethical performances, including the risks of UAS. It is essential to reflect on buying practices and ensure sourcing models and risk management systems are adaptive to the challenges and to new trends in local supply chains. More sustained and engaged business models should be adopted and integrated into every stage of the process: from supplier selection; order forecasting; order placement; suppliers motivation; price negotiation and issue remediation.

#### Investment in improving local supply chain capacity:

Local suppliers continue to request more guidance and/or consultation on practical issues related to subcontractor management, such as detailed reporting procedures and risk prevention practices when placing production orders at a new site or where an authorized subcontractor has changed its business name and/or location etc. They reported insufficient support from buyers in managing lower tier suppliers and coping with an increasingly challenging business context.

In addition to developing clear policies and procedures, buyers should invest more resources in working with suppliers and external experts to develop technical guidance/tools and providing trainings to improve production efficiency and flexibility, and to better manage subcontractors and factory’s lower tier suppliers.

## 5.3 Examples of good practice

There are some examples of good practice in supporting brands and local suppliers to address UAS issues. These include improved dialogue and awareness on the issue, supplier capacity building projects, toolkits and the development of guidelines development.

### **TAOS Sustainable Social Compliance Program (SSCP)**

TAOS believes a partnership approach is best when seeking to analyse the root causes of UAS, assess the risks and achieve sustainable transparency and compliance. This can be conducted through open and ongoing conversation between ethical teams, sourcing teams, agents, and technical support provided by brand’s internal team or external experts. TAOS’ SSCP has three core elements:

- Buyers should understand the local situation/context
- Buyers should work with suppliers to analyze the root cause(s), and assess risk(s) of UAS
- Buyers should support transparency practices and encourage the disclosure of UAS

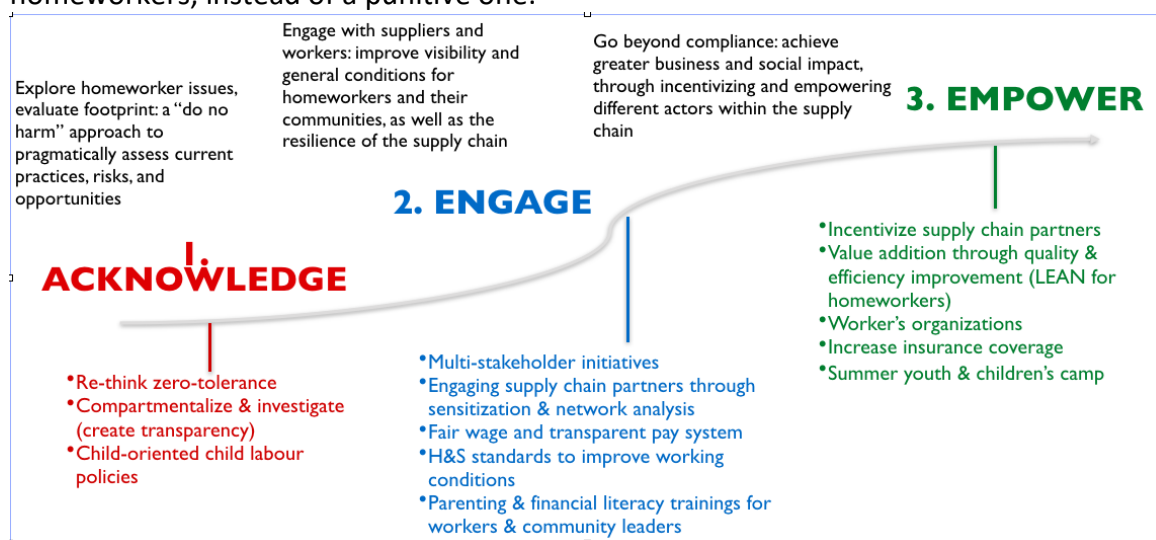
Under SSCP, suppliers are trained in identifying the root causes of UAS and best practice in establishing and implementing a subcontractor management system. The basic management framework of lower tiers training project is as below.



### CCRCSP subcontracted homemaker management framework

Home-based workers are key to global supply chains, but buyers have little knowledge of where and under what conditions home-based work occurs. The CCRCSP survey indicated that 51.6% of the interviewed homeworkers are known to produce for global buyers but 68% of them were not aware of this link. A brand's COC may not reach that tier of producers. 50% of survey brands stand neutral on the employment of homeworkers, 30% discourage it, and 20% have not yet decided what stance to take. A buyer's zero tolerance policy on child labour might reduce transparency around children's involvement in work. However, most homeworkers feel they have sufficient time to look after their children, which is not the case for factory workers.

CCRCSP suggests three key principles, **acknowledgment, engagement and empowerment** for buyers looking to take a more participatory and engaged approach to suppliers on homeworkers, instead of a punitive one:



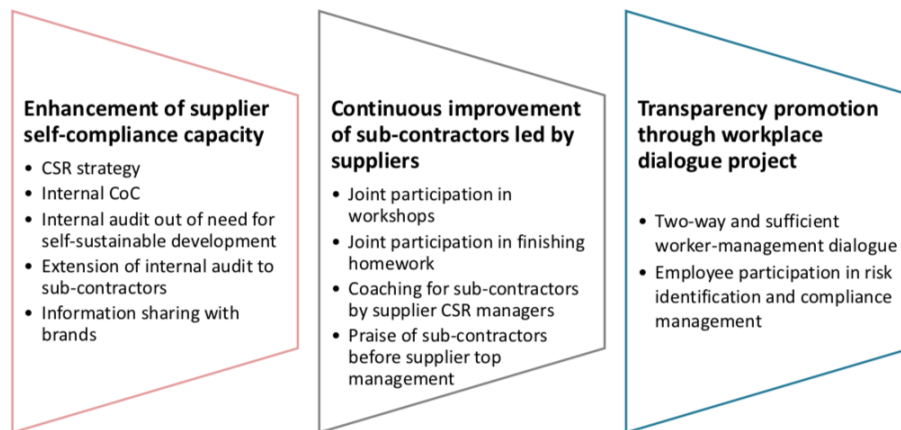
### TIMELINE supplier ownership building program

Timeline believes that only when suppliers take ownership of managing ethical trade issues can they achieve sustained results which are good for business and for the workforce. They support local suppliers to improve ownership and build capacity in integrating ethical trade requirements into day to day business operations. The key successful factors include:

- Senior managers' commitment to developing factory's COC strategy
- Cross-departmental collaboration to develop internal audit tools

- Worker representative empowerment and workplace dialogue to remediate workplace issues identified by internal audits.

Below is the project framework. The results show worker representatives participated in internal audits and remediations discussions. Many project factories improved internal capacities to manage issues including subcontractors' risks.



#### **Impactt temporary workers management program**

One Jiangsu factory has worked with an individual broker for years to bring subcontracted temporary workers into the factory during peak season. Some of these workers have worked in the factory for more than 3-6 months without signing contracts.

Impactt supported the factory to develop subcontracted temporary workers and lower tier suppliers management procedures. The factory signed short term piece wage contracts (at a lower rate) with these temporary workers, and covered all the costs for their social insurance. The individual broker with the long-term stable relationship with the factory changed role and took up a new post as line supervisor in the factory.

The factory followed lower tier supplier risk prevention procedures, which greatly reduced UAS risks. When there was supplier training organized by the buyer, the agents, brokers and lower tier suppliers of the factory would also participate.

