

Shift

Putting Principles into Practice



Respecting Human Rights Through Global Supply Chains

Shift Workshop Report No. 2, October 2012

1. Introduction

From 18-19 October 2012, Shift held the second in a series of workshops with business leaders, co-hosted with the Corporate Social Responsibility Initiative of Harvard's Kennedy School of Government. The workshops form part of Shift's

Shift is an independent non-profit center for business and human rights. Our team was centrally involved in shaping and writing the UN Guiding Principles on Business and Human Rights. We help governments, businesses and their stakeholders put the UN Guiding Principles into practice.

Business Learning Program, aimed at supporting the implementation by companies of the UN Guiding Principles on Business and Human Rights. The purpose of the October 2012 workshop was to explore challenges and generate practical guidance for companies regarding respect for human rights through global supply chains.

Participants in the workshop included teams from Anglo-Gold Ashanti, Codelco, Coca-Cola, The Walt Disney

Company, Ericsson, Hitachi, McDonalds, PVH, Total and Unilever, as well as participation from the Fair Labor Association. Some of the companies already had relatively sophisticated systems for managing human rights through their global supply chains, while others were at much earlier stages; yet all had faced and continue to face a variety of challenges along the way. Participants' diversity – representing a number of industries, from consumer-facing brands to infrastructure providers to extractive companies, headquartered and operating across all continents, and with a range of different types of supplier relationships – enabled rich cross-fertilization of experience and ideas.

Respecting Human Rights Through Global Supply Chains

The UN Guiding Principles state that companies may be involved with adverse human rights impacts either through their own activities or as a result of their business relationships. 'Business Relationships' are understood to include relationships with 'entities in [the company's] value chain.' As part of their corporate responsibility to respect human rights, companies are expected not only to avoid causing or contributing to adverse human rights impacts, but also to address 'human rights impacts that are directly linked to their operations, products

or services by their business relationships, even if they have not contributed to those impacts.¹

Adverse human rights impacts can occur at any level of a supply chain – from the first tier of direct or strategic suppliers, all the way down via multiple layers of sub-suppliers and sub-contractors, to those providing the raw material inputs. For some companies, relationships with suppliers are held by their licensees, or may be intermediated by vendors or other agents, creating yet more complex structures. To meet their responsibility to respect human rights, companies need to understand human rights risks at all levels of their supply chain – not only in the first tier.

Adverse human rights impacts can occur at any level of a supply chain- from the first tier of direct or strategic suppliers, all the way down to the sourcing of raw materials.

However, this is not simple to manage in practice. Many questions arise for companies as they seek to meet this particular aspect of their responsibility to respect human rights:

- How should companies realistically conduct due diligence on complex, dynamic, geographically diverse global supply chains that can number as high as 10,000, 50,000 or even over 100,000 individual suppliers –when even identifying all these suppliers can pose a substantial challenge?
- Given the scale and complexity of many supply chains, how should companies prioritize action once potential adverse impacts are identified?
- When potential impacts are identified and prioritized, what forms of leverage can companies exert on suppliers, and what should companies do when that leverage does not exist – not least when the choice of suppliers is narrowed by either commercial realities or regulatory requirements?
- With recent research showing that compliance auditing is insufficient on its own to promote sustainable change, what strategies can companies use to effectively manage human rights challenges within their supply chains in a scalable manner?
- How can companies effectively ensure that they do not create human rights dilemmas for their suppliers through their own procurement or purchasing practices?

While much has been learned in some industries about what works, possibly even more has been learned about what does not work. The October 2012 Business

¹ See UN Guiding Principles, Principle 13(b) and accompanying Commentary

Learning Workshop explored these implementation challenges and company approaches for meeting them.

The workshop was organized around several key themes that also form the structure of this report:

- Identifying risks: mapping and prioritizing challenges within the supply chain
- Leverage and incentivizing sustainable change in suppliers
- Application of these approaches in sensitive, high-risk contexts
- Internal alignment within and across a business enterprise
- Grievance mechanisms with respect to supply chains

The workshop was conducted under the ‘Chatham House’ rule, meaning that insights and reflections shared during the workshop are reported without attribution. While many of the human rights issues being discussed in the supply chain context relate to labour rights, this report uses the broader term ‘human rights’, which should be understood to include labour rights.

2. Identifying Risks: Mapping and Prioritizing Within the Supply Chain

The corporate responsibility to respect human rights requires companies to conduct human rights due diligence to identify, address and mitigate adverse human rights impacts with which they may be involved through their business relationships. However, in most cases, it is simply not feasible for a company to conduct due diligence for the entirety of its supply chain – particularly where supply chain relationships may number into the thousands, tens of thousands, or more. Companies therefore often need to prioritize those business relationships for which it is most critical to conduct human rights due diligence. However, as a first step, they need to know who is in their supply chains.

A Threshold Challenge: Who Are My Suppliers?

While it may sound simple, for many companies this threshold challenge of knowing who one’s suppliers are can be immense. Those within a company who

have primary responsibility for mapping supply chains are almost always dependent on others – internally within the company and externally within their supply base – to help identify suppliers. Internally, it is most often the purchasing or procurement departments at regional or country level offices, and various functions at the corporate level, that have direct interaction with the supply chain. Externally, cooperation is required from the suppliers themselves – and from any licensees, vendors, agents or other intermediaries who deal with suppliers – to identify subsequent tiers in the supply chain.

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However, in many instances, there may be competing motivations, disincentives, or different business drivers that make this cooperation less forthcoming. For instance, suppliers are often reluctant to disclose information about their own supply chains, either for commercial reasons, or in a deliberate attempt to circumvent the standards and requirements of buyers. Undisclosed suppliers and subcontractors, despite contractual obligations, are a frequent reality across many industries. Even where these challenges can be overcome, it is not uncommon in some industries for there to be key links at certain levels of a supply chain controlled by a single party (including licensees, third-party consolidators, and other ‘middle men’, which can create ‘black boxes’ that become a barrier to the traceability of goods and services at key points in the supply chain. And all of this takes place in a dynamic and evolving supply chain context, in which specific suppliers may change at each level of the supply chain on a regular basis.

Mapping Supply Chains: Engaging Internal and External Actors

Many companies have established, or are in the process of establishing, centralized systems for tracking the ‘moving target’ of their supply chains. While these systems can be housed centrally, the inputs into that system must come from a variety of decentralized sources. Company leaders note the need for internal and external buy-in for a collaborative approach to mapping the supply chain. Internally, this means engaging across the different business functions that might interact directly with the supply chain. Externally, this requires the authentic

engagement of one's own suppliers in the mapping exercise. In developing that buy-in, company leaders emphasize the critical importance of spending as much time on the 'why' as on the 'how' – conveying an underlying rationale for the importance of mapping the supply chain that resonates for key audiences.

Specifically, they have found that simply contractually obligating suppliers to disclose their supply chains, while necessary, has proven ineffective and inadequate.

“When we engage internally [on the need to map our supply chain], I think we may be spending too much time on the ‘how’ question and not enough on the ‘why’.

- Workshop Participant

For both internal audiences and external suppliers, this may require conveying the importance of mapping the supply chain through a commercial lens, rather than a human rights lens. For instance, one company emphasizes the importance of knowing all levels of the supply chain in order to safeguard quality, and engages the quality control team, which is regularly in the field, to report back new suppliers that are uncovered during site visits. Others make the case in terms of commercial efficiencies, limiting commercial business risk and ensuring the sustainability of supply. Another company uses health and safety – an issue that has widespread buy-in across the company – as an entry point, since the company needs to know its suppliers, contractors, and sub-contractors in order to ensure that health and safety requirements are met.

However, one company leader suggested that the broader context of a company's relationship with suppliers will determine whether those rationales have any traction: *“If the driving force behind your supply chain is price, rather than a comprehensive approach to the relationship, any effort to engage your suppliers in mapping your supply chain is going to be very difficult.”*

Experience from the Field: Mapping the Supply Chain in Practice

One large brand company first learned of some of its own suppliers through crisis, when an NGO launched a YouTube video showing the abuse of rights of migrant agricultural workers in a developed country and then, on its website, accused the company of being complicit. The company responded by investigating the claims, and quickly learned that it knew far less than it had supposed about the farm suppliers, in particular the employment terms and working conditions of workers in the harvest. Rather than pursuing a public relations response, the company recognized a business integration opportunity for human rights issues, given the heightened profile this case had given them.

Seizing upon the opportunity, the company hired an outside audit firm to conduct a paper audit of its supply chain for the particular commodity in question – which each supplier was required to pass up its supply chain. The immediate results: only one of the ten suppliers even knew who was in its supply chain. And so the company pursued the mapping exercise with that one supplier. The migrant labor practices in question were traced back to third-party recruiting firms that supplied farm labor, which enabled further due diligence in order to identify and mitigate against potential adverse impacts.

When the company began the exercise, they expected it might take 60 days. In the end, the process required more than 1 year. Although time and resource intensive, the reputational exposure of the company raised internal awareness of the risks of not knowing its suppliers, and the exercise has provided both a platform and a template for replicating the supply chain mapping exercise across other geographic regions and products. It has also highlighted the need to identify where labor enters the supply chain and not simply to end at the farm site.

Companies identified various additional sources of information about who their suppliers are, including audit processes and documentation required by customs, which can bring previously undisclosed suppliers to light. Another company has incentivized its procurement team to engage actively in the process by developing a metric on the percentage of the supply chain that is mapped, which is then factored into individual performance targets and annual sustainability awards. Similarly, that company is trying to incentivize its suppliers to map and disclose their own pieces of the supply chain by including this metric as part of the criteria for certain commercial benefits and symbolic awards. It was noted that, despite

existing efforts, in some cases suppliers only come to light through crisis, when adverse human rights impacts occur or reports surface in the media.

Prioritizing Relationships for Due Diligence

Given the sheer scale of many companies' supply chains, those with responsibility for managing human rights issues within supply chains can face a daunting task. The pressing question for many company leaders is simply: Where do I begin?

As a practical reality, most large companies will almost certainly need to prioritize the management of human rights risks within their supply chain. That prioritization may take place at several levels, including prioritizing which areas of the supply chain to map, which business relationships may need to be prioritized for a more detailed assessment of potential human rights risks, and which adverse human rights impacts may need to be prioritized for prevention and mitigation.

Tools for Assessing Country Risk

Typically, companies determine country risk by using human rights country risk assessments prepared by private consultancies, which may be thorough, but due to cost, are not accessible to suppliers or licensees with limited resources. One company instead utilizes the [World Bank's Worldwide Governance Indicators](#) – a free index which is publicly available and enables comparisons across different countries – as a primary source for determining country risk.

“It has the advantage of being credible, comprehensive, and publicly accessible, and our suppliers can access it for free. While it does not relate directly to human rights, it does relate to issues of voice, corruption, and rule of law, and these are good proxies for us.”

Company experience reflects this practical reality, as companies apply a range of different filters to determine which business relationships to focus their attention on. Typically, these filters look at a combination of factors including:

- where the supplier is based or where operations are taking place;
- who the supplier is, including their track record and the sophistication of their systems and processes;
- the nature of the business activity, and whether that activity is associated with a particular set of common human rights risks.

The Guiding Principles also take a pragmatic approach to the need to

prioritize.² While many of the same factors are recognized as relevant, the Guiding Principles differ from prevalent company practices in two important ways: in defining whose risk is paramount and which impacts to prioritize.

Whose Risk is Paramount: that of Businesses or Stakeholders?

In prioritizing which business relationships and which adverse impacts to address, prevalent company practices focus first and foremost on risks to the business. Many companies define their supply chain due diligence priorities based on their ‘top spend’ suppliers or their top tier, strategic suppliers, or other factors that suggest their leverage with the supplier is greatest. Others focus on relationships that pose greatest risk to their own reputation, such as suppliers of products carrying their own brand, or issues where public pressure and mobilization are greatest. According to one company leader, “[One particular product line] represented 25% of our revenues, so we started there, prioritizing that in our due diligence. We prioritized based on business risk, ultimately, to protect our brand, not to protect human rights.”

While this can make intuitive business sense, applying a human rights lens to due diligence requires a different set of calculations, instead of, or in addition to, approaches based on business risk. When assessing human rights risk, companies should start by assessing risk from the perspective of potentially affected stakeholders, based on the severity and likelihood of potential impacts. These adverse impacts – the most severe and most likely – may not be occurring among a company’s top tier suppliers, where a company has more leverage to compel mitigation measures, but may be deeper within the supply chain, even several steps removed from a direct relationship with the company, and where leverage is lacking. In line with this approach, one company highlighted that it carries out more extensive due diligence for projects involving substantial start-up construction. They do so given

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- Workshop Participant

² The commentary to Guiding Principle 17 recognizes that, ‘Where business enterprises have large numbers of entities in their value chains it may be unreasonably difficult to conduct due diligence for adverse human rights impacts across them all. If so, business enterprises should identify general areas where the risk of adverse human rights impacts is most significant, whether due to certain suppliers’ or clients’ operating contexts, the particular operations, products or services involved, or other relevant considerations.’

the greater potential harm to human rights, albeit the number of suppliers is larger, the relationships with those suppliers is more distant, and their duration is generally shorter. This contrasts with the ongoing operation of projects, where the number of suppliers is more limited and the relationships with those suppliers is closer and longer-term, but the risks to human rights are also relatively reduced.

When assessing human rights risk, companies should start by assessing risk from the perspective of potentially affected stakeholders, based on the likelihood and severity of potential impacts.

Prevalent company practice also demonstrates a tendency to mitigate those adverse impacts that are easiest to address, often because the company has greater leverage with a particular supplier. The human rights lens requires that, where necessary to prioritize, companies should focus first on those adverse impacts which are most severe, because of their

scale, their scope, or where delaying action would make the impacts irremediable. Among these, those that are most likely to occur should be addressed first. This need not preclude the company from addressing other risks where there are easy ‘quick wins’. But where there are limited resources and choices to be made, those impacts that would be both most severe and most likely should take priority.

3. Managing Human Rights Risks in Supply Chains: Leverage and Sustainable Change

Once potential human rights risks in the supply chain are identified, all companies face challenges in figuring out, simply put, ‘what works?’. An initial challenge may arise in generating sufficient leverage with suppliers to influence their practices.

Finding and Increasing Leverage

Where a company has identified that it may be linked to an adverse human rights impact through its supply chain and that it has leverage over the supplier in question, the Guiding Principles require a company to exercise that leverage to prevent or mitigate the adverse impact. Where it lacks the leverage, the company should look to increase its leverage in order to be in a position to prevent or mitigate the impact.

A company’s leverage is a function of the unique relationship it has with a particular supplier, including the commercial or reputational importance of the business relationship to the supplier, the quality of the relationship between the

company and the supplier, and other factors. Sometimes, the company has leverage through its purchasing power – suppliers want to maintain commercial business relationships, and will take actions required by their clients to maintain that business. However, as one company representative noted, *“I can only have leverage with my supplier if those other parts of the company are united in that leverage. Those responsible for making the deals care more about price, performance and delivery. Those concerned with human rights compliance – and therefore the issues as well – are not at the table.”*

Additional leverage often lies through the relationships that companies have with other actors, particularly with governments. In Bangladesh, for instance, one company increased its leverage with suppliers by engaging the government on issues related to labor conditions. In another instance, a large multinational lacked leverage with a local commodity producer because of a sole-source situation, in which continuing the relationship was more important to the buyer than to the supplier. The multinational increased its leverage by engaging external government and commercial actors, with whom it did have relationships, who could themselves exercise leverage. Other companies related experiences where leverage is built over time, through consistency and slowly building credibility with a business partner.

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Companies also create leverage through collaborative platforms for action. For instance, the Fair Labor Association provides a platform for companies to pursue common labor standards and consistent approaches to supplier auditing/assessment. In various examples, industry collaboration has enabled companies to address systemic issues collectively, where any one company lacked the leverage to address the issue on its own. Some companies related experiences of multi-stakeholder action in which leverage was increased by partnering with civil society organizations, which can bring increased credibility, capacity-building, or public pressure to a particular situation.

Creating an Opportunity for a Conversation: A Dialogue, Not a Monologue

One way that companies often exercise their leverage is at the contracting stage. Many companies have supplier codes that outline a variety of social and environmental standards, including human rights, by which a company's suppliers are expected and contractually obligated to abide. However, company leaders note that these are often extensive pro-forma documents with boilerplate language that suppliers must sign in order to secure the business. Rarely does a dialogue between company and supplier take place around these supplier codes, and some company leaders question whether they are even read by suppliers.

A Dialogue, Not a Monologue

Building expectations regarding human rights standards into contracts with suppliers often takes place as a pro forma exercise, with boilerplate language appended to the contract, and signature required as a condition of the contract. However, some companies question whether their suppliers ever even read these documents.

The real potential may lie in the opportunity to create a dialogue with suppliers – rather than a monologue – regarding the terms of the contract, the expectations and challenges they raise, and how they can best be met.

One company described a more flexible approach to its supplier code, allowing suppliers to use their own codes if they are judged to be equivalent. This approach creates an opportunity for a conversation between company and supplier about the underlying principles in each set of

standards, and an opportunity to create a sense of shared purpose. Some other companies build these types of conversation into supplier opportunities for business at the front end of the process. One requires suppliers to participate in two workshops sponsored by the company on social and human rights standards and compliance, in order to be eligible to bid for business. Another company suggested building human rights compliance criteria and conversations into the bidding process, before the business has been awarded. Each of these approaches recognizes the opportunity to create a dialogue with suppliers at a critical moment in the relationship, when the leverage of the company is potentially at its high point, to discuss expectations and potential roadblocks to meeting them. As one company representative reflected, *"It has to be a dialogue, not a monologue."*

Beyond Compliance Auditing and Towards Sustainable Improvement – What Works?

For many years, companies attempted to manage human rights performance in their supply chains through compliance auditing. However, recent research points to the clear conclusion that compliance auditing alone is insufficient to promote sustainable improvements on issues of social performance.³ Quoting an Asian proverb, one participant summarized the thrust of the research: *“You don’t fatten a pig by continually weighing it.”*

“You don’t fatten a pig by continually weighing it.”

- Workshop Participant, on the limitations of compliance auditing

This is not to suggest that compliance audits do not have an appropriate role to play in managing human rights performance in supply chains. Collectively, the companies participating in the workshop conduct an estimated 10,000 or more compliance audits per year. Audits can serve as a tool for identifying current shortfalls in standards. But they are only ever a snapshot in time. One participant summarized his message to suppliers as being: *“It’s what happens after the audit that matters. If you improve, there will be continued and expanding commercial opportunities with us. If you don’t improve, then you will not continue to be our supplier.”*

Other companies have shifted their emphasis away from a reliance on compliance auditing towards more collaborative approaches, working with suppliers to assess gaps, build capacity, and incentivize sustainable improvements. One company pointed to more extensive ‘systems gap analysis’ audits conducted by some firms, in which the company and the supplier share the cost of the audit.

³ Notably, Professor Richard Locke of MIT’s Political Science Department has conducted substantial research on the compliance auditing approach, including “Virtue out of Necessity?: Compliance, Commitment and the Improvement of Labor Conditions in Global Supply Chains,” *Politics & Society*, Vol. 37, No 3 (September 2009): 319-351, and a forthcoming book, *Improving Labor Rights in a Global Economy*.

Cultural Shifts in Supply Chain Management

In various parts of Asia, supply chain management has traditionally been based on relationships and trust. This made particular sense when companies were largely organized along family lines. However, this relationship-based approach can make it uncomfortable for companies to adopt a compliance oversight role with their suppliers. Some such companies are shifting their approach as they grow internationally, recognizing that relationships based solely on trust are unlikely to be sufficient to address human rights and other risks associated with their supply base.

At the same time, the purely compliance-driven relationships that have long been characteristic of many western companies and their suppliers are showing real limitations. These are shifting towards more of a relationship-based approach founded on dialogue, capacity-building and partnership, with some companies increasing the vertical integration of their supply chains.

It is interesting to consider what these two corporate cultures can learn from each other, and whether they might eventually meet at a constructive point in the middle, balancing relationship-driven approaches with effective and appropriate oversight and compliance roles.

Other research being conducted by Shift has highlighted experiments by some consumer goods companies foregoing audits altogether, and instead opting for a collaborative assessment process, in which suppliers themselves prioritize actions for improvement.⁴ A food company has embedded social compliance in a holistic approach to its relationship with growers, incorporating better payment terms, delivery, cost, contract duration, volume and capacity-building. Two companies are advancing pilot projects to develop metrics for suppliers, to help quantify and measure the business case for them to invest in better labor standards, in the form of a monthly profit and loss statement which monetize savings from reduced absenteeism, increased worker retention, and increased efficiency, productivity and quality. One of the challenges to be addressed when exploring such innovations is the extent to which they can provide a replicable, scalable and therefore afford-

⁴ Shift is conducting a project on innovations in supply chain management to promote sustainable improvements in the human rights performance of suppliers. The project is being conducted in collaboration with the Global Social Compliance Program (GSCP), a business-driven initiative for the continuous improvement of labor and environmental conditions in global supply chains. The project report will be available in spring 2013.

able approach across a large supply base, which remains the natural attraction of the current audit system.

Learning from Extractives: A Necessary Focus on Capacity-Building

One challenge, perhaps particular to extractive companies, is the need to incorporate local suppliers around their operations into their supply chains. This may be due to a regulatory requirement, the need to secure a 'social license to operate', or a corporate strategy to promote local economic development through its operations.

However, these local suppliers very often have less-sophisticated management systems in place than suppliers with a national or international presence, and may not be in a position to 'know and show' that they are themselves in compliance with human rights standards. Choosing only to work with suppliers and contractors that are capable of meeting those standards would eliminate many local suppliers from consideration.

Many extractives companies have found that capacity-building approaches must be an essential part of their supply chain management if they are to meet both these challenges. This means working with local suppliers to enable them to understand and start complying with human rights standards in order that they can become a sustainable part of the company's local supply base. This may also support longer-term local development by helping them become viable suppliers to other major companies in the region.

One workshop participant observed that capacity-building approaches may not only be ways to promote compliance, but also to increase the leverage to do so: *"The size of my business may not make me important to [a supplier] commercially right now, but I can make myself more valuable to you through the capacity-building that I can offer."*

If You Are Going to Conduct Compliance Audits...

Recognizing the constructive role that compliance audits can play as part of a more holistic approach to supply chain management, participants identified several key lessons for companies that may be starting or reevaluating compliance auditing programs:

- Ensure the audit is focused on seeking the truth and not just a check-box exercise to make it seem like due diligence is being conducted;
- Adopt a continuous improvement approach, where the audit is seen as a diagnostic starting point, not a de facto certification;
- Emphasize that not the audit, but the improvement that happens after the audit, is what suppliers will be measured by;
- Measure performance against all key indicators in numbers, rather than just providing a single overall rating or red/amber/green system, to enable the company and supplier to see incremental improvements;
- Follow up with suppliers on the corrective actions, to send a clear message of the importance the company places on remediation;
- Conduct due diligence on the auditing firms and individual auditors as well, since the quality and credibility of auditors varies widely.

4. Managing Supply Chains in High-Risk Contexts

Multinational companies frequently find that commercial interests make it desirable to initiate or expand operations in high-risk contexts. For extractive companies that have to locate themselves where the natural resources are, operating in such contexts is increasingly unavoidable. 'High-risk contexts' typically include conflict-affected zones, where security issues are prevalent, the state is unable to fulfill its duty to protect, and the rule of law is weak. They also include other contexts with clear and severe risks to the fulfillment of human rights, which may be denied either in law or in practice. While the same principles for managing human rights risks in supply chains more generally apply also in these contexts, the costs of not getting it right can be much higher – not only in terms of the reputational risk to the company, but also in terms of the potential severity (scale, scope and irremediability) of adverse human rights impacts on individuals.

In one case presented during the workshop, a company discussed its experience working with factories in Bangladesh, where systemic issues with respect to wages, working hours and fire safety conditions pose continuous challenges. In another case, a company detailed the extensive due diligence it has been

conducting over the course of twelve months as it considers entry into the Burma/Myanmar market.

From these experiences, and additional insights shared by participating companies, a number of lessons emerge with respect to managing human rights risks in supply chains in high-risk contexts:

- It is necessary to go above and beyond what might be expected in a ‘normal’ due diligence process. In the Burma case example, this had entailed a 12-month process of engagement and due diligence, including 3 levels of corruption due diligence on all potential business partners.
- Collaborative approaches are more likely to be necessary to mitigate risks to human rights. In the Bangladesh case example, this entailed industry-wide engagement with other brands, dialogue with relevant government entities, and partnerships with credible civil society organizations – recognizing the limitations on the capacity of the company to address the challenges alone.
- Engagement with key stakeholders, including, wherever possible, representatives of potentially affected groups, requires heightened attention. In the Burma case example, this included serious engagement with the political opposition and key civil society leaders on issues relevant to business activities, and engagement at the international level with the home country government, socially responsible investors, and credible human rights civil society organizations. According to the leader of this exercise, *“It would have been unimaginable to do this [level of human rights due diligence] without stakeholder input.”*
- Meaningful engagement with in-country business partners is vital to ensure authentic understanding of principles that must underpin business activities, and to align and ensure joint commitment to clear expectations.
- Increased transparency about a company’s expectations of its business partners and its efforts to engage responsibly with them can both provide reassurance to stakeholders about the rigor and sincerity of its due diligence and act as a disincentive for those business partners to act at odds with those expectations.
- It is important to ensure that top managers within the company understand the steps being taken to mitigate potential risks, in order to ensure consistent messaging both privately and publicly. In one example, a top manager spoke from an uninformed position about the company’s engagement in a high-risk context, substantially undermining those efforts.

Benefits of Transparency

Many complex human rights challenges within supply chains do not have immediate or easy solutions. Time may be required for root cause analysis, for industry-wide collaboration, for increasing company leverage to enable action with a supplier, and for identifying appropriate and effective remediation measures.

In such instances, increased transparency can be particularly beneficial, enabling a company to convey internally and externally the seriousness with which it is treating challenging issues and indicating the concrete steps it is taking in response. One company noted that they receive 'a lot of credit from external stakeholders' when they discuss with them their efforts to address a problem, even when the company acknowledges that it does not yet have the answers.

- Effective and credible complaints processes can play a vital role given that potentially-affected workers and communities may be more vulnerable and less likely to speak out. They can provide an independent avenue for issues to be raised and for early identification and mitigation of further risks.
- Both the context and business relationships need to be reassessed with greater-than-usual frequency as part of on-going due diligence, to ensure that potential adverse human rights risks are identified, prevented and mitigated.

5. Internal Alignment Within and Across a Business Enterprise

While discussions of human rights challenges in supply chains often focus on the suppliers themselves, there are important dimensions internal to the buying company that can increase or reduce human rights risks. Central to these are the company's own purchasing practices. There may in some instances be inherent tensions between the commercial interests that guide buying decisions and the avoidance of human rights harms. If left unreconciled, these can place the

company in a situation of actively contributing to human rights impacts by its suppliers.

For instance, if a company makes late changes to the design of a product or to the volume of an order without taking into account the consequences for the supplier in terms of time and costs, the company is contributing to any resulting adverse impacts such as excess hours, unpaid overtime or illegal sub-contracting. One consumer goods company recently held a roundtable with suppliers in China to better understand from the suppliers' perspective the obstacles they faced to improving their performance against labor standards. The conversation highlighted a number of gaps and inconsistencies in the company's own purchasing practices that were a significant contributing factor.

The relationship between those responsible for driving issues of social and human rights compliance and those driving purchasing, procurement or other supply chain management decisions is often what separates 'good on paper' from 'good in practice'.

For an extractive company sourcing security services, poor decisions or misleading messages with regard to the treatment of local communities that it expects from the external security providers may leave the company in the position of contributing to any adverse human rights impacts that result.

In sum, the relationship between those responsible for driving social and human rights compliance and those driving purchasing, procurement or other supply chain management decisions is often what separates 'good on paper' from 'good in practice'.

Embedding the Responsibility with Those Who Make Purchasing Decisions

The FLA's Principle 8: A Systems Approach to Alignment of Purchasing Practices

When the FLA recently revised its Principles of Fair Labor and Responsible Sourcing, it recognized the critical role that purchasing practices can play in contributing to adverse human rights impacts in supply chains. The revisions included a new Principle 8, which takes a systems approach to responsible sourcing in three parts:

- First, companies should analyze their orders in real time to ensure that sourcing criteria are consistent with workplace standards.*
- Second, companies should have a mechanism to resolve in a timely fashion conflicts between sourcing criteria and workplace standards.*
- Third, companies should analyze their supply chain on a quarterly basis to identify negative impacts of sourcing decisions on compliance and make necessary adjustments.*

In the experience of many companies, reconciling the internal tensions that can exist between commercial drivers for procurement decisions and the company's responsibility to respect human rights can only occur if that responsibility to respect is embedded with those who make procurement decisions. One participant, herself located within a purchasing department, captured the essence of this: *"Purchasing has to drive this. It's their relationships with suppliers. That's a change management process unto itself."* Some argue that for these approaches to be truly effective, those driving procurement decisions need to connect with issues of human rights on a human level, rather than simply as a process of technical compliance: *"We need to put the 'human' back in 'human rights'"*.

Some consumer goods companies – in which purchasing departments play a central role in creating value for the company – have chosen to locate the human rights function within those departments, or have allocated specific human

resources to those departments to address these issues from within. In another such company, the human rights function reviews all purchase orders after they have been submitted and compares them against a rating system. If it determines that the order might be inconsistent with the company's human rights commitments it has the authority to cancel or re-route the order. Ultimately, however, the successful integration of human rights considerations comes down to individual buyers making individual decisions that need to incorporate this added human rights dimension into the business formula.

One company's human rights function reviews all purchase orders after they have been submitted and compares them against a rating system. If it determines that the order might be inconsistent with the company's human rights commitments it has the authority to cancel or re-route the order.

Procurement departments within extractives companies are positioned differently to those in consumer goods companies. According to one company representative, they may see themselves more as 'paper pushers' or bureaucrats, supporting the operational (construction, production, operations) units that are seen as the key drivers of business value. It can be important in such cases to encourage procurement managers to take on a more strategic role.

Companies identified several additional ways in which they have attempted to foster ownership of human rights issues within procurement/purchasing and other relevant departments. One company organizes trainings for their Research & Development and Design teams on the implications of design changes in terms of added costs or time delays incurred by suppliers. Another company conducts joint audits between their procurement and corporate social responsibility teams, creating one team that can apply two different lenses. One company seeks regular opportunities for its senior corporate officers to visit supplier factories. Others have instituted mechanisms to hold their purchasing departments accountable for the social and labor performance of their suppliers, issuing report cards that enable the company to see and to show how well individual buyers are managing their aspects of the supply chain's performance, for instance in terms of quality and logistics as well as social and labor compliance.

“If you want procurement to own the responsibility for implementing supplier codes on human rights compliance, then you have to engage them in the process of developing those standards.”

- Workshop Participant

One approach that companies have found particularly effective is to engage all the relevant parts of the company in a collaborative approach to developing or revising supplier codes on human rights standards. If companies want purchasing departments to ‘own’ the responsibility, then these departments need to be integrally involved in the development of the specific requirements. One company has

engaged in a 12-month internal consultation process around their proposed supplier code, including sending the code to all of its regional offices for comment and feedback. Another company, which has been particularly effective in creating shared internal responsibility for human rights compliance, engaged in an 18-month process of internal stakeholder engagement around their supplier guiding principles, to jointly define the criteria against which suppliers will be audited. While these processes are long and time-intensive, they have proven to be more effective when it comes time to implement those standards.

6. The Role for Grievance Mechanisms with Respect to Supply Chains

A basic requirement of the UN Guiding Principles is that companies engage actively in ensuring access to effective remedy for adverse human rights impacts they cause or to which they contribute. Many companies, industry- and multi-stakeholder initiatives require that grievance processes are available at the level of suppliers as well.⁵ However, by their own admission, these efforts have not generally included practical guidance to suppliers; nor conveyed the value of effective complaints processes; nor ensured that their quality is sufficient.

⁵ Examples of different types of grievance mechanisms are available at www.baseswiki.org, an online repository for information about non-judicial grievance mechanisms.

One company includes functioning grievance mechanisms as one of nine categories against which it measures its suppliers, and it is the one category in which suppliers consistently perform poorly. Others admit that they do not require suppliers to have grievance mechanisms because they themselves have not yet established effective grievance mechanisms at the company level.

“In practice, the most common things we see are the [highly problematic] ‘suggestion box’ on the manager’s office door and 3rd-party hotlines. Reality is that the performance of these hotlines is very mixed. To be effective as grievance mechanisms, hotlines need to have both the ‘front-end’ intake function and the ‘back-end’ process for following up with complaints and providing resolution. Too many of the hotlines we see only have the front-end, but no back-end.”

- Workshop Participant

Making Grievance Mechanisms Effective

Effective grievance mechanisms need to be tailored to the unique contexts they intend to serve. What works in one setting is not necessarily a model for what will work in another setting. However, there are several effectiveness criteria that any grievance mechanism needs to meet if it is to be trusted and used. These criteria, which are elaborated in Guiding Principle 31, consist of the following:

- ***Legitimacy***: they are designed in a way that enables trust from all intended users and are accountable for the fair conduct of grievance processes;
- ***Accessibility***: they are known to all intended users and provide adequate assistance for those who may face particular barriers to access;
- ***Predictability***: they provide a clear and known procedure with indicative timeframes, clarity on the types of processes and outcomes that are possible, and means of monitoring implementation;
- ***Equitability***: they seek to ensure reasonable access to information, advice and expertise to enable complainants to engage on fair, informed and respectful terms;
- ***Transparency***: they keep users informed about the status of their complaints, and provide sufficient information about the mechanism's performance to build confidence in its effectiveness and meet any public interest at stake;
- ***Rights-Compatibility***: they ensure that outcomes and remedies accord with internationally recognized human rights;
- ***Based on Dialogue and Engagement***: their design and performance is subject to consultation with user groups, and they focus on dialogue as the means to address and resolve complaints;
- ***A Source of Continuous Learning***: they draw on relevant measures to identify lessons for improving the mechanism and preventing future complaints and human rights impacts.

*A **report on several pilot projects** that tested these principles provides examples of what meeting these criteria might look like in practice in different contexts.*

The Business Case for Suppliers

As set out in the UN Guiding Principles, if companies cause or contribute to adverse impacts, they have a responsibility to provide for or cooperate in remediation of that impact. Grievance mechanisms provide a path for these impacts to be raised by those who suffered the harm, and a process for resolving the issues constructively. Companies have often not been effective at conveying the ‘business case’ for effective grievance mechanisms to suppliers. Robust mechanisms enable impacts to be identified and addressed early and directly, preventing escalation. In simple terms, it is better to know, than not to know, the concerns that stakeholders have about company operations. In the absence of a constructive pathway for addressing these concerns, affected stakeholders will frequently create their own pathways, which may not be as constructive for the company. Analysis of the types of complaints being raised through a grievance mechanism can also provide insights into systemic challenges that require further

Because the potential human rights impacts are one step removed from the company in supply chain contexts, effective supplier-level grievance mechanisms are particularly important in helping ensure that potential human rights impacts will be identified and addressed in a timely fashion, assisting with the due diligence process.

corrective action from the company. Moreover, creating a process for complaints to be addressed can help to improve relationships and trust between a supplier and its workers and enable opportunities for broader dialogue on systemic issues where these are currently absent. Early research and anecdotal evidence suggest that effective grievance mechanisms can contribute to increased productivity, worker retention and other positive metrics.⁶

The Business Case for Companies to Support Supplier-Level Grievance Mechanisms

For all of these reasons, companies should have a strong interest in helping their suppliers to develop effective grievance mechanisms. Because the potential human rights impacts are one or more steps removed from the company in supply chain contexts, effective supplier-level grievance mechanisms are particularly important in helping ensure that potential impacts can be identified and addressed in a timely fashion. In the case of extractive companies and others that have suppliers and contractors operating in the same area as company staff, those

⁶ The Guiding Principles make clear that company-level grievance mechanisms should never undermine the role of legitimate trade unions in addressing labor-related disputes.

suppliers and contractors are often equated by local stakeholders with the company, such that a grievance against the supplier is expressed as a grievance against the company. One company described its decision to open up its grievance mechanism to stakeholder complaints against its suppliers and contractors for precisely this reason. Other companies have instead focused on ensuring that recourse is available via their suppliers, to prevent the risk of receiving complaints that the company lacks the authority to act on. A few have begun testing scalable approaches to grievance mechanisms, such as collectivized mechanisms based on geography or industry. According to one company, *“We found that in two-thirds of our factories, we represented less than 5% of the factory’s business, and so a 3rd-party grievance mechanism serving a number of factories made a lot of sense.”*

7. Potential Areas for Further Research and Thought

Based on suggestions from participants, several areas emerged for potential follow-up, which Shift may take forward for further research and reflection:

Human Rights Due Diligence in High Risk Contexts: Developing further practical guidance, tools and lessons learned on conducting human rights due diligence in high risk contexts. Shift will be part of a major collaboration in 2013 to develop guidance on this issue.

Metrics: The ‘business case’ for managing human rights through supply chains requires more and better metrics. There are several initiatives that have and are seeking to develop some of these metrics, and Shift might collect and disseminate some of the more promising efforts.

Experiences of ‘Beyond Compliance’: Companies are interested in seeing more examples of what companies are doing to move beyond the compliance auditing paradigm. In Spring 2013, Shift will publish a report from its project on ‘incentivizing sustainable human rights performance in supply chains’, which will look at a number of examples in this area.

Using Contractual Obligations More Effectively: Companies would be interested in seeing further experiences of the ways in which companies have used contracting and bidding opportunities to create dialogue with suppliers around social performance expectations and challenges.