

**“From Audit to Innovation”**  
**Keynote Address at the Annual Conference of the**  
**Business Social Compliance Initiative**  
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Over the past two decades, many international companies have come to recognize that they have roles and responsibilities in addressing labor conditions and other social impacts within their supply chains – a responsibility that is now enshrined in the UN Guiding Principles on Business and Human Rights, endorsed by the Human Rights Council in June 2011.

Your own Business Social Compliance Initiative is testimony to this development: you recently had your tenth anniversary, and you have a new Code of Conduct, adopted by some 1,400 retailers, brands and trading companies.

It is a foundational understanding of the Guiding Principles that companies, by themselves, cannot solve the problem of global labor injustice: the fact that many of the goods that we wear, watch and communicate with, and even the food we eat and the beverages we drink, may be produced in conditions that are abusive to workers. Therefore, the Guiding Principles reaffirm and elaborate upon the legal obligations of states to protect human rights, and the critical enabling, regulatory and judicial roles that flow from those obligations.

But the Guiding Principles also affirm an independent corporate responsibility to respect human rights, irrespective of whether or not governments are doing their job. Respecting rights means that businesses should avoid infringing on the human rights of others and should address adverse human rights impacts with which they are involved. This requires effective human rights due diligence processes and remedial measures. It is this corporate responsibility to respect human rights that is my focus here today.

What the Guiding Principles have added to the equation is to stipulate, inform, and promote more robust and effective ways of generating better and more sustainable results than have been achieved previously.

So with due recognition of the many efforts that have been undertaken, and learning from their experience, allow me to step back and assess where I believe we are at today, and what further we need to do.

For businesses such as yours, any such assessment begins with social compliance auditing. Hundreds of thousands of such audits are conducted each year to ensure minimum workplace conditions in companies' supply chains. Yet exhaustive research has shown that auditing alone has failed to generate sustained improvements in many social performance issues, such as working hours, overtime, wage levels, and freedom of association. This is true even for the leading global companies, which have invested significant resources in the effort over the years.<sup>1</sup>

There are many reasons why the traditional audit paradigm has struggled to produce sustainable improvements. They are so well known by now that there is no need for me to rehearse them here yet again. Instead, I propose to look at a growing body of individual and collective company experience with supplementary and alternative approaches to addressing social performance challenges in supply chains, many of which have been inspired by the Guiding Principles.

I draw on the important work done by Shift, the New York-based non-profit that I chair, founded by members of my former UN team to help advance implementation of the Guiding Principles. These newer approaches seek to recast the very nature of the relationship between global buyers and their suppliers: from 'policing' to 'partnership'.

Not wishing to be accused of having a Moses complex, I have reduced this to just nine leading trends and elements that form the new generation of social compliance programs for supply chains.<sup>2</sup> Some of these will be familiar to you; others perhaps not so much.

1. The shift from pass/fail compliance to **comprehensive continuous improvement programs**.

Under a continuous improvement model, companies shift the focus from the findings of an audit to what happens after the audit. Suppliers are held accountable for their progress on work plans that prioritize remedial actions based on the audit findings. By placing less emphasis on audit findings and more on the progress made to improve upon the results, continuous improvement models tend to elicit greater honesty from suppliers in the audit process, without fear of commercial penalties. This model involves a shift from a “blame culture” to a “learning culture.”<sup>3</sup> And it requires appropriate “performance metrics” in addition to “audit metrics.”

2. Supplementing audits with **collaborative assessment** and root cause analysis.

Here, the company and its suppliers jointly engage in assessments of factory performance on labor issues, undertake root cause analysis of identified issues, and collaborate in joint problem-solving on identified priorities. This ensures greater buy-in on the part of suppliers.

3. The role of **supplier-level grievance mechanisms** in improving social performance.

Supplier-level grievance mechanisms are becoming more common. But too often they are tokenistic. Poorly implemented, they can raise expectations and then fail to deliver, fueling the impression that they are being used to undermine real dialogue with workers and unions, rather than support it.

Yet effective supplier-level grievance mechanisms can serve as an early warning system, identifying and addressing potential issues before they escalate. At the same time, well-designed grievance mechanisms can provide important additional data points beyond audits for brands and retailers, who want to better understand the practical realities of working conditions within a given supplier.

Grievance mechanisms can also help identify and address underlying root causes. They are particularly important in contexts in which organized labor is less prevalent or mature. Providing redress for harm that a company has caused or in which it is otherwise involved is encompassed under the Guiding Principles.

4. The integration of **capacity-building** approaches for suppliers.

Suppliers have to be in a position to address identified challenges; otherwise the exercise is purely academic. Awareness-raising through pamphlets or webinars is an important first step, but it is not sufficient. Incentives have to be provided. These can include providing technical expertise to identify operational efficiencies that can reduce pressures on working hours and forced overtime; training on advanced practices that can reduce adverse social and environmental impacts; and they can be financial, as in the case of an 'innovation fund' provided by one major retailer.

5. Forming **NGO partnerships**.

A key feature of the social compliance programs of many leading companies is the extensive partnerships they form with global and local civil society organizations. These civil society partnerships play several roles, from helping to set credible certification or compliance standards, to providing capacity-building support for suppliers in the form of training and guidance materials to help meet those standards, to joint problem-solving on particularly complex issues.

6. Providing **commercial incentives** to suppliers for improvements in social performance.

To paraphrase one company leader interviewed in the Shift study, ignoring economic incentives is to live in a land of illusion. That's true for the global brands and retailers. Why would it be any less true of their suppliers? In return for sustained improvements in social performance, such incentives can include price premiums, volume increases, extended contract duration, preferential contracting, and helping successful suppliers to move up the value chain.

7. Developing **metrics** to help suppliers identify the business case for better social performance.

External incentives can provide an effective driver for suppliers to commit to social improvements. Promoting a better understanding of internal incentives may be an even more sustainable approach. There is substantial anecdotal evidence on how improved working conditions can lead to reductions in costly workplace accidents, lower workforce turnover, higher workforce morale, and increased workplace productivity. However, there is still too little quantitative data for making a compelling business case that there is both a cost to poor social performance and a direct business benefit to investing in improved workplace conditions. You can help change that.

8. **Aligning internal purchasing practices** with social commitments made by global brands and retailers.

Even where a supplier gets the business case, there is still the proverbial elephant in the room: the extent to which the purchasing practices of buyers contribute to the very conditions their compliance programs are intended to address. You know better than I do what those practices are: ever-shorter lead times, producing greater varieties of products in smaller batches, last minute order changes, and relentless cost-pressures. Responsible purchasing is as important as responsible manufacturing. Here, leading companies have attempted to create greater functional alignment between purchasing and compliance programs, including reviewing orders before they are placed, providing upstream managers with downstream impact reports, and tying the results of those reports to upstream and even senior management performance reviews.

9. **Company and industry-wide collaboration** to tackle systemic issues.

As I stated at the outset, business cannot, and is not expected to, resolve all of these challenges by itself. I have focused on factors over which business does have considerable influence, and where desirable innovation is taking place. My last such category concerns efforts that use individual company or industry-wide leverage to try to change some of the larger systemic

dynamics that are under the control of other actors, including governments. Although it is too late for the many workers who have lost their lives in Bangladesh factory fires and building collapses, the responses since Rana Plaza illustrate the potential of collaborative approaches to such systemic issues – and their desirability as preventative measures. But it really should not take catastrophes on that scale to get brands, retailers and trading companies to pool their leverage in order to generate change.

Some of the innovations that I have outlined here may be more familiar to you than others. Companies are testing them in an increasing variety of ways and learning as they do so. But scalable change can only happen if they share their experience, along with the challenges and lessons learned along the way. And that means greater transparency.

Unless companies become more open to sharing publicly how they are innovating for sustainable change – not what their favorite project is, but how they are meeting their own responsibility to respect human rights through their supply chains – it will take far too long to see the improvements we need in the lives of workers. And despite fears about the potential legal risks of increased transparency expressed by some, the evidence that I see is that where companies disclose genuine efforts for change they get credit for doing so.

For further insights into leading thinking on what good reporting on human rights performance looks like, I urge you to examine the draft Reporting Framework just released by the Reporting and Assurance Frameworks Initiative (RAFI).<sup>4</sup> This initiative is co-facilitated by Shift and Mazars, the international audit and accounting firm. The Reporting Framework is intended to be fully aligned with the UN Guiding Principles. The draft is currently open for public consultation, and it is already being piloted by Unilever. It is the face of where sound human rights disclosure is heading.

Let me draw these remarks to a close. I readily acknowledge that the challenges you face are not easy ones – if they were, they would have been resolved by now, more than twenty years since routine compliance auditing was first instituted.

Moreover, you are but one part in a much larger ecosystem – which ultimately involves the very workings of an increasingly integrated global economy coupled with a highly fragment and frequently dysfunctional system of global and often national governance.

Lastly, your initiative includes companies that are not large by global standards – the *Mittelstand*, as it is called in German – whose individual leverage, therefore, may be limited, as is their human and financial capacity.

But at the same time you have the advantage of being in a collective effort that includes some 1,400 participating companies representing 600 billion euro in annual turnover.

Through an initiative of this kind, even small players can leverage their positive impact. And as we know from studies of the famous butterfly effect, even relatively small movements can affect outcomes in large ecosystems.

So I urge all of you to redouble your efforts to explore emerging practices such as I have outlined, and to adopt those that show the best results.

The cries for social justice in our increasingly turbulent world are getting louder. The dislocating consequences of globalization exceed the capacity of too many societies to adapt, and the ability of too many people to enjoy its benefits. The post-World War II institutional frameworks by which nations and economies were expected to operate are stressed, in some cases to the breaking point. Thus, the need is great, the time is short, and the mission is clear: all of us need to do better – much better.

Thank you for the honor of inviting me, and giving me the opportunity to share these thoughts with you. I look forward to our discussion.

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<sup>1</sup> The definitive work on this subject is Richard M. Locke, *The Promise and Limits of Private Power: Promoting Labor Standards in a Global Economy* (New York: Cambridge University Press, 2013). The book is based on years of empirical research in different industry sectors and countries, including direct access to audit data provided by several leading companies.

<sup>2</sup> These are elaborated in the Shift report "From Audit to Innovation: Advancing Human Rights in Global Supply Chains," <http://www.shiftproject.org/publication/audit-innovation-advancing-human-rights-global-supply-chains>.

<sup>3</sup> I borrow these terms from John Braithwaite, *Regulatory Capitalism: How it works, ideas for making it work better* (Cheltenham, UK: Edward Elgar, 2008), p. 150.

<sup>4</sup> See "Reporting Framework on UN Guiding Principles," available at <http://business-humanrights.org/en/business-and-human-rights-reporting-and-assurance-frameworks-initiative-rafi>.