

Sustainability Matters

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Rethinking the global supply chain – how the focus on impact can foster sustainability in the clothing industry

While corporate social responsibility (CSR) is on the agendas of companies around the world, a gap exists between corporate “words” and “actions”. This was devastatingly demonstrated by the factory collapse in Bangladesh in April 2013: apparently, the clothing industry had failed to properly monitor its supply chain. Where are the positive results of these many years of CSR commitment?

In this edition of the Inrate Sustainability matters, we point out why shaping policies and codes of conduct is not enough. If companies really want to foster sustainability, they will need to apply CSR across the entire value chain. Furthermore, sustainability specialists recommend companies to focus on the most relevant sustainability challenges that occur during their business activities along the entire value chain and along their products’ life cycle. By reducing these challenges, companies reduce their overall negative impact.

There are risks and costs to a program of action, but they are far less than the long-range risks and costs of comfortable inaction
(John F. Kennedy)

Corporate Social Responsibility: since the 1990s an issue in the clothing industry

In the 1990s, Nike became a global symbol of abusive labor practices, hazardous working conditions, poor wages, and anti-union efforts throughout its contract supplier factories in Asia. Nike's brand suffered damage as its name became synonymous with sweatshop labor following reports by labor and human rights groups. The collapse of the eight-story commercial building "Rana Plaza" in April 2013 in Bangladesh provided a powerful reminder that the industry is still not able to systematically improve the bad working conditions in their global supply chain, despite of two decades with codes of conduct and factory audits. The garment-factory has been supplier for well-known brands like Inditex (parent company of Zara), Wal-Mart, Benetton and Primark. Has an industry failed to monitor its suppliers?

These past years, global retailers tried to ensure their global corporate standards for safety, labor, and product quality are adhered to and maintained by implementing codes of conduct. Also supplier codes of conduct have become common. But the results were not satisfying: environmental and social impacts remain at high levels. There is a clear gap between corporate intentions in the form

of policies, standards and guidelines and the impact business activities have on communities.

Clothing Industry is known for long and nontransparent supply chains

The clothing industry is characterized by long supply chains encompassing various steps: the growing of cotton or the manufacturing of synthetic fibers, the transformation of fibers to yarns and fabrics and finally the production of a wide variety of clothing and luxury goods. The complexity of supply chains has even increased during recent years, not only due to regional distribution of suppliers, but also as a result of the high number of different players. Retailers such as Marks & Spencer and brands such as GAP or H&M often design and market their products themselves, but in nearly every case they outsource the production of the apparel they sell (see figure 1). They have direct suppliers (e.g. garment factories), sub-suppliers (e.g. manufacturers of dyed fabrics and accessories), sub-sub-suppliers (e.g. spinners) and so on, down to the raw material suppliers (e.g. cotton farmers). As a consequence, it is per se difficult for such companies to control their supply chains (Eurosif 2011).

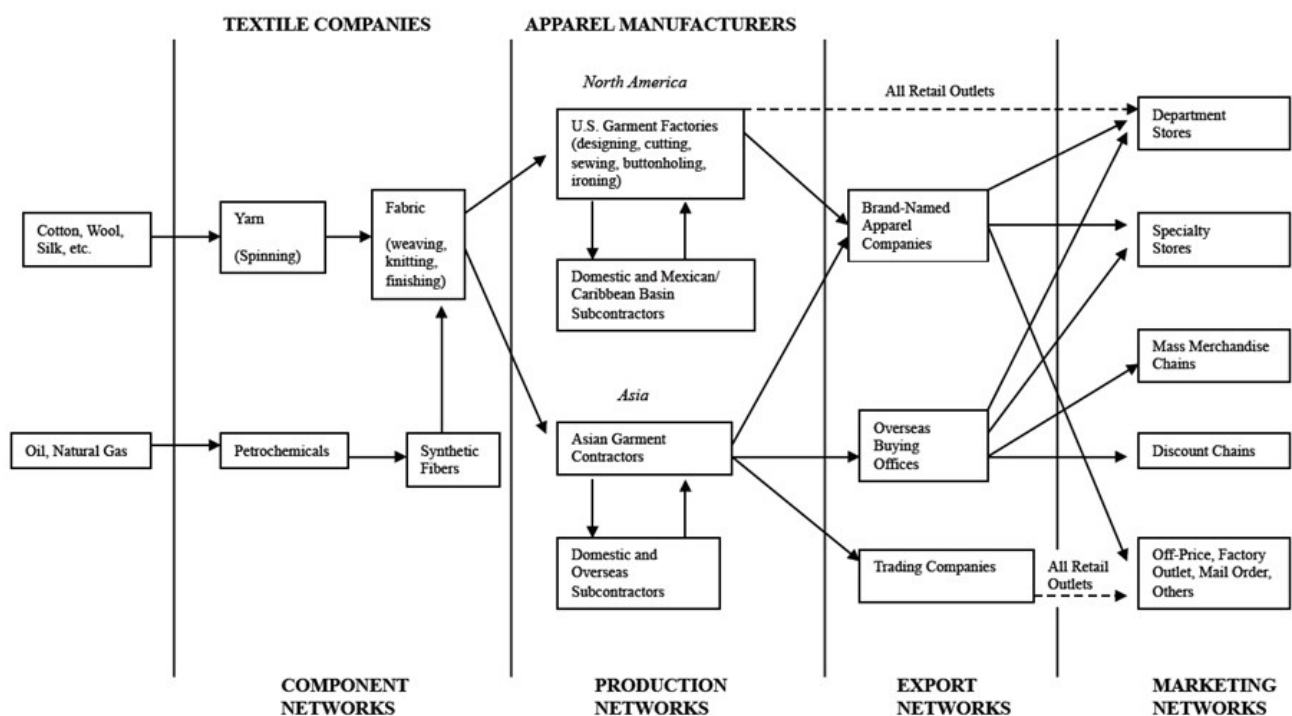


Figure 1: The Apparel Global Value Chain. Source: Gereffi & Memedovic 2003

Social impacts in this labor-intensive industry

The clothing industry is labor-intensive. In the context of globalization, the industry has relocated production sites and outsourced production processes to external suppliers mostly in emerging and developing countries like China, India, Bangladesh, Turkey and Vietnam. The more than 60 million people working for the textile industry nowadays are predominantly unskilled workers such as young women, migrants or workers on short-term contracts. While on one hand the industry offers working opportunities for those minority groups, there are on the other hand numerous reports of workers being forced to work long hours for low pay under dangerous and unhealthy working conditions. Furthermore, the clothing industry is one of the sectors in which child labor is still common (Locke 2014). The improvements made in the 19th century for industrialized countries were at the time achieved by collective bargaining agreements and state regulation (AFL-CIO 2013). Today, the producing countries often have inadequate laws, weak enforcement and deficient employment rights. For companies selling luxury goods, such as gold and diamonds, responsible procurement is a major issue as well. Gold, silver and diamonds used in luxury goods are often mined in regions affected by conflicts or instability with insufficient safety standards for the miners.

Most recent tragedies (see table 1) express the urgency for social responsibility being integrated and enforced along the global value chain. In addition, they highlight the need for companies to pay much closer attention to how they implement and monitor their publicly disclosed policies, as there is no use to have a well-written but ignored code of conduct.

Environmental impacts at nearly each stage of the supply chain

Environmental impacts can occur at any stage of the supply chain. The manufacture of synthetic fabrics from polyester-fibers, which are derived from crude-oil and are currently the most widely used fibers, is an energy-intensive process that contributes to global warming due to CO₂ emissions. Furthermore, emitted air pollutants including volatile organic compounds (VOC) can cause respiratory diseases. The cultivation of cotton in plantations can also impact the environment: cotton production accounts for a quarter of overall pesticide use in the U.S. The textile industry is extremely water-intensive: cleaning, bleaching, dyeing and finishing all happen in an aqueous environment. In each of these manufacturing processes, a variety of chemical substances are used. The latest reports about residues of hazardous chemicals in clothing show that this can pose safety risks (Greenpeace 2014).

How to improve: Active supply chain management and impact analysis

There is a strong need to rethink the supply chain

Historically, supply chain management used to be about getting the right product to the right customer at the right time. Today it's still about delivering on that promise, but with additional requirements. Supply chain sustainability includes managing the business impacts on both the social and the environmental side. Transforming the global textile and garment industry in such a way that supply chains become transparent, working conditions appropriate and environmental footprints optimized will require a lot of work. A modern approach for retailing brands is “capacity building”, where they

Recent tragedies in major clothing factories	
Gazipur, Bangladesh, October 8, 2013	Due to a fire in a textile factory, at least seven workers die and more than 50 are injured (The Guardian 2013)
Sabhar, Bangladesh, April 24, 2013	An eight-story factory building (Rana Plaza) with several clothing factories working for European and American consumers collapses. More than 1100 people lose their lives and injure 2500 more (The New York Times 2013)
Dhaka, Bangladesh, November 24, 2012	A fire breaks out in a fashion factory. At least 117 people are killed in the fire and at least 200 are injured (CNN 2012)
Karachi, Pakistan, September 11, 2012	Fire ravages in a textile factory complex, killing almost 300 workers trapped behind locked doors (New York Times 2012)

Table 1

help the contract manufacturer in the value chain to understand and take seriously their own impacts and improve conditions. Retailers can provide the factory managers with organizational skills and technical assistance so they can fix the problems (Locke 2014).

Transforming the apparel industry and making supply chains sustainable can help to manage risks and secure efficiency gains through:

- ⇒ **Avoiding bad news:** Headlines about poor working conditions, child labor or chemical residues in clothing products can seriously damage business reputation and weaken customer trust. It can also trigger compensation claims or slumps in sales. For example fashion giant Gap may experience negative consequences due to its Public Eye Award, received in January 2014. Gap has refused to sign the binding agreement “Accord on Fire and Building Safety in Bangladesh”. According to the Public Eye, it is even actively undermining serious reforms by promoting a non-binding corporate-controlled program. Such awards remind the corporate world that the social and environmental consequences of their business practices do not only affect people and the environment, but also a company’s reputation (public eye 2014).
- ⇒ **Meeting customer expectations:** Consumers are attaching increasing importance to ethical, social

and environmental aspects when buying clothes. Companies applying and enforcing high standards can therefore benefit from this trend towards “ethical consumerism”.

- ⇒ **First mover advantage:** Taking early action allows a company to be compliant with new legislation and regulation prior to its entry into force. This gives an advantage over competitors who scramble to take action reactively.
- ⇒ **Avoiding supply chain disruptions:** Globalized supply chains are also exposed to the risk of supply chain disruptions caused by labor unrest or strikes (Eurosif 2011). Working collaboratively with suppliers can help to secure the continuity of supply and quality. A study (PWC 2008) found that the average stock return of companies suffering from supply chain disruptions was almost 19 percent lower than those who had not suffered any disruptions (BITC 2009).

In summary, responsible supply chain management helps companies to tackle competitive challenges in their industry. The potential of integrating CSR within the supply chain has been recognized as a major new area of profit and growth as it contributes to the reduction of business risks (Perry/Towers 2012). Two companies engaging in responsible supply chain are H&M and Tiffany & Co. Their successes and occasional failures are described in the grey boxes.

H&M – commitments supported by action

The Swedish multinational clothing company Hennes & Mauritz (H&M) opened its first store in Västerås, Sweden in 1947. It now comprises six independent brands and sells its clothes in 3'200 stores around the world. It ranks the second largest global clothing retailer, behind Spain-based Inditex (parent company of Zara).

H&M has defined seven commitments on sustainability that it communicates to customers, and takes concrete actions to reach them. Of major importance is the commitment to “use natural resources responsibly”. Because H&M is selling fast-fashion clothing affordable for almost everybody, its business is rather resource-intensive. Cotton is the raw material mostly used by the company. Because conventional cotton production requires huge amounts of water, pesticides and fertilizers, H&M started offering clothes made of organic cotton back in 2004 in order to mitigate environmental impacts. Since then, the organic cotton product range has widely grown and H&M is now the number one user of organic cotton. Considering raw materials of animal origin, H&M has sound policies for ethical sourcing with respect to animal welfare. For example, H&M no longer sells Angora rabbit hair products and products made of real fur. In addition, it only accepts feathers and down taken from slaughtered birds bred for meat production, but not from live plucked birds. H&M is one of the few large clothing companies not accepting “mulesing”, which is a common practice used to prevent fly-strike at sheep farms, and known to be very painful for the sheep.

Another of H&M’s commitments is to “reduce, reuse, recycle”. In this respect, H&M uses recycled cotton, recycled wool, and recycled polyamide, which leads to considerably lower use of energy and natural resources than “fresh” material.

However, H&M cannot yet fully fulfil its commitments to “choose and reward responsible partners” and “be ethical” – but is working on it. In recent years, the company has been criticized for poor working conditions at its Asian suppliers, particularly in Cambodia, India and Bangladesh. Therefore, H&M has adopted a Code of Conduct addressing working condition rules to be respected by suppliers. The company also takes attempts to improve conditions in its supply chain by using a formal and systematic monitoring system.

Tiffany & Co. – actions for responsible sourcing

Tiffany is a leading multinational jewelry corporation with headquarters in New York. Under its brand Tiffany & Co. the company sells silver and gold jewelry, engagement and wedding jewelry, as well as fine and designer jewelry.

Sustainable sourcing of jewels is of major importance for luxury and jewelry brands, which had to face scandals about “blood diamonds” and “dirty gold” in recent years. Tiffany was not affected very much by the negative reputation of the industry, because the company could control its supply chain quite well. Already in 1992, the company started to buy its diamonds directly at the mine head, so the company could identify where the diamonds were coming from. Becoming more vertically integrated allowed the company to control the quality of raw materials as well as its impact at the mining sites. Tiffany & Co. developed responsible operating standards and actively engages with the mining industry, nongovernmental organizations and local communities. The company claims to respect workers’ rights throughout the supply chain and supports community development in the regions where it sources raw materials. Tiffany & Co. became a founding member of the Responsible Jewelry Council (RJC). This international nonprofit organization was established to reinforce consumer confidence in the jewelry industry by advancing responsible business practices throughout the diamond, gold and platinum jewelry supply chain.

Tiffany & Co. is also a participant in the Steering Committee of the Initiative for Responsible Mining Assurance (IRMA). IRMA is supposed to be launched in 2015. It seeks to establish a voluntary system of globally recognized environmental, human rights and social standards for mining operations. The initiative includes a certification standard developed through a multi-stakeholder approach, independent third-party verification as well as fair and equitable distribution of benefits to affected communities while protecting their rights.

Tiffany & Co. also acts responsibly in terms of other materials used. In order to protect rare species in marine ecosystems, it has refused to use coral in its jewelry since 2002. And for its leather accessories line, Tiffany is able to trace the source of all leather, at a minimum to the tannery, and exotic leathers to their farm of origin.

Moving a step forward: Impact assessments to tackle true sustainability issues

Obviously, disclosures of codes of conduct are not enough. They only mark the beginning of a company’s willingness to continually manage its social and environmental business obligations. A more comprehensive approach towards sustainability tries to substantially reduce the most relevant social and environmental damages – the adverse impact – that actually occur as a result of a company’s business activities. Such impact depends primarily on the products and manufacturing processes and cannot be dealt with by simply implementing policies and codes.

Active supply chain management offers ways to manage sustainability impacts. Another popular approach to tackle sustainability challenges starts first with identifying the most relevant sustainability issues of business processes along the entire value chain and products along their life cycle. This approach is increasingly pushed forward by sustainability specialists such as the Global Reporting Initiative (GRI). The new GRI Guidelines G4 – a global sustainability reporting standard released in May 2013 – encourages companies to focus on the most relevant issues to their business and stakeholders, rather than reporting on everything (KPMG 2013).

From the perspective of a sustainability rating agency like Inrate, a similar approach should be taken. For companies in the clothing industry, Inrate identifies certain issues that are crucial for the overall impact their business activities and products

exert on society and the environment. Companies that take measures to reduce their impact in terms of those issues, rather than improving only their policies and strategies, make a step forward towards sustainability. The key sustainability challenges faced by companies in the clothing industry as well as the associated opportunities for companies to improve are shown in the following table.



Clothing sector: key sustainability challenges and opportunities for action

Environmental challenges	Improvement measures for sustainable companies
Resource use and raw material sourcing • Use of endangered or protected species as raw materials, e.g. corals, shark or alligator leather, ivory • Use of animal products that stem from non-sustainable and unethical production such as farmed fur or mulesing and use of pesticides against flies on sheep farms for wool production • Ecological impacts caused during sourcing of raw materials such as precious metals for jewellery production	• Use sustainable raw materials like organic cotton, organic fibre such as hemp or bamboo, fibre made of recycled plastics etc. • Strictly adhere to the agreements of the Convention on International Trade of Endangered Species of Wild Fauna and Flora (CITES) that prohibits commercial trade in wild-caught specimens of endangered species • Use alternative materials to animal products (e.g. artificial fur instead of farmed fur) unless sustainable production and animal welfare can be guaranteed • Request mulesing-free wool production from suppliers • Support research for flystrike prevention during sheep farming (alternatives to mulesing and pesticide use). • Use recycled materials/recycled metals and strictly prevent from using precious metals and mineral from regions affected by conflicts and instability ("conflict minerals")
Production and processing • Use of critical chemicals for textile processing e.g. use of caustic soda and sulphuric acid, or chlorine bleaching which exerts the by-product dioxin which has extremely harmful effects on the environment and on human health. • Standards for waste and treatment of waste, hazardous waste and effluent from production units • Environmental regulations applied at production locations	• Use/require from suppliers to use alternatives to chlorine bleaching, e.g. ozone or hydrogen peroxide, which in wastewater treatment breaks down into oxygen and water • Implement high environmental standards and control them, independent of environmental regulations that apply to production locations (since requirements are often low in developing and emerging markets)
Social impact issues	Improvement measures for sustainable companies
Responsible supply chain management • Working conditions of suppliers (for companies which outsource) and employees (for companies which produce themselves) • Health and safety during production processes which are harmful to labourers' health (e.g. chlorine bleaching, sandblasting for jeans production)	• Postulate from suppliers to implement codes of conduct and to guarantee high standards regarding worker rights, appropriate living wages and maximum working hours • Require from suppliers to disclose all sub-suppliers • Conduct independent audits of suppliers and sub-suppliers or own production facilities, in order to improve health and safety as well as working conditions • Use alternative production processes or ask suppliers to do so, e.g. high pressure water, glass or dry ice blasting instead of sandblasting
Consumer health • Chemical residues in textiles or critical ingredients contained in cosmetics such as paraben or UV-filters	• Phase-out controversial substances, for example by use of special packaging techniques for cosmetics that make conservatives (like parabens) unnecessary. • Use approved natural ingredients
Ethical standards • Anti-competitive practices and price-fixing • Bribery and corruption	• Distribute the codes of conduct and business ethics policies among employees • Implement a reporting channel for breaches related to business ethics which is available for all employees and can be used anonymously. • Openly communicate also about small ethics breaches and their consequences for the company.

Impact assessments are crucial for sustainability investments



There's a wide variety of assessments conducted by sustainability rating agencies in the market. They are ranging from simple ethical exclusion screens over CSR assessment to detailed impact assessments. Financial analysts therefore face the question which approach they should favor. Which approach identifies the most sustainable ones? Which companies should they invest in to reduce sustainability risks?

Sustainability analysis has often been criticized for focusing too much on the facade erected by compa-

nies rather than on the true impact of the building which lies behind it. Sustainability assessments based simply on corporate communication were perhaps justified in the beginning, when sustainability initiatives reflected a genuine awareness and commitment on the part of companies. But as soon as environmental and social communication became fashionable it was often the case the more the building was cracked, the more the facade was decorated.

The current development to put the focus on impact is an answer to this criticism: Inrate places the environmental and social impact at the heart of its sustainability analysis in order to map the true risk situation in terms of sustainability. By assessing the negative impacts and identifying those market players which are already on a sustainable path Inrate provides valuable additional insights for sustainability-oriented investors. In this way, Inrate builds the basis for redirecting investment flows toward a more sustainable economy and to reach the objective of sustainability "to meet the needs of the present without compromising the ability of future generations to meet their own needs (Brundtland Commission 1987)."

The table below shows the result of Inrate's sustainability assessment of companies in the clothing industry. The different colors of the table indicate the grade category:

- **Grade category A:** sustainable or helping transition towards sustainability
- **Grade category B:** on the path to sustainability
- **Grade category C:** not sustainable, but with diminished impact
- **Grade category D:** not sustainable

		GRADE	Environment	Labour	Society	Governance
Adidas	Germany	■	■	■	■	■
Christian Dior	France	■	■	■	■	■
Compagnie Fin. Richemont	Switzerland	■	■	■	■	■
Hennes & Mauritz	Sweden	■	■	■	■	■
Inditex	Spain	■	■	■	■	■
Luxottica	Italy	■	■	■	■	■
LVMH	France	■	■	■	■	■
Nike, Inc.	United States	■	■	■	■	■
Tiffany & Co	United States	■	■	■	■	■
VF	United States	■	■	■	■	■

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