AN INVESTOR BRIEFING ON THE APPAREL INDUSTRY:

MOVING THE NEEDLE ON RESPONSIBLE LABOUR PRACTICES

An investor initiative in partnership with UNEP Finance Initiative and UN Global Compact

THE SIX PRINCIPLES

PREAMBLE TO THE PRINCIPLES

As institutional investors, we have a duty to act in the best long-term interests of our beneficiaries. In this fiduciary role, we believe that environmental, social, and governance (ESG) issues can affect the performance of investment portfolios (to varying degrees across companies, sectors, regions, asset classes and through time). We also recognise that applying these Principles may better align investors with broader objectives of society. Therefore, where consistent with our fiduciary responsibilities, we commit to the following:

1 We will incorporate ESG issues into investment analysis and decision-making processes.

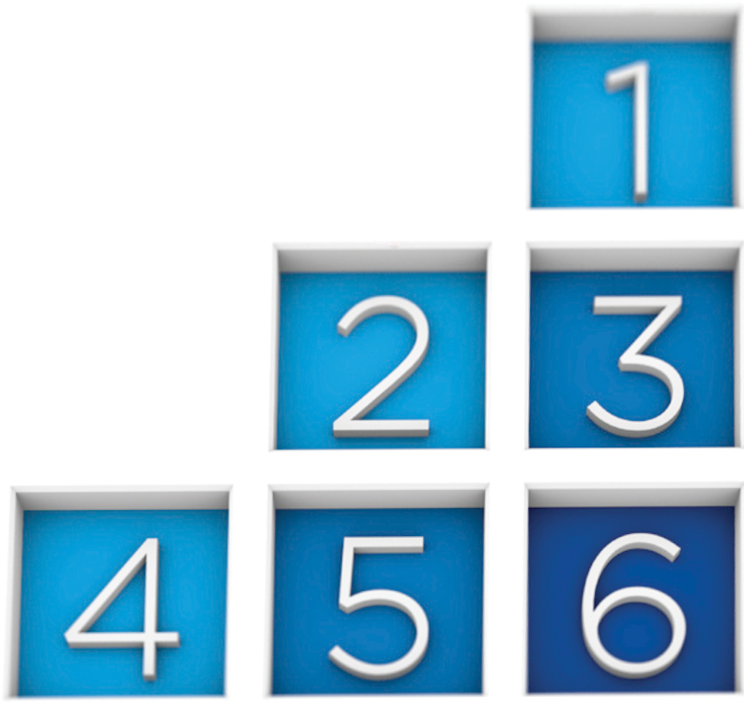
2 We will be active owners and incorporate ESG issues into our ownership policies and practices.

3 We will seek appropriate disclosure on ESG issues by the entities in which we invest.

4 We will promote acceptance and implementation of the Principles within the investment industry.

5 We will work together to enhance our effectiveness in implementing the Principles.

6 We will each report on our activities and progress towards implementing the Principles.



PRI's MISSION

We believe that an economically efficient, sustainable global financial system is a necessity for long-term value creation. Such a system will reward long-term, responsible investment and benefit the environment and society as a whole.

The PRI will work to achieve this sustainable global financial system by encouraging adoption of the Principles and collaboration on their implementation; by fostering good governance, integrity and accountability; and by addressing obstacles to a sustainable financial system that lie within market practices, structures and regulation.

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WHY RESPONSIBLE LABOUR PRACTICES MATTER FOR INVESTORS

The starting point for respecting human and labour rights is to understand the impact of a company's activities on people. There is a global expectation today that all companies need to respect human rights. The investment community increasingly recognise they have a role to play in ensuring that investee companies are meaningfully addressing human rights issues while mitigating any negative impacts.

Investors increasingly appreciate the need to understand the root causes of the systemic issues typically found in the apparel industry and how they affect the rights of people, impact businesses, and ultimately influence investment and financial returns. Whilst governments have the duty to protect these rights, investors recognise the corporate duty to respect human rights, as well as the role companies can provide to create a more sustainable industry.

RISKS AND OPPORTUNITIES

As the apparel industry is dominated by multi-tiered supplier relationships, a lack of traceability and rapid market-driven changes, the scope for risks and negative human rights impacts remains large:

- **Reputational risks** – potential brand damage and consumer backlash, which could lead to potential loss of sales for companies. Triggered by social media, reputational concerns can reach a wider audience faster than before. Consumers are also better empowered to research brands.
- **Operational risks** – potential cost savings from cheaper labour in countries like Bangladesh need to be balanced against incremental business risks, such as impact on lead times and product quality. The discovery of poor labour practices also leads to supply chain disruption which can cause stock outs, lost sales, reduced market share[1], and lack of trust in the company brand. This could ultimately directly impact company revenue.
- **Legal and regulatory risks** – global regulatory pressure, including potential lawsuits and fines, encourages greater transparency around sourcing of products and services. This is reflected through developments such as the UK Modern Slavery Act, the recent Duty of Care of Parent Companies and Ordering Companies in France, the Dutch Child Labour Due Diligence Law, the Trade Facilitation and Trade Enforcement Act in the US (which bans the import of goods produced by force labour) and the California Transparency in Supply Chains Act.

Responsible supply chain labour practices present opportunities including:

- **Increase in employee motivation** – more motivated employees lead to higher retention, increased productivity and improved product quality. For example, factories with improved labour practices reduce their product rejection rates by 44%[2].
- **Supply security** – building long, stable relationships with suppliers reduces a company's risk of labour abuses in its supply chain, limiting the need to change or drop suppliers at short notice following unexpected incidents.
- **Access to supply chain innovations** – building stable relationships with suppliers can lead to companies benefitting from more innovation within the supply chain. Suppliers with innovative products or processes are most likely to share them with companies with whom they have positive relationships.

To understand existing and emerging risks that may impact financial performance, both in the short and long term, investors need greater transparency and an informed understanding of how companies are managing practices on the ground.

THE PUSH BY 'SOFT LAW' MECHANISMS

An additional driver for investor focus on labour practices is the growing number of frameworks, standards and guidance on human rights. These include the UN Guiding Principles on Business and Human Rights[3], the revised ILO Tripartite Declaration of Principles Concerning Multinational Enterprises (MNE Declaration)[4], the OECD's Responsible business conduct for institutional investors[5] and the UN Sustainable Development Goals. These frameworks have raised expectations for investors to identify human rights impacts within their portfolio, and to use their leverage to address impacts and risks, prioritising based on severity.

Drawing upon investor engagement in this area, this brief highlights key issues at stake associated with labour practices, investor insights and recommendations based on multi-year engagements on the topic led by PRI signatories. It focuses on the apparel industry supply chain, from the production of raw materials to manufacturing.

1 Jacobs, B.W., SInghale, V.R. (2017) The effect of the Rana Plaza disaster on shareholder wealth of retailers: Implications for sourcing strategies and supply chain governance

2 SAI, IFC (2010) https://www.sustainabilityxchange.info/filesagri/SAI_IFC_LaborHandbook.pdf

3 http://www.ohchr.org/Documents/Publications/GuidingPrinciplesBusinessHR_EN.pdf

4 Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy (Revised March 2017) http://www.ilo.org/wcmsp5/groups/public/---ed_emp/---emp_ent/---multi/documents/publication/wcms_094386.pdf

5 OECD (2017) http://mneguidelines.oecd.org/rbc-financial-sector.htm

WHAT DO WE MEAN BY RISKS?

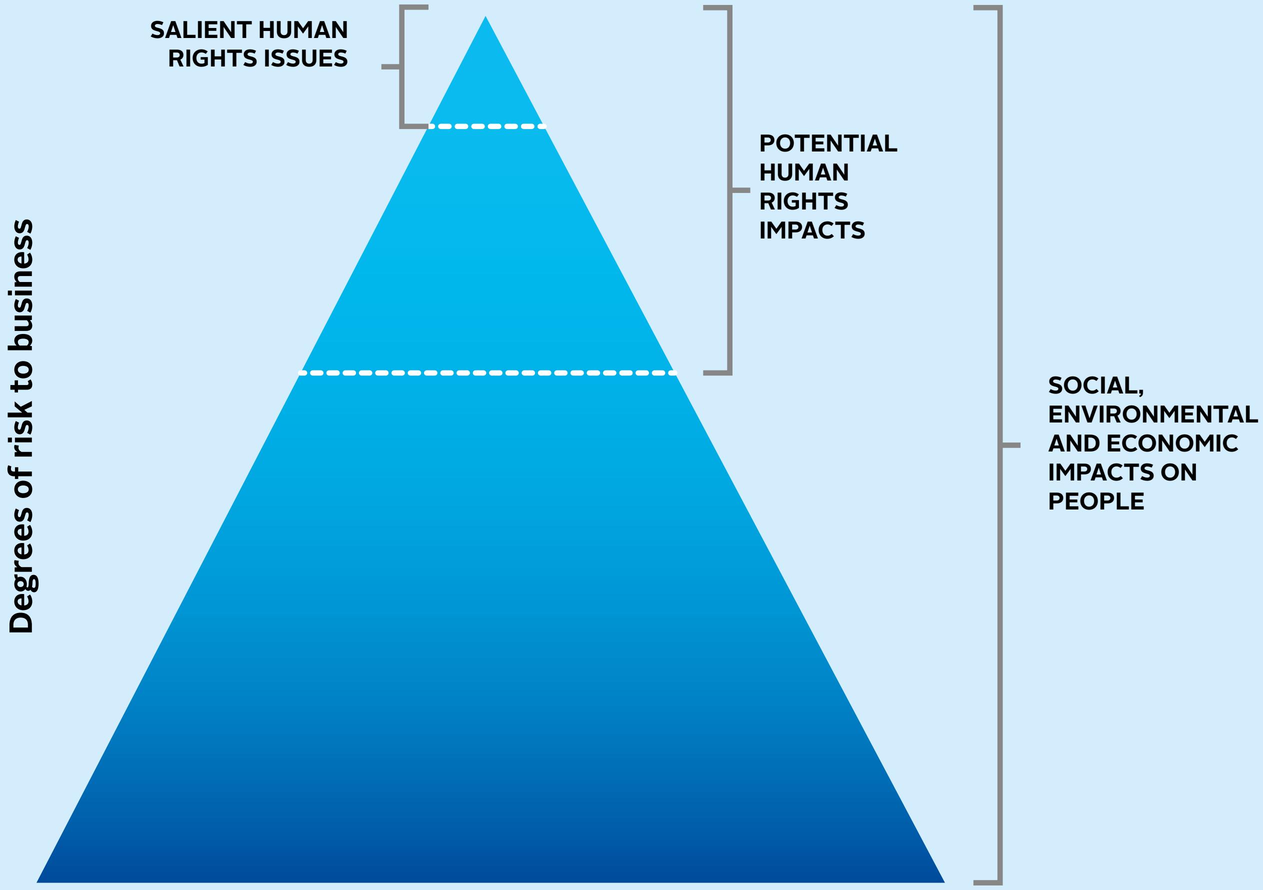
Under the UN Guiding Principles on Business and Human Rights, the corporate responsibility to respect human rights means for companies to focus their human rights efforts and due diligence on the most severe actual and potential impacts on human rights risks associated with their business activities and relationships. It also shifts the focus from risk to business to risk to people.

THE FOCUS ON SALIENT HUMAN RIGHTS ISSUES

Salient human rights issues are those human rights that are at risk of the most severe negative impact through a company's activities or business relationships.* The most severe are defined in the UN Guiding Principles as those impacts that would be greatest in terms of:

a. their scale: the gravity of the impact on the human right(s); and/or
b. their scope: the number of individuals that are or could be affected; and/or
c. their remediability: the ease with which those impacted could be restored to their prior enjoyment of the right(s).

The relationship between salient human rights issues and risk to business:



This graphic is reproduced courtesy of Shift Project, Ltd. and Mazars LLC.

* UN Guiding Principles Reporting Framework (2017) https://www.ungpreporting.org/resources/salient-human-rights-issues/

THE APPAREL INDUSTRY IN THE SPOTLIGHT

The apparel industry is a complex sector.[6] Valued at US$3 trillion, the global market accounts for 2% of the world's GDP[7].

Between 2000 and 2014, the number of workers employed in the sector almost tripled from around 20 million workers to 60-75 million. Over the last few decades, the industry has served as a stepping stone to economic and social development by providing employment opportunities for women, youth and low-skilled workers. Three quarters of garment workers worldwide are female[8]. The sector also enables developing markets to pursue export-oriented industrialisation.

Despite this, the industry carries a number of significant risks to workers' human rights, safety and working conditions across the value chain, from sourcing of raw materials to manufacturing of finished products. These risks also flow through to listed manufacturers, retailers in the apparel sector and their investors.

Engagement by PRI signatories:

HEALTH AND SAFETY IN THE CLOTHING SECTOR

Objective

From 2013-2016, the sustainability asset manager, RobecoSAM, engaged with eight companies, ranging from brand owners that have their own clothing manufacturing operations, to retailers that do not engage in manufacturing, but source products from suppliers.

What is the progress?

After three years of engagement, seven of the eight companies evaluated their risk exposure and formulated health and safety (H&S) policies for their own factories and those of their suppliers. During the engagement, the selected companies developed, or are in the process of developing, a structured risk management process to ensure a better H&S profile of manufacturing facilities, and commitments to ensure better living wages for workers.

Areas for development

Subcontractors and monitoring of second-tier relationships in the supply chain are the most challenging when it comes to managing sustainability. The extent to which companies can influence suppliers in tier two and beyond is limited and is an area for development.

The industry has suffered from numerous safety incidents such as the Tazreen garment factory fire in 2012 and the Rana Plaza collapse in Bangladesh in 2013 – which resulted in the death of 1,100 workers. These events have drawn concern from consumers, stakeholders and investors regarding industrial safety. They also highlighted the complexities and lack of transparency in apparel supply chains.

THE GLOBAL GARMENT INDUSTRY: THE GEOGRAPHICAL DIMENSION

Whilst Asia has dominated the industry, accounting for 71% of market share in 2016[10], health and safety incidents in Bangladesh and Pakistan have triggered some companies to look for new sourcing destinations. One emerging region is Sub-Saharan Africa, and Ethiopia in particular. This is because of the combination of low wages, export incentives and a growing pool of labour resources, as well as convenient access to both US and European markets.[11] However, companies may also encounter a number of environmental and social risks there, especially in cotton production. Whilst Ethiopia is regarded as a politically stable country, it may be exposed to regional unstable geopolitical risks. Alongside issues associated with labour standards, there are concerns over land usage resulting in numerous protests, which pose security threats to cotton production. According to the Verisk Maplecroft Global Risks Forecast, concerns over land grabs and usage might intensify as drought and food insecurity worsen, exposing companies not only to social but also environmental risks.

Interestingly, rising labour costs in China have caused Chinese garment manufacturers to begin to move their factories abroad to countries like Myanmar to exploit relative wage differences.[12]

6 http://ilo.org/global/industries-and-sectors/textiles-clothing-leather-footwear/lang--en/index.htm
7 https://fashionunited.com/global-fashion-industry-statistics
8 https://fashionunited.com/global-fashion-industry-statistics
9 https://www.hrw.org/report/2017/04/20/follow-thread/need-supply-chain-transparency-garment-and-footwear-industry
10 http://www.reportlinker.com/p04647018/Textile-Manufacturing-Market-Global-Briefing.html
11 Women's Economic Empowerment in Sub-Saharan Africa https://www.bsr.org/reports/BSR_Womens_Empowerment_Africa_Apparel_Brief.pdf
12 Ausbil (2016) Is the Fast Fashion Industry at an Inflection Point? http://www.ausbil.com.au/research-insights/research/is-the-fast-fashion-industry-at-an-inflection-poin

Engagement by PRI signatory:

THE ROLE OF PENSION FUNDS IN ENHANCING LABOUR PRACTICES[13]

Objective

On behalf of pension fund BPF MITT, asset manager MN engaged on ESG risk with 15 companies worldwide in the fashion and apparel industry.

What progress has been made?

MN and BPF MITT developed company engagement programmes focusing on good labour standards – especially the implementation of freedom of association, the right to collective bargaining and decent living wages. They also verified how companies hold business partners and suppliers accountable on widely accepted standards.

MN traveled to Indonesia to visit apparel factories together with local brand representatives to learn more about the latest improvements on the work floor. They also met with the Fair Wear Foundation (FWF) and local trade union leaders to hear experiences about violations of labour standards at other factories.

Areas for development

Most companies require suppliers to commit to a code of conduct. However, supplier commitment on paper does not always ensure sufficient impact on local factory level. Severely low wages are also still common in many apparel supply chains.

What can investors do?

Investors should:

- ensure that freedom of association and the right to collective bargaining are in place in investee companies' supply chains;
- ensure investee companies mitigate issues in their own supply chain and aim for long-term partnerships with suppliers;
- encourage companies to seek cooperation with competing businesses to tackle industry problems together and liaise with governments to take down barriers to improving labour standards;
- regularly communicate with local organisations to solve labour issues and gain a comprehensive understanding of the challenges for workers and trade unions when organising themselves (e.g. hostility, violence, fraud).

Engagement by PRI signatories:

FOUR YEARS ON FROM THE BANGLADESH INVESTOR STATEMENT

Objective

Following the Rana Plaza collapse in 2013, more than 200 investors representing over US$4.3 trillion signed an investor expectations statement. It urges companies to sign the Accord on Fire and Building Safety in Bangladesh and provide actions to remediate building safety hazards and the continuation of worker safety training. In June 2017, companies and global unions agreed on a second accord, which will come into effect in May 2018.

What progress has been made?

Workplace safety in garment factories in Bangladesh is believed to have improved, with over 400 accord factories completing 90% of the remediation plans. These plans cover corrective actions undertaken to fix inadequately protected fire exits, inadequate fire alarm and fire protection systems, and electrical and structural safety measures that have been identified by independent inspections. The Alliance for Bangladesh Worker Safety, a similar coordinated industry response, was highlighted by investors to have shown less robust progress. Investors voiced concerns including lack of transparency and not following through on corrective action plans, and emphasised the need to ensure remediation of outstanding issues and publicly report on progress.

Areas for development

Despite encouraging progress, investors recognise that remediation has been slow, partly because funding needs to be negotiated, reflecting a lack of trust between factory owners and brand companies. Investors who support the statement recommend, amongst other issues, to:

- assess financial capacity of suppliers and ensure proper financing is available to expedite the remediation of more costly safety hazards, such as enclosed stairwells, sprinkler systems, hydrants and structural retrofitting;
- ensure remediation of outstanding issues and publicly report progress;
- broaden the current accord to include a focus on freedom of association and collective bargaining and integrate this into the complaints mechanism process and additional parts of the supply chain where similar risks exist.

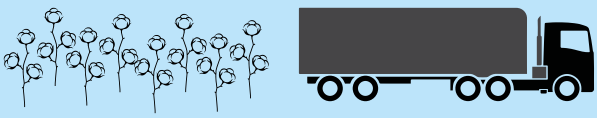
What can investors do?

Investors can endorse the Investor Statement on the 4th Anniversary of the Rana Plaza Tragedy.

13 FNV, VBDO (2016), Freedom of Association & Right to Collective Bargaining: The role of pension funds

THE GLOBAL GARMENT INDUSTRY SUPPLY CHAIN

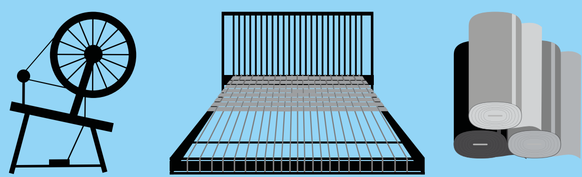
Growing, Ginning, Trading



1 Ginners receive cotton from multiple growers and sell to the global market through traders.

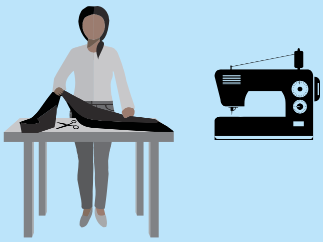
Spinning, Knitting or Weaving, Dyeing

2 Spinners use cotton from a variety of origins to produce yarn; fabric mills produce cloth.



BRAND ORDERS ITS APPAREL

Cutting, Sewing, Trimming



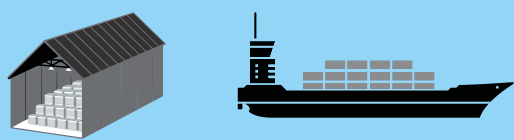
3a Cut-make-trim (CMT) factory manufactures garments.

3b A CMT factory that lacks in-house capacity for smaller processes subcontracts them to another facility, which then sends the garments back to CMT factory.

Embroidery, Printing, Washing

Warehousing, Shipping

4 CMT factory ships garments wholesale to the brand that placed the orders.



Retail

5 Brand distributes garments globally to retail and online stores.

Based on the diagram in Human Rights Watch (2017) Follow the Thread - The Need for Supply Chain Transparency in the Garment and Footwear Industry

THE POTENTIAL HUMAN RIGHTS ISSUES COMPANIES FACE WHEN MAKING A T-SHIRT

Adverse human rights issues and impacts are found throughout the supply chain. Incidents of forced labour are prevalent – from cotton picking to apparel manufacturing around the world – in both developed and developing markets. The growth in migrant workers has also fuelled labour exploitation within the sector.

STAGE 1 OF MAKING A T-SHIRT: RAW MATERIALS SOURCING AND PRODUCTION

Risk of child labour, forced labour and human trafficking

In both the 'growing, ginning and trading' phase and the 'spinning, knitting or dying' phase of the supply chain, there are risks associated with sourcing cotton[14]. Cotton harvesting tends to be labour intensive and often sourced in countries such as Uzbekistan, Tajikistan or India where there is a lack of enforcement of national law and forced and child labour is prevalent. Cotton workers are also exposed to health and safety hazards, including pesticide contamination.

Spotlight on migrants: workers on the move

Adding to the complexity in both the early stages of the supply chain and the manufacturing phase, is the use of refugees and migrant workers, including children. In Turkey, the third largest textile exporter to the European Union in 2013[15], migrant children and Syrian refugees are at risk of child labour, forced labour and are often subject to recruitment fees. A recent media expose[16] highlighted sweatshop conditions in Turkish garment factories, putting the reality of abuse and exploitation of Syrian refugees on the agenda for brands, retailers, consumers, and not least investors. However, forced labour in the apparel sector also occurs in developed countries. For example, migrants from India, Pakistan and China were found to be forced to work in textile factories in Spain and Italy.[17]

Specific labour issues arise within certain regions affecting both domestic and foreign migrant workers, so companies need to understand their own particular operating context and risks in regions from which they are sourcing. For example, in India, companies are increasingly aware of Sumangali practices, a form of child labour where young unmarried women are recruited from rural villages to work in spinning mills for a number of years and receive a lump sum towards the end of the contract.

The risk of child labour, forced labour and human trafficking are also prevalent in the cutting, sewing and trimming phase (Phase 3 in the diagram illustrated above). These issues are often more difficult to identify because of the opaque nature of the supply chain, especially as they may occur deeper beyond tier 1 suppliers, challenging the visibility and oversight, e.g. among sub-suppliers or homeworkers.

TOOLBOX: RESOURCES FOR RESPONSIBLE SOURCING

To identify and prioritise risks among their portfolio companies, investors can consider companies' sourcing geographies and the risks they present. Resources such as The Responsible Sourcing Tool, The Danish Institute for Human rights impact assessment guidance and toolbox and Verisk Maplecroft's Human Rights Risk Atlas can help investors identify regions of concern. The OECD Due Diligence Guidance for Responsible Supply Chains in the Garment and Footwear Sector is a comprehensive sector-specific tool which can help investee companies to implement the due diligence recommendations contained in the UN Guiding Principles on Business and Human Rights.

STAGE 2 OF MAKING A T-SHIRT: MANUFACTURING

In the manufacturing stage, a number of human rights risks include:

- lack of living wages;
- excessive overtime work;
- poor health and safety mechanisms;
- poor building safety influencing working conditions;
- lack of worker voice, including lack of freedom of association.

Workers often lack both an understanding of and access to their human rights as they tend to be low-skilled and come from rural or low-income communities. Challenging political environments in which civil society organisations and trade unions are not accessible may also risk limiting workers' voice. Some unions may also be connected to political parties which can make the labour unions more aggressive and militant in their demands.

Companies carry a responsibility to identify and uncover these issues, and implement ways to manage them. Where workers are not aware of or are unable to exercise their rights, companies can focus on educating workers, providing awareness-raising programmes, training and local capacity building.

14 Responsible Sourcing Network (2012) From the Field: Travels of Uzbek Cotton Through the Value Chain

15 https://business-humanrights.org/sites/default/files/160131%20Syrian%20Refugee%20Briefing%20FINAL.pdf

16 Undercover, the Refugees Who Make our Clothes http://www.bbc.co.uk/programmes/b0813kpq

17 KnowTheChain (2016) Apparel & Footwear Benchmark Findings Report https://knowthechain.org/wp-content/plugins/ktc-benchmark/app/public/images/benchmark_reports/KTC_A&F_ExternalReport_Final.pdf

Spotlight on gender: respecting women's rights

As the majority of garment workers worldwide are female, they are often subject to a lack of gender rights. Issues such as sexual harassment in the workplace and a lack of professional development, childcare and hygiene and sanitation facilities are realities for many garment workers. These clear human rights impacts fall under the corporate responsibility of companies to respect and if processes to mitigate these issues are not in place might link to wider risks to investors.

Spotlight on a decent standard of living: the importance of a living wage

In many apparel sourcing countries, the current minimum wage is insufficient to meet the basic cost of living. The absence of industry wage bargaining has left workers reliant on ineffective minimum wage mechanisms for wage increases[18]. This puts them in a weaker position, and factors such as faster turnaround pressure and shorter lead times can increase the risk of exploitation.

Workers are also often subject to a living wage gap, in which living expenses are growing faster than wages. For example, in China it grew from 6% in 2015 to 11% in 2016 (based on living wage estimates provided by the Asia Floor Wage).[19] Often, companies do not distinguish between a living and minimum wage which can pose a risk to investors, as it is unsustainable for a business model to rely on underpaying workers. Sustaining a living wage can translate into operational benefits reflected in improvements in turnover, retention, absenteeism and morale. To encourage this, investors can ask for companies to integrate fair and responsible hiring policies and practices into corporate-wide operations and supply chains, and encourage companies to encourage suppliers to provide a living wage.

TOOLBOX: THE GLOBAL LIVING WAGE COALITION BETTER WORK PROGRAMME

The Global Living Wage Coalition brings together six of the world's most influential sustainability standards to improve wage levels in certified supply chains. It produces Living Wage Benchmark Reports for key countries including Bangladesh, India, Pakistan, Vietnam and Ethiopia, which can provide investors with a source of data for what is actually paid in contrast to living wages.

See more here

THE BETTER WORK PROGRAMME

The length and depth of supplier relationships are important factors to make sure that factories are implementing change. The Better Work Programme, a partnership between the International Labour Organization (ILO) and the International Finance Corporation (IFC), seeks to train workers and improve labour standards at the factory level in the apparel sector, and can help guide investors on progress of factories involved in the programme. The initiative produces resources for brands and factories which can be a useful source for investors to help frame their engagement with companies.

18 IndustriAll (2015) Industry bargaining for living wages

19 Ausbil (2016) http://www.ausbil.com.au/research-insights/research/is-the-fast-fashion-industry-at-an-inflection-poin

Engagement by PRI signatories:

ENGAGING FOR A LIVING WAGE

Objective

Increasing access to decent work on a living wage consolidates security of supply for international brands and presents a fundamental pathway out of the "in-work" poverty trap for workers. The Dutch investors ASN Bank, Triodos Investment Management and MN (the fiduciary and pension fund asset manager for PME and PMT) worked on a long-term engagement to achieve a living wage for the garment industry.

What progress has been made?

ASN Bank carried out a baseline study that ranked 14 listed companies on supplier payment practices in 2016. The bank also released a manual for textile and footwear companies that explains the required steps to successfully introduce a living wage in supply chains. The three Dutch investors recently shared the manual with a carefully selected group of international garment companies and will continue to engage and monitor them in the coming two years.

Areas for development

Whilst most companies in the baseline study still have a long way to go to implement a living wage, the investors identified the following useful steps:

- It helps to join a sector or multistakeholder initiative, and the role of governments is vital in this process and cannot be solved by a single company.
- In many cases, paying the industry average wage takes companies a major step closer to a living wage.

What can investors do?

Investors can explore the manual for textile and footwear companies which explains the required steps to successfully introducing a living wage for supply chains in their engagement efforts with their portfolio companies.

ALERTS: WHAT INVESTORS SHOULD LOOK OUT FOR

We interviewed a number of investors who have engaged companies on human rights issues. Below are some of the warning signs they highlighted as potential indicators of negative actual and potential human rights impacts.

COMPANY GOVERNANCE OF HUMAN RIGHTS

No human rights policies in place (e.g. codes of conduct, policies covering internationally-recognised human rights and labour standards, or referencing the Ethical Trading Initiative's base code)

Having policies in place reflects senior management buy-in and oversight. Where companies do not have a commitment in place, or where it is limited, investors can help companies understand their responsibility to respect human rights. When engaging an investee company, they can start by asking them to implement the UN Guiding Principles on Business and Human Rights, and to manage supply chain labour risks in alignment with IFC Performance Standards[20] and ILO's fundamental conventions.[21]

Unresponsive to investor requests for dialogue

Company dialogue is key. Whilst it can be difficult for investors to assess and influence corporate culture and commitment externally, the tone and responses given by companies on the topic can help investors grasp the extent to which the companies perceive sustainability as a cost centre or value driver. Companies that are not responsive to requests for dialogue or do not recognise potential human rights issues may not have an adequate understanding of these risks. Where companies are unresponsive, investors can escalate the dialogue – for example, by collaborating with other investors or by seeking to raise the issues at board level.

Unclear governance processes and lack of board oversight

The governance structure and reporting lines to decision makers is important in understanding how labour practices and associated human rights risks are acted upon within the company and throughout its business relationships. Lack of a clear mechanism for board oversight of these issues may indicate a lack of attention. Where this is not integrated into existing governance structures, investors can request companies to assign some level of oversight to senior management with overall accountability for performance.

TOOLBOX: FASHION REVOLUTION'S FASHION TRANSPARENCY INDEX

The Fashion Transparency Index ranks 40 of the largest global fashion companies according to their level of transparency based on a questionnaire and publicly available information about supply chain issues.

See more here

Ignoring the consequences of a 'fast fashion' business model

Investors highlighted the implications of the 'fast fashion' apparel industry on labour practices. As fashion trends change rapidly, delivery requirements from buyers are impacted. Shorter lead times have allowed apparel brands to introduce new lines more frequently[22] and supply more products in stores. However, these quick turnarounds influence suppliers' visibility of delivery orders – for example, late orders which can create overtime and long working hours. Companies need to work with suppliers to manage these deadlines and consider the implications and unintended consequences in buying decisions. Investors can ask their portfolio companies about the relationship 'fast fashion' companies have with their suppliers – for example, the way purchasing teams within a company are dictated by targets to delivery. This can help investors understand how to urge brand companies to give more visibility of delivery orders to suppliers.

TOOLBOX: CLEAN CLOTHES CAMPAIGN'S TRANSPARENCY PLEDGE

Together with eight NGOs and Global Trade Union Federations, the Clean Clothes Campaign has contacted over 70 brands to sign a Transparency Pledge, promising to disclose information about their supply chains before December 2017.

See more here

20 IFC(2012) https://www.ifc.org/wps/wcm/connect/c8f524004a73daeca09afdf998895a12/IFC_Performance_Standards.pdf?MOD=AJPERES

21 ILO (1998) http://www.ilo.org/global/standards/introduction-to-international-labour-standards/conventions-and-recommendations/lang--en/index.htm

22 http://www.mckinsey.com/business-functions/sustainability-and-resource-productivity/our-insights/style-thats-sustainable-a-new-fast-fashion-formula

Overlooked small and mid-cap companies

Investors tend to focus on large brands or the worst performers at risk of being excluded from their investment universe. However, there is a large segment in the middle, comprising small and midcap companies, that do not receive the same level of attention and may not have adopted the good practices implemented by some of their larger peers. This may be because small and mid-cap companies often do not have the capital or leverage over factories that their larger counterparts have, making the implementation of best practices even more difficult. Investors can expand their focus to engage small and mid-cap companies, as they can be more focused on improving sourcing and may see strategic value in building close-knit relationships with garment factories, presenting opportunities for improvement.

Lack of disclosure on sourcing regions and recruitment practices

In certain regions such as Turkey, the recent influx of migrant labour and Syrian refugees carries reputational, operational and compliance risks for investors. Many migrant workers work further down the supply chain as subcontractors of the exporting garment factories[23], which makes monitoring very difficult. Undocumented workers lack access to legal employment contracts and social security, putting them at risk of exploitation and sweatshop conditions.

Linked to this is the risk of recruitment fees. Vulnerable and migrant workers are often charged recruitment fees and exploited through corrupt middlemen and employment agencies. Investors should look out for lack of disclosure on sourcing regions and can actively encourage companies to adopt recruitment systems that ensure workers in their immediate and extended supply chains are not paying employment fees.

DHAKA PRINCIPLES FOR MIGRATION WITH DIGNITY

The Dhaka Principles are a set of human rights-based principles, built on the UN Guiding Principles on Business and Human Rights, to enhance respect for the rights of migrant workers from the moment of recruitment, during overseas employment, and through to further employment or safe return to home countries.

See more here

ICCR BEST PRACTICE GUIDANCE ON ETHICAL RECRUITMENT OF MIGRANT WORKERS

The Best Practice Guidance on Ethical Recruitment of Migrant Workers highlights models for companies looking to implement ethical recruitment policies and drive change at recruitment agency level.

See more here

THE LEADERSHIP GROUP FOR RESPONSIBLE RECRUITMENT

The Leadership Group for Responsible Recruitment is a collaboration between leading companies and expert organisations to drive positive change in the way that migrant workers are recruited. It calls for the Employer Pays Principle to be embedded in corporate and government policy and practice – to protect migrant workers and counter the risk of forced labour in their own operations, business relationships and global supply chains.

See more here

23 http://labourbehindthelabel.net/wp-content/uploads/2017/01/Invisible-workers_Turkey_Fair-Action_20170118.pdf

COMPANY MANAGEMENT OF POTENTIAL OR ACTUAL HUMAN RIGHTS IMPACTS

Nonexistent supply chain mapping

It can be difficult for investors to assess the actual human rights risks of their portfolio companies. Companies have visibility to a certain degree, typically the first tier of suppliers, which has been the main focus for investors because of the lack of disclosure and transparency at further tiers in the supply chain. For salient human rights risks associated with labour practices, investors can set out clear steps to encourage investee companies to map their supply chains and inform investors of the risks.

Fragmented supplier relationships and dispersed sourcing locations

The nature of a fragmented and dispersed supply chain, along with expansion to sourcing from newer countries such as Ethiopia, can carry risks for companies, and ultimately investors. Building long, stable relationships with suppliers and encouraging consolidated supply chains can help reduce a company's exposure to labour abuses, may limit the need to change or drop suppliers at short notice following unexpected allegations[24], and can build trust between factory owners and retailers. Whilst apparel companies set out their sustainability commitments at corporate level, they depend on the factories and suppliers they work with to implement them. Investors can engage with companies to push for training of procurement professionals to equip them with knowledge and tools to make sourcing decisions that positively affect wages and working conditions. Longer term relationships between retailers and suppliers can enable investment in training and capacity building.

KNOWTHECHAIN'S APPAREL AND FOOTWEAR BENCHMARK

KnowTheChain has benchmarked 20 apparel and footwear companies on their efforts to eradicate forced labour from their global supply chains. The results found that apparel companies take little action to ensure workers have a voice throughout their supply chain, highlighting the need for stronger action to protect workers during the recruitment process and providing remedy in the event of adverse and negative human rights impacts. It will benchmark 40 apparel companies in 2018.

See more here

Track record of human rights violations

Due to the limited granularity of reporting, investors stressed the challenge of proactivity and understanding the real picture before it is too late. There also tends to be a disconnect between what is disclosed on paper and practices in reality – for example, some of the labour standards around freedom of association and collective bargaining that are officially in place are aspirational in reality.

Investors can encourage companies to demonstrate good practice by reporting on meaningful metrics and key performance indicators (KPIs), and supporting standardisation of assessment guidelines and reporting of data. This would encourage greater transparency and enhance the quality of data being reported to ensure it is valid and valuable for investors. As disclosure matures and improves, investors can seek ways to encourage companies to look beyond standard metrics to move ahead into greater nuance and complexity.

CORPORATE HUMAN RIGHTS BENCHMARK FOR APPAREL

The Corporate Human Rights Benchmark assesses the 30 largest apparel companies in the world by ranking them against the CHRB's apparel criteria to incentivise better disclosure and reporting by companies. It has identified forced labour as a key industry risk for the apparel sector.

See more here

A checklist approach to auditing

Auditing has become a mainstay within the industry in an attempt to understand what is happening in practice. Whilst investors recognise the value of independent third party audit processes and reports, they also highlighted many of the shortcomings and noted the shift towards more robust measures.

For example, companies that show serious commitment and greater maturity to tackling human rights risks, are increasingly moving away from auditing to establishing a local presence that can work with and monitor progress with worker-led initiatives, local stakeholders such as trade unions, NGOs, and civil society organisations.

24 PRI (2016) From poor working conditions to forced labour – what's hidden in your portfolio?

MULTI-STAKEHOLDER INITIATIVES

Limited engagement with NGOs, worker unions and community organisations

Lack of worker voice across the supply chain is a key industry risk. NGOs, worker unions and community organisations can provide companies with expertise on company practices, as well as access to workers and community representatives. Investors can look out for active company participation in multi-stakeholder initiatives as they can play an invaluable role in exchanging expertise and awareness of issues, bringing worker and community voices to the table, and scaling up good practice by companies, NGOs, investors and government. Investors highlighted that companies that are working with these organisations often show real signs of leadership and commitment to addressing systemic issues facing the sector.

THE SUSTAINABLE APPAREL COALITION'S HIGG INDEX AND THE SOCIAL & LABOR CONVERGENCE PROJECT

The Sustainable Apparel Coalition (SAC) is a global alliance of retailers, brands, suppliers, industry and advocacy groups, labour unions and academics aiming to drive collaboration, innovation and action on sustainability in the footwear, apparel and home textiles supply chain. The core driver is the Higg Index, a suite of self-reporting assessment tools for companies to use to measure their environmental and social and labour impacts and identify areas of improvement. Although investors call for more transparency on the Higg Index and encourage more investors to join as stakeholders, it is widely used and provides a common framework and tools to analyse and quantify the sustainability impacts of products from the raw material sourcing to finished end-product.

More recently, the SAC has launched The Social & Labor Convergence Project which aims to develop a common assessment framework and data collection system to increase industry efficiency and reduce audit-related costs.[25]

See more here

25 http://apparelcoalition.org/social-labor-convergence-project-triples-number-of-participants/

RECOMMENDATIONS FOR ENGAGING WITH APPAREL COMPANIES

To encourage apparel companies to improve labour practices in the apparel industry, investors can:

- **Encourage companies to publish factory lists**
  Although some companies argue that publishing factory lists is commercially sensitive, greater transparency of supplier networks and mapping is informative to investors, and helps make the industry less opaque. Companies demonstrating good practice are also beginning to report on their workforce supply chain (e.g. number of workers and percentage of migrant workers). This is supported by the recently launched Workforce Disclosure Initiative, which aims to provide investors with better information on the workforce reporting data from listed companies, covering employees in companies' global operations and workers in their supply chains.

- **Ask companies to report on challenges and performance, not just policies and commitments**
  As social issues tend to be more challenging to quantify, with less mature data to show how they can impact a company's performance, companies tend to be less granular in reporting. Investors are encouraged to ask for more disclosure on results, not only on policies and commitments, but also for performance information that demonstrates the company has a systematic approach to the issues. Although this might be difficult, investors echoed that companies that acknowledge the difficulties of collecting and reporting on performance data can enhance credibility.

- **Encourage a unified approach to auditing**
  There is currently a lack of standardisation of auditing processes, which allows for every brand and retailer to have their own audit and modular approach. This is costly for manufacturers and can create audit fatigue for suppliers and factories, as many brands use the same suppliers. Whilst investors recognised the existence of current long-standing standards and initiatives, such as Sedex Members Ethical Trade Audit (SMETA) or the SA 8000 Standard, they recommended a unified and agreed model for auditing and industry standard that has a common frequency and verification process, and opportunity for capacity building would help drive the race to the top. Together with increased pressure from investors, greater collaboration between investors was recommended. A number of companies, and increasingly investors, participate in multi-stakeholder initiatives such as the Social & Labour Convergence Project to drive common standards to support a collective approach and create resources for capacity building.

- **Encourage leading companies to use their leverage and collaborate with multi-stakeholder initiatives**
  For investors, collaborating with companies (both leading and lagging) is important to tackle challenges. Investors highlighted examples of companies who have positioned themselves as leading in supply chain management, but who initially hesitated in joining initiatives such as the Bangladesh Accord,[26] as they argued they had little leverage. Relevant collaborative multi-stakeholder initiatives investors can ask companies to join include the Action, Collaboration, Transformation (ACT) initiative which addresses the issue of the living wage in the textile and garment sector, the Fair Labor Association or Social Accountability International (SAI), which is dedicated to improve workplaces and communities by developing socially responsible standards. The Fair Wear Foundation annually assesses and publicly reports on member brands' human rights due diligence efforts, requiring members to provide a full list of suppliers to Fair Wear Foundation as part of their membership.

- **Take advantage of new and innovative technologies**
  Investors highlighted the need to look at some of the areas where labour issues, such as forced labour or use of worker recruitment fees, can be addressed through new technologies which can provide more reliable and accurate workers' voices (e.g. use of mobile phones to document poor labour conditions, mobile phone applications that can record and act as a grievance mechanism). For example, the apparel brand H&M recently joined the United Nations' Better Than Cash Alliance[27], and announced that it will digitalise the payment of workers across its supply chain, which would benefit stakeholders with greater transparency, reduce the time and costs to factories associated with cash payments, and ultimately improve workers' access to financial services.[28]

26 http://bangladeshaccord.org/signatories/
27 https://www.betterthancash.org/about
28 http://www.triplepundit.com/2017/03/hm-better-than-cash-alliance/

- **Encourage companies to build relationships with suppliers and become less 'transactional'**
  Brands and retailers should be able to explain to investors how purchasing decisions are made, describe how they impact wage levels in the supply chain and clarify how unintended consequences of purchasing practices were mitigated. This process requires close cooperation between the purchasing departments and compliance and/or ethical teams in a company, not only to share knowledge and perspectives, but also to establish the threshold in pricing strategies that allows workers to receive living wages.

  Buyers often tend to fully defer risk to suppliers, putting pressure on timing, workers' arrangements and supplier margins. Poor critical path management by brands or retailers such as late changes to product specification or order size may have major production and cost impact on suppliers, increasing waste or making it difficult to manage shift patters and piece work. Often, suppliers accept prices that are lower than total production costs per unit because of a perceived risk of losing contracts.[29]

  Investors should ask investee companies to disclose their sustainable garment pricing strategies. For examples, questions could include:

  - How have purchasing strategies changed over time and how is the true cost of labour being calculated?
  - Is it based on the national minimum wage or is it truly looking at the relevant living wage benchmarks?
  - Also, is the company calculating Standard Minute Value (the time it takes for a worker to perform a given task), taking into account living wage levels?

  It is essential that garment and textile companies start rewarding suppliers for paying living wages by giving them more business instead of shifting to cheaper sourcing locations.

- **Take advantage of the ability to influence**
  It is no good having all the policies and tools in place when a company sources 1% of the volume from a factory and so has little influence. Therefore, investors can encourage companies by rewarding improving suppliers with more business or consolidating their supply chain. For example, investors can encourage companies through engagement to publish supplier lists, consolidate their supply chains and benchmark salaries to provide for living wages.

- **Ask concrete questions in engagement dialogues**
  Engagement benefits from a focused scope and approach, with clear objectives. Examples of questions that investors can ask include[30]:

  - What is the percentage of production volume from suppliers where a business relationship has existed for at least five years?
  - Does the company conduct human rights due diligence at all new suppliers before placing orders?
  - Are all new suppliers required to sign and return a code of conduct for suppliers before first orders are placed?
  - Is supplier compliance with a code of conduct evaluated in a systemic manner?
  - Do the production planning systems support reasonable working hours?
  - How are root causes of excessive overtime identified and mitigated?
  - How does pricing policy allow for payment of at least the legal minimum wages (and minimum wage) in production countries?
  - How are suppliers monitored in payment of wages to workers and managed if legal minimum wages were failed to be paid?
  - How do companies assess root causes of wages lower than living wages with suppliers and take steps toward the implementation of living wages?

29 https://www.dieh.dk/dyn/Normal/3/23/Normal_Content/file/950/1461571467/ieh_eti_dieh_report_web.pdf

30 Fair Wear Foundation (2017) Brand Performance Check Guide

PROCESS RECOMMENDATIONS FOR ENGAGING COMPANIES

INVESTOR FIELD TRIPS – THE 360º VIEW

Investors argued that field trips outweighs many other tools, as they help them see what actually happens in practice on a day-to-day basis.

STYLE OF ENGAGEMENT – FROM 'NAMING AND SHAMING' TO 'KNOWING AND SHOWING'

As practitioners, investors need to be constructive and focused in their company engagement. A statement outlining investor expectations on particular issues (e.g. working conditions, remedial actions on health and safety following an incident) have been highlighted as a very useful and powerful tool with companies, as it helps provide a clear, succinct and well-thought through scope for discussion.

It was also recommended that investors should use a collaborative and positive tone. They should also consider using diplomatic language and providing solutions to issues instead of just criticisms.

Investors also highlighted the value of talking about performance progress in terms of maturity of reporting, rather than ranking and scoring as companies can feel they are being punished for their honesty, rather than rewarded for it.

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The Principles for Responsible Investment (PRI)

The PRI works with its international network of signatories to put the six Principles for Responsible Investment into practice. Its goals are to understand the investment implications of environmental, social and governance (ESG) issues and to support signatories in integrating these issues into investment and ownership decisions. The PRI acts in the long-term interests of its signatories, of the financial markets and economies in which they operate and ultimately of the environment and society as a whole.

The six Principles for Responsible Investment are a voluntary and aspirational set of investment principles that offer a menu of possible actions for incorporating ESG issues into investment practice. The Principles were developed by investors, for investors. In implementing them, signatories contribute to developing a more sustainable global financial system.

More information: www.unpri.org

PRI Principles for Responsible Investment

The PRI is an investor initiative in partnership with UNEP Finance Initiative and the UN Global Compact.

United Nations Environment Programme Finance Initiative (UNEP FI)

UNEP FI is a unique partnership between the United Nations Environment Programme (UNEP) and the global financial sector. UNEP FI works closely with over 200 financial institutions that are signatories to the UNEP FI Statement on Sustainable Development, and a range of partner organisations, to develop and promote linkages between sustainability and financial performance. Through peer-to-peer networks, research and training, UNEP FI carries out its mission to identify, promote, and realise the adoption of best environmental and sustainability practice at all levels of financial institution operations.

More information: www.unepfi.org

UNEP FINANCE INITIATIVE

United Nations Global Compact

The United Nations Global Compact is a call to companies everywhere to align their operations and strategies with ten universally accepted principles in the areas of human rights, labour, environment and anti-corruption, and to take action in support of UN goals and issues embodied in the Sustainable Development Goals. The UN Global Compact is a leadership platform for the development, implementation and disclosure of responsible corporate practices. Launched in 2000, it is the largest corporate sustainability initiative in the world, with more than 8,800 companies and 4,000 non-business signatories based in over 160 countries, and more than 80 Local Networks.

More information: www.unglobalcompact.org

United Nations Global Compact