

# Process Steps in Sustainable Supply Chain Management



**Practical guidelines for companies**

with a decision matrix

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## Abstract

More and more businesses are focusing their attention on sustainability and their responsibility to promote social, labour and environmental standards. The term “corporate social responsibility” (CSR) has taken on increasing importance since the mid-1990s and now holds a permanent place in business life. Companies today recognise their moral responsibility to comply with the above standards, improve them and curb activities with adverse impacts. For many companies, such thinking has been a matter of course for generations, even if they never used the term corporate social responsibility or its acronym. Responsibility for upholding labour, social and environmental standards is not limited to businesses, their employees and their immediate environment; it also extends to business partners and the supply chain. Moreover, it applies to enterprises of all sizes, from large international corporations to small and medium-sized businesses. All companies must reflect on their responsibility for sustainable supply chain management and consider what steps they must take.

The purpose of this brochure is to provide decision makers in large and small companies, as well as persons responsible for implementing company policy, with a guide to sustainable supply chain management. The topics include identifying risks, setting priorities, establishing monitoring mechanisms and helping suppliers to raise their standards. The brochure is therefore a supplement to other publications offered by econsense relating to sustainability in the supply chain.

## 1 Sustainable supply chain management: a strategic topic for companies?

Sustainability is not a new topic in the business world. All companies, regardless of their business sector or size, must pay attention to it. The reasons are obvious: Whatever a company does, its actions will have an impact on the environment. This includes many positive effects: job creation, innovation and launching of new products or services that further the development of society. In global supply chains involving developing and newly industrialised countries, companies also make positive contributions to economic and social development through purchases of goods. Global supply chains thus have a component that is important to development policy.

On the other hand, business activities can also have negative impact. These are most evident where our natural environment is concerned, but there are also unwelcome effects on labour conditions and social standards. What is important is to be aware of these negative effects and to avoid or minimise them.

Here, both external and internal (or operative) risks need to be taken into account.

### External risks

Campaigns and reports focusing on suppliers with poor working conditions or low environmental standards can be extremely harmful to a company's reputation, especially when social media are involved. More and more companies are therefore demanding that their suppliers, including those in Germany and other European countries, comply with appropriate standards in these areas. Negative headlines can cast an unfavourable light on a company's entire supply chain as well as its worldwide operations. Consumers and consumer associations are increasingly scrutinising the conditions under which products are manufactured, and they view these conditions as a part of product quality. As a consequence, more and more governments are pressuring companies to improve their standards in the scope of their supply chain management. This can lead to new legislation, but it does not necessarily have to.

### Internal (operative) risks

In addition to the external aspects of risk management, there are internal reasons for implementing better social, labour and environmental standards.

First, poor supply chain management can cause interruptions of the supply chain in the event of environmental incidents or disasters (such as a flood or fire in a factory). Interruptions can also occur if a supplier has to suspend or cease production owing to violations of statutory regulations, especially

relating to the environment. Depending on the importance of the supplier and its product, this can result in critical bottlenecks for the purchasing company, with unforeseeable financial impacts.

Second, the improvement of management systems can significantly help to raise standards in the above areas. Such measures clearly also lead to higher-quality products and more efficient production.

Moreover, companies have a moral obligation to society. This includes respecting human rights and conserving our natural resources. No company can deny its responsibility in these areas, and sustainable supply chain management is important for this reason.

Companies that make an effort to improve standards in their supply chains are seen in a positive light not only by customers, employees, the media and political groups, but also by financial analysts and investors. Thus there are abundant reasons to make sustainability a goal of supply chain management.

## 2 Relevance in different business areas

As said at the outset, sustainable supply chain management is strategically important for companies of all sizes. In all companies it is a matter for top management, but implementation can be organised in different ways. Some companies have special departments for CSR or sustainability. Some divide responsibility among several departments, such as purchasing, legal affairs, quality management or communications. The goal must always be to make sustainability a part of everyday business, not an “extra” burden.

The top management must emphasise the company’s commitment to sustainable supply chain management and convey this message to as many different departments and employees as possible. This will ensure that the subject is perceived as important throughout the company and in all of its aspects (strategy, economic efficiency, use of resources).

In large corporations as well as small and medium-sized businesses, sustainable supply chain management is important in many different departments:

- **Branch offices in procurement markets (if applicable)**  
Employees in procurement markets are in direct contact with suppliers and therefore have a key role in identifying and discussing sustainability risks.
- **Purchasing**  
In direct contacts and negotiations with suppliers, sustainability is one of the requirements that suppliers must fulfil in order to be listed.

- **Quality management**  
Sustainability must be perceived as a quality feature.
- **Legal affairs**  
Suppliers must be required by contract to ensure sustainable working conditions.
- **Communications**  
In their internal and external communications, companies must show a clear commitment to sustainability in the supply chain in keeping with the expectations of customers, consumers, financial analysts, investors, employees and job applicants.
- **Sales**  
Customers, including business customers, are increasingly demanding sustainability in the supply chain.

The top management must see to it that employees in these areas are informed about the strategic importance of sustainable supply chain management. Ideally this should be done by spelling out individual sustainability goals and discussing them through in-house training sessions that permit open, critical dialogue. Sustainability goals are best communicated by people in the company who are in direct contact with suppliers because they are most familiar with the technical details. In order to coordinate sustainability management in the supply chain, the management should appoint a person to form a working group made up of representatives from the above departments.

### 3 Regulatory and normative framework for sustainable supply chain management

A clear framework now exists for companies that want to observe sustainable business practices or are required to do so. Many companies have set forth their requirements in the form of codes of conduct, especially when it comes to compliance with social standards. These codes are drawn up either by the companies themselves or by sector initiatives or associations. They are becoming increasingly similar in content and are based on the generally recognised conventions and recommendations of the International Labour Organization (ILO). Other important documents are the Guidelines for Multinational Enterprises of the Organisation for Economic Cooperation and Development (OECD) and the UN Guiding Principles on Business and Human Rights (“Rugby Principles”). These have now become reference points for national initiatives.

In addition, a number of best practices have gained wide acceptance. An example is the 12-hour limit on regular overtime per week. International companies that want to expand their presence in their procurement markets and contribute to social progress, especially in developing countries, now realise that they must not only comply with applicable international and national legal regulations but also observe other standards and generally acknowledged best practices. For example, they establish complaint mechanisms and hold training courses on work safety. The guiding principles of the United Nations draw special attention to the importance of due diligence where human rights are involved.<sup>1</sup> The concept of due diligence goes hand in hand with the time-honoured notion of the honourable businessman – every company has an obligation to recognise and minimise risks. The same idea applies to the supply chain.

Along with international guidelines, national regulations must be observed. Here the problem is not a lack of standards, but insufficient monitoring and weak local structures. In other words, unacceptable working conditions and inadequate compliance with environmental standards are the result of deficiencies in national governance. Moreover, companies in developing countries often do not understand the applicable regulations and are poorly managed. Other problems are unsatisfactory organisation and planning, plus a high degree of corruption. The first important step for companies with international operations in developing and newly industrialised countries is therefore to inform their suppliers when they notice non-conformities or when certain conditions are unacceptable. Here it is important to refer to internationally recognised regulations. These can be applied directly (for example, the Core Labour Standards of the ILO) or implemented

on the basis of national law. Sometimes disagreements will arise. For example, under certain circumstances national law may authorise forced labour, allow children under 15 to work or permit extremely long working hours.

National or cultural differences can play a role when it comes to choosing the best means of implementation. For example, instead of accusing a supplier of failing to comply with workplace and social standards, it is more constructive to explain how to reduce work accidents through an effective social management system or how to cut back on excessive overtime. Direct accusations can make a supplier lose face, which impedes open and constructive communication. To give another example, when providing training in work safety or employee participation in countries with a low level of literacy, it is more effective to use role games or pictures than to distribute copies of legislation.

Sustainable supply chain management should be implemented on the basis of company guidelines that show a solid commitment to sustainable business practices, especially as applied to the supply chain. Such guidelines should clearly refer to international regulations such as the Core Labour Standards of the ILO, relevant UN declarations and other international standards such as the Guiding Principles on Business and Human Rights.

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<sup>1</sup> Fulfilment of due diligence in human rights is also one of the demands of national action plans. Examples are Germany's National Action Plan for Business and Human Rights and France's “Loi sur le devoir de vigilance des multinationales”.

## 4 End-to-end transparency in the supply chain

Achieving full transparency in the supply chain is usually very difficult, especially since supply chains can be very complex depending on the industry, product and location. Not all companies are willing to reveal their suppliers because such information is a business secret and can be used to circumvent a contracting party. Moreover, it is sometimes impossible for a company to identify all of its suppliers, for example when it comes to procurement of raw materials. Nonetheless, having a clear picture of one's direct suppliers is important. This information is essential for an analysis of risks in the supply chain. It may seem trivial, but the task can be big depending on a company's size. If a company has ten suppliers and has worked with them for many years without change, that is one thing. But if a company works with five thousand suppliers and purchases goods through twenty offices in ten different countries, it is a very different matter.

*SMEs: Small and medium-sized enterprises with limited resources and low commercial leverage can find it very difficult to create a transparent supply chain. The first step can be very time-consuming, but it is vitally important for the steps that follow.*

One thing is clear: It is essential to define a number of key parameters at the start of any attempt to create transparency in the supply chain. Only if a company has a thorough knowledge of its business partners can it analyse the risks arising from violations of labour, social and environmental standards. Several different criteria can be applied:

- Certain risks are inherently **product-based**. Some products or product groups carry an increased risk in terms of social, labour and environmental standards. This is the case if chemicals are used in certain production steps or if certain steps are labour-intensive. Consumer goods with a possible emotional appeal deserve special attention in this connection. Toys that children like to put in their mouths are an example. Other examples are food for human consumption and clothing that is worn close to the body. In such cases the production conditions are of critical importance to consumers.
- Other risks can be **location-based**. Here it is important where a product is made or where a service is performed. The reason is that international and national regulations are taken less seriously in countries with poor governance. The country in which a supplier is located is therefore another important criterion in any analysis of sustainability risks.

- The specific **characteristics of the supplier** can also be decisive for a risk assessment. For example, it makes a difference if the supplier is already aware of the important standards and participates in the corresponding auditing and certification systems. Another key question is who owns the supplier and how big the supplier is (turnover and number of employees).

In addition, one must determine whether the supplier is a manufacturer or "merely" an intermediary supplier. In the latter case, for example if an agent, trader or similar entity is involved, the entity must identify its suppliers.

A company's success in achieving transparency depends on the degree of its leverage with suppliers. The difficulties here can be considerable, because in some sectors the suppliers have more influence than the companies that rely on them – the power relationships are not always the same. On the other hand, a company's reasons for demanding transparency can be so compelling that its suppliers may be willing to cooperate and name their business partners.

### 4.1 Assessment of risks in the supply chain

After a company has obtained a clear picture of the supply chain and knows which product comes from which supplier and which country, it must assess the risks. Of course, risks can exist in any production plant, in any country and at any level of development. But as a rule, suppliers have different degrees of relevance to sustainability in the supply chain. Therefore the task is to set priorities. The following criteria should be taken into account:

**Countries** with poorly developed governance are often referred to as "risk countries". No country is free of risks, but social audits have shown that violations of laws and codes of conduct are more frequent and more severe where there is poor governance. The following sources can provide help with risk assessment:

- Corruption Perceptions Index – a description of the levels of corruption in the public sector of different countries, updated annually by Transparency International: <https://www.transparency.org/research/cpi/>
- Human Development Index – an indicator of national prosperity, published annually by the United Nations: <http://hdr.undp.org/en/content/human-development-index-hdi>
- Least Developed Countries – a list of the world's poorest countries, compiled by the United Nations: <http://unohrrls.org/about-lDCs/>



- Worldwide Governance Indicators – an evaluation of 215 countries and territories issued by the World Bank: <http://info.worldbank.org/governance/wgi/#home>
- Certain **business sectors** have higher risks of violations relating to social, labour and environmental standards. – this was already mentioned above in section 4 in connection with product-based risks:
  - Labour-intensive industries: low-wage industries such as textiles, clothing and primary food production – long working hours in certain seasons, high proportion of workers with low literacy
  - Toys and food: emotional factor
- **Production processes** can have elevated risk levels:
  - Use of chemicals – dependent on the product and relevant to many industries
  - Use of production methods with adverse health effects – examples are sandblasting of jeans, application of adhesives in shoe production and cutting of natural stone
  - Handicrafts – examples are piecework in the textile industry and basket weaving. Many products are made by homeworkers, and this increases the risk of excessive working hours and child labour.

#### 4.2 Setting priorities – Where to start?

In view of the many different factors to consider in a risk analysis, the first thing for a company to determine is which suppliers are of **strategic importance**. The greater a company's dependence on a supplier, the more important it is to understand the risks that might arise from the business relationship. An example would be if the most important supplier of raw materials were shut down by the authorities owing to a violation of environmental protection regulations. In this case it would be necessary to find a new supplier. If the new supplier enjoyed a monopoly in its market and was able to demand a much higher price, this could jeopardise the purchasing company's economic future. If a company has worked with a supplier for a considerable amount of time or if the supplier's product is of key importance to a company's manufacturing processes or product range, such a supplier must be given top priority in sustainability management.

Another factor to consider in this connection is the **purchasing volume** generated with a specific supplier, which can be an indication of a company's influence on the supplier. When setting priorities, it is also important to assess the risk of human rights violations and the severity of these violations. One should look at the production methods and the products themselves and ask whether terminating the business relationship would have negative effects on labour and social standards.

## 5 Decision matrix

The elements named in 4.1 should be listed in a decision matrix. These are the production location, business sector and production processes. The list should also include the degree of production automation in the case of Tier 1 and Tier 2 suppliers and the level of turnover with the Tier 1 supplier. Another factor to consider is consumer sensitivity to sustainability issues, for example pertaining to food or toys. It is especially important to determine whether a supplier has a monopoly, in which case the purchasing company would be highly dependent on the supplier and would give it high priority. These various elements could be weighted by means of coefficients. The more points assigned to a supplier, the greater its importance in the sustainability process.

The task is therefore to use a variety of parameters for risk assessment in order to decide whether or not, and when, to monitor certain suppliers for compliance with labour, social and environmental standards. An example of such a decision matrix is shown on the following page. When there is a large number of suppliers, it is best to select only a few at first and evaluate this core group using the matrix.

The coefficients for the different scenarios can of course vary depending on individual assessments and priority decisions. Special attention should be paid to the level of risk for third parties. When this risk is large, a greater weight should be assigned to it. The total score for a supplier is determined by adding all the coefficients. The higher the total, the greater the potential risk.

In this section we have discussed the risk factors that are generally important for an analysis of the supply chain and how they should be rated when setting priorities. In the next section we will examine some specific applications of this analysis and the weightings it includes. A distinction will be made between Tier 1 suppliers and the deeper supply chain, which comprises Tier N suppliers.

# Decision matrix

Name of supplier

Location	Strategic supplier	Purchasing volume			Status: sum of the coefficients
		<5%	5-10%	>10%	
OECD	2	0	1	2	
Non-OECD	3	1	2	3	
Least developed country	6	2	4	6	10

## Business sector and production process

### For Tier 1 supplier

High degree of automation (e.g. automotive or ICT sector)	1	2	3	4	
Medium degree of automation	2	3	4	5	
Low degree of automation (e.g. textiles)	3	4	5	6	8

### For Tier 2 supplier

Predominantly high degree of automation	1	2	3	4	
Predominantly medium degree of automation	2	3	4	5	
Predominantly low degree of automation	3	4	5	6	

### Optional:

High degree of customer sensitivity (e.g. food, toys)	1	2	3	4	4
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## Turnover

### For Tier 1 suppliers

(Adjust values where necessary)

< 100 million euros	1	2	3	4	
100 million – 1 billion euros	2	3	4	5	6
> 1 billion euros	3	4	5	6	

**Grand total of coefficients:**

28



## 6 Ensuring standards for Tier 1 suppliers

A company must also set priorities and take a systematic approach when improving labour, social and environmental standards. The process goes in steps, starting at the top of the supply chain and working down. Even if the company sees many severe violations of its code of conduct at lower levels of the global supply chain, it must start with its Tier 1 supplier, which is its direct business partner.

### 6.1 Contractual commitment of the Tier 1 supplier

Direct business partners are also contracting parties. The code of conduct should therefore be made part of these contracts, for example in the terms of delivery for certain goods. When a company incorporates its rules for compliance with labour, social and environmental standards in a contract, the supplier must commit itself to observing them. If the code of conduct is not included, it will not be legally binding. International conventions covering labour, social and environmental standards are not binding on companies, only on countries. Moreover, it is not enough for a supplier just to recognise a code of conduct, it must agree through a contract to implement them.

The purchasing company can verify implementation in various ways:

- It can carry out plant inspections on the supplier's premises. Such inspections can be made part of quality management audits (see 6.2.2 Quick check).
- Auditing models and development models (especially social audits) provide another means of verifying compliance with social and environmental standards. These audits can be carried out by accredited, independent inspection institutes or by the company's own auditors (see 6.2.4). The development approach evaluates the supplier's status quo. If deficiencies in performance are found, the supplier is usually required to make improvements by establishing training measures and by submitting to monitoring.
- Compliance with labour, social and environmental standards can be demonstrated by means of certification. Certification always requires prior auditing by an accredited, independent institute.

### 6.2 Monitoring and inspection

As soon as a company has achieved transparency in its supply chain – at least for its Tier 1 suppliers – it must determine whether and to what extent these suppliers are complying with labour, social and environmental standards. This is where the monitoring process comes in. It involves looking at

the situation in the production facilities, identifying risks and talking objectively with the supplier about risks, their causes and ways to make improvements.

An important first step for the purchasing company is to inform the supplier of its intention to improve the labour, social and environmental standards in its supply chain. The company should not only demand that the supplier sign its code of conduct, it should also say clearly how it will support the supplier in this process. Already in this phase it should answer the following questions:

- Would low performance in social or environmental matters have consequences for the business relationship?
- Will the company support the supplier in its efforts to prevent violations of the code of conduct, and if so, by what means?
- Will good performance be rewarded, for example through contracts with a longer term or through bigger purchase volumes?

Every company must answer these questions for itself and establish corresponding guidelines. The guidelines must be made known throughout the company and implemented in a consistent manner. If a purchasing company were to send mixed messages to its suppliers, it would throw doubt upon its commitment to sustainability.

#### 6.2.1 Self-assessment

At the start, it is wise to give a supplier an opportunity to evaluate its own performance. The supplier can then acquaint itself with the subject matter and gather its own information. Possibly it will discover on its own that it has certain deficits relating to labour, social and environmental standards. The reason may be that it lacks of a code of conduct, has no process for documenting work accidents or has failed to obtain official permits. Self-assessment is thus part of the learning process for a supplier, and it is a way for it to become actively involved in sustainability management. A completed self-assessment form also gives the purchasing company an initial picture of the supplier's situation. However, this will not be a neutral inspection, so there may be deficiencies in the self-assessment form or its results. It is nevertheless a valuable first step. The purchasing company's supply chain management officer, possibly assisted by the working group described in section 2, will then have to evaluate the self-assessment and decide what steps to take next. The working group should develop guidelines for the evaluation of self-assessments. These guidelines should also specify how to deal with suppliers that are uncooperative and perhaps even fail to submit the required forms. The guidelines must be valid for the entire company and communicated to all departments. It is also important for employees to have access to self-assessment data through a database.

### Online/offline questionnaires

There are different ways to submit self-assessments. Some sustainability management systems provide online questionnaires. Others allow questions to be answered offline. In any case it is important to set a clear deadline for submitting a completed self-assessment questionnaire. Four weeks ought to be sufficient.

### Content of a self-assessment

The main purpose of a self-assessment is to gain an initial picture of a supplier and give the supplier a chance to give its own thought to these matters. Ideally, a self-assessment should contain the following basic information:

#### General information about the production location

(size, employees, production units, capacity, etc.) helps to create an awareness of topics like working hours and wage levels. Such information is also helpful for estimating a supplier's capabilities, such as its ability to make deliveries on time. It also can show whether the supplier has to rely on subcontractors owing to a lack of capacity in some areas – in such cases the purchasing company should request information about the subcontractors so that it can identify and minimise the associated risks.

By asking whether the supplier has a **sustainability officer, a work safety officer or an environmental safety officer** is an indication for established appropriate management systems.

If the **supplier participates in systems** for auditing or certification according to labour, social and environmental standards (see also 6.2.3, Evidence-based assessments), and in particular if the supplier has a code of conduct, this shows that such questions are not new and that the supplier has already done some work in these areas.

**Existing certifications**, such as ISO 9001, ISO 14001, OHSAS and SA8000, are a good sign that the supplier has concerned itself with labour, social and environmental standards. Such evidence is very important because management systems are essential for implementing and improving compliance. If certifications of this kind do not exist, it is important to find out whether at least some basic management systems are in place. Has the supplier assigned responsibility for certain tasks? Are workflows documented? Are records made of incidents (such as work accidents) in production facilities?

**Previous audit reports** on compliance with labour, social and environmental standards show how the supplier's performance has developed over the past months and years. The comparability of the systems used for these audits is of secondary importance. What matters is whether the supplier has shown progress in these areas.

**Transparent information on subsuppliers** reveals the extent to which the supplier is aware of its own supply chain and has its own risk management system. Here compliance with standards is not the only question. What is important is the general way in which the supplier works with its suppliers on which the former in turn is dependent.

### 6.2.2 Quick check

A quick check in the form of a questionnaire can show various representatives of the purchasing company whether the supplier is complying with the relevant sustainability requirements. The aim is to call attention to noticeable shortcomings, pass this information on to the company and, if necessary, activate the supplier in additional steps of sustainable supply chain management. A quick check is only a visual inspection to confirm compliance in areas such as safety, occupational health and environmental protection. As a rule, it comprises no more than 20 questions, all of which can be answered without querying the supplier in detail. This makes it suitable for company representatives from areas such as purchasing, quality management and product management, even if they have not been thoroughly trained in matters related to sustainability.

### 6.2.3 Evidence-based assessments

An evidence-based assessment is a risk analysis that is based on the supplier's self-assessment, an inspection of documents and information about the supplier from external sources. The focus is on the supplier's management system for sustainability issues. Professional service providers in the market offer various evidence-based assessment solutions, each with different areas of emphasis and solutions. To list only a few: Achilles, BSCI, CDP Supply Chain Program, Ecodesk, EcoVadis, EICC, E-TASC, Fair Factories Clearinghouse, GOTS, Intertek GSM, Made In A Free World, NQC, PSCI, Sedex, Supplyshift, Together for Sustainability and Verisk Maplecroft. Additional information is offered by the econsense discussion paper, "Ansätze für Lieferantenabfrage und -management – Exemplarische Darstellung web-basierter Lösungen" (2014) (available in German only).

#### 6.2.4 Local audits

The next step is to determine by means of a more thorough inspection whether or not the supplier is complying with labour, social and environmental standards. One should bear in mind that audits are snapshots and are not a guarantee of conditions over a long period. Although they are an important and useful measuring instruments, they should not be overrated.

An audit generally begins with a talk between the auditor or auditing team and the supplier's management. If there are employee representatives, they usually participate as well. The auditor also holds talks with selected employees without the management being present. Then there is a plant inspection with the main purpose of checking conditions as related to labour, social and environmental standards. The auditor will also examine documents provided by the supplier pertaining to wage payments, working hours and procedures. Other documents of interest concern relevant laws, regulations and official permits. The auditor will compare the information from these different sources to determine its consistency (so-called triangulation). At the end, the auditor will again hold a talk with the supplier management to summarise the positive and negative findings. Audits can be internal or external, but the two types are not mutually exclusive. They can also complement one another.

##### Internal audits

- In internal audits, employees of the purchasing company carry out an inspection on the supplier's premises. These auditors should pay regular visits to the supplier and ideally provide assistance in implementing labour, social and environmental standards. In this constellation internal auditors are like coaches.
- The internal auditors should regularly share information about their work and the results of their audits. An internal auditor network has the advantage that it can collect specialist knowledge and pass it among the group. In this way the auditors can agree on their methods and apply the same methods with all suppliers. A uniform approach helps to produce comparable audit results.
- If a company uses external audits at the same time, internal audits can be very useful as a supplement in the intervals between external audits. They can also help to train the supplier.

*For SMEs: If a small or medium-sized enterprise has branch offices in a supplier's country, sporadic internal audits are a good idea. If no such branch offices exist, the company can carry out internal audits when its representatives pay a visit to the supplier. External audits (see below) must be used if suitable resources are not available.*

##### External audits

- As an alternative to an internal audit, an independent third party can be commissioned to check on compliance with labour, social and environmental standards. Such external audits have greater credibility with critics in the media and with other stakeholders. However, this does not mean that internal audits cannot be equal in quality.
- External auditors generally check for full compliance with the code of conduct and its rules pertaining to labour, social and environmental standards unless they have been given a limited task. Limitation can be appropriate if the aim is to concentrate on a few key issues, such as prohibition of child labour, forced labour or discrimination, or if health and safety are in the foreground. The focus can also be limited to labour and social standards if the company so decides.
- The duration of an audit must also be specified, one reason being that the costs are typically calculated in man-days. Enough time should be allocated to permit a comprehensive investigation of the supplier and a meaningful audit report. The time required for a social audit can range from one 8-hour day to as many as five days depending on the number of employees in the company being audited and the applicable audit guidelines.<sup>2</sup> Similar periods apply to environmental audits. The audit duration should not include the auditor's travel times, but these can be considerable depending on the supplier's location.
- Before commissioning an institution to do an audit, the purchasing company should contact several such providers and solicit quotations to enable a comparison. When choosing, the company should make sure that the auditing institution provides a competent contact. This is especially important for resolving questions that may arise after the audit.
- The quality of an audit is of decisive importance. One must therefore make sure that the auditors have the necessary qualifications. The following parameters should be given special attention when soliciting quotations:
  - Professional auditing experience: labour, social and environmental standards; occupational health and safety; quality inspection
  - Professional experience in the business sector
  - A knowledge of international and national laws and regulations, especially in labour law and environmental law
  - Mastery of the local language
  - Participation in training courses and continuing professional development

<sup>2</sup> The details are usually stipulated in the instructions for auditors. These instructions establish different systems for verifying compliance with labour, social and environmental standards.

- In some cases there will be no auditors in the country where the supplier is based. Examples are countries with very few production facilities and very little demand for audits. In such cases auditors must be obtained from other countries. This in itself does not diminish the quality of an audit, but special care must be taken to ensure that the audit is not hampered by ethnic or language barriers.
- Besides expertise, an important criterion for auditors is their behaviour. For example, auditors must be trained to deal with different discussion situations. When analysing and evaluating social, labour and environmental standards they must be impartial and independent. Moreover, they must disclose to the company all notes taken in connection with the audit and hold all documents in safe keeping.

### 6.3 Possible measures arising from internal and external audits

#### 6.3.1 Scoring: internal evaluation of the audit report

After an audit, the first step is to evaluate the audit reports. Audit results are recorded as scores to provide orientation. Depending on the degree of nonconformity with the requirements in its code of conduct, a company must set priorities and decide which supplier needs which kind of training and for how long.

#### 6.3.2 Drawing up corrective action plans with suppliers

Suppliers must not be left alone after an audit. They must be actively involved in follow-up processes so that they assume responsibility and take an interest in further steps. Most importantly, they must understand the ways in which they fail to conform with standards and where the causes of these violations lie. Improvement will be possible only if these facts can be communicated to them. This must be achieved through a discussion of the audit results between the purchasing company and the supplier. On this basis they must create a corrective action plan.

The corrective measures should first focus on areas immediately relevant to employee health, in other words occupational health and safety. Cases of child labour naturally have absolute priority.

#### 6.3.3 Commissioning of another audit if necessary

A clear deadline should be set for implementing corrective action plans. The usual period is two to six months, sometimes up to 12 months. After this time another audit (re-audit or follow-up audit) is held in order to see what measures have been put into practice.

#### 6.3.4 Capacity development

Although considerable attention is paid to auditing, it is not the only important means of implementing and improving labour, social and environmental standards. In the final analysis, suppliers must learn to think in new ways and make an effort to put codes of conduct into practice. Motivation is therefore important, and it can be boosted by means of economic incentives. But knowledge transfer is another major factor. Even highly motivated suppliers often need to learn more about efficient management processes, organisation, pricing, delegation of tasks and legal and technical requirements. This process is called capacity development or capacity building.

Some specific kinds of knowledge:

- introduction and optimisation of management systems,
- compliance with laws and regulations,
- dialog between management and employees,
- safety at the workplace,
- avoidance of excessive working hours and
- payment (at least) of the legal minimum wage.

Such important information must be communicated to the management through training and continued professional development. One solution is to provide training to several suppliers through joint measures, in this way reaching a number of managers and relevant company representatives at once. The advantage of this approach is that the participants can compare notes and are more highly motivated in a group setting. Training sessions for single suppliers remain important, however. They make it easier to address a supplier's individual situation and deal with its special challenges.

These training courses must be conducted in the local language by qualified experts for better cultural acceptance, credibility and communication.

*For SMEs: To make the best use of limited resources, training should focus on groups comprising a number of suppliers. Although coaching of individual suppliers is always worthwhile, small and medium-sized companies are not always able to provide it.*

#### 6.3.5 Cooperation with stakeholders

Suppliers that want to improve their compliance with labour, social and environmental standards can also take advantage of help from non-government organisations. Many suppliers are not familiar with this kind of cooperation, but they will find that it opens up new perspectives and additional access to expert knowledge. For example, to develop management strategies against child labour, a supplier can get in touch

with local children's rights organisations or local branches of international organisations (such as UNICEF or Save the Children).

Companies that want to build a sustainable supply chain should also look into support from non-government organisations. This can be helpful when analysing risks in preparation for measures such as social audits of a supplier.

## 7 Management of subsuppliers (Tier-N)

Sustainable supply chain management does not stop with Tier 1 suppliers. To establish credibility with critical observers, it is not enough for a company to limit its efforts in this area to direct business partners. If, for example, a Tier 3 supplier is found to be using child labour or is illegally discharging chemicals into a river, the purchasing company must be able to take a position. In the eyes of the public, the absence of a contractual relationship with this Tier 3 supplier is not an excuse for inaction, even if there is no legal obligation to have such a contract. Although a purchasing company rarely is able to apply economic pressure to a Tier 3 supplier with which it has no contract, experience has shown that many violations occur precisely in upstream stages of the supply chain. Companies must therefore make every possible effort to ensure that these upstream suppliers also have sustainable practices. Numerous initiatives have therefore taken up this issue. An example is the cascade effect of the Business Social Compliance Initiative (BSCI). It commits Tier 1 suppliers to make companies in the next step of the supply chain, that is their Tier 2 suppliers, aware of the code of conduct and demand that they achieve transparency concerning their respective suppliers.

So what can be done to explain labour, social and environmental standards to a subsupplier and achieve compliance? When analysing its supply chain, a company should also record its subsuppliers, ideally along with information on their production activities and locations. In this way, information on Tier N suppliers can be fed right into the risk analysis. Like the Tier 1 suppliers, Tier N suppliers should receive the code of conduct and be made aware of labour, social and environmental standards by means of appropriate information material. In order to reduce risks, Tier N suppliers can and must carry out self-assessments or be inspected, audited and trained by external parties.

Another important question is who should negotiate with Tier N suppliers. One possibility is direct control by the purchasing company. Involvement of the Tier 1 supplier in this communication is essential, because it has a contractual relationship at least with the Tier 2 suppliers. Alternatively, the Tier 1 supplier can take full control of this task. In this way, responsibility for compliance with labour, social and environmental standards can be extended from one step of the supply chain down to the next. Such an approach is logical in view of the contractual relationships involved. In reality, however, this „cascading“ represents a big challenge and cannot be implemented universally. Owing to their limited turnover volume, purchasing companies do not always have sufficient leverage with their business partners to achieve transparency about their subsuppliers. The task is easier if a number of purchasing companies join forces to present their requirements. Participation in sector initiatives is one useful approach.

*Sector initiatives are of particular interest for small and medium-sized companies because they are complete systems and open the way for communication with other companies, leading to synergy effects.*

## 8 Sector initiatives for sustainable supply chain management

Individual companies often do not have enough economic influence to motivate their supply chain when it comes to improving sustainability. However, by working with other companies they can make progress. In the last 15 years a number of sector initiatives and external cross-industry systems have arisen in which companies combine forces to raise the efficiency of sustainability measures and cut the associated costs. Typical activities include establishing uniform standards, applying uniform instruments, sharing audits, carrying out joint training measures and adopting a common stance in public affairs. Due to overlapping of supply chains, these initiatives can take advantage of synergies that are unavailable to single companies.

### Overview of current initiatives (selection):

#### Automotive

DRIVE Sustainability – The Automotive Partnership  
<http://www.csreurope.org/european-automotive-working-group-supply-chain-sustainability-1>

#### Chemistry

Responsible Care (RC)  
<https://www.vci.de/nachhaltigkeit/responsible-care/uebersichtsseite.jsp>  
Together for Sustainability (TfS)  
<http://tfs-initiative.com>

#### Railways

Railsponsible  
<http://railsponsible.org>

#### Electronics

Electronic Industry Citizenship Coalition (EICC)  
<http://www.eiccoalition.org>  
Global e-sustainability Initiative (GeSi)  
<http://gesi.org>  
Joint Audit Cooperation (JAC)  
<http://jac-initiative.com>

#### Trade

Business Social Compliance Initiative (BSCI)  
<http://www.bsci-intl.org>  
Business Environmental Performance Initiative (BEPI)  
<http://www.bepi-intl.org>  
Ethical Trade Initiative (ETI)  
<http://www.ethicaltrade.org>

#### Coal

Bettercoal  
<http://bettercoal.org>

#### Pharmaceuticals

Pharmaceutical Supply Chain Initiative (PSCI)  
<https://pscinitiative.org/home>

#### Textiles

Global Organic Textile Standard (GOTS)  
<http://www.global-standard.org>  
Fair Wear Foundation (FWF)  
<https://www.fairwear.org>



## 9 Organisational framework for processes

Sustainability in the supply chain affects the work of the entire company. In section 2 was discussed which departments should be involved in these processes. But another key question is where to carry out the monitoring and inspection steps described in 6.2. The code of conduct can always be included in the general terms of business or purchase, making it a part of all contracts later concluded with suppliers. But there are additional details to consider in relationships with suppliers:

- When **selecting new suppliers**, the company must clearly state what its expectations: implementation of social, labour and environmental standards, credible efforts to make continuous improvements, and regular transmission of these requirements to sub-suppliers. For this reason it is wise to require new suppliers to sign the code of conduct and fill in a self-assessment form before including them in the supplier pool. In any case, this should be done before placement of orders.
- **Suppliers in the existing pool** should receive the code of conduct so that they are aware of the company's basic expectations. They should also complete a self-assessment.
- **Strategically important suppliers** in the pool should additionally be audited. They should receive training depending on the results.
- Once the basic decision has been taken to place an order with a supplier, the code of conduct should be presented for signing **before the order is placed** and a self-assessment should be completed. In addition, an audit should be performed unless this was done very recently. The company can then consider whether to link placement of the order with the audit results, although this is not absolutely necessary.
- **Low performance on the part of the supplier** in terms of compliance with labour, social and environmental standards should result in training measures, but not delisting. However, if training does not bring about a measurable improvement, the supplier's willingness to improve may become doubtful. Termination of the business relationship is always an option, but this should be the last resort.

As already mentioned, **audits** are not a means of raising labour, social and environmental standards, they are a **measuring instrument**. Audits are important because they provide an objective evaluation of a supplier's current situation and can serve as the basis for detailed discussions and improvement measures. They should not be regarded as the conclusion of the improvement process but as the start.

**Open and constructive dialog** on sustainability between the company and its suppliers is essential for improving compliance with labour, social and environmental standards. The more thorough this discussion and the better the two sides get to know each other, the more willing suppliers will be to change their conduct and their business processes.



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## Conclusions

The instruments and approaches described here can help a company to analyse and improve compliance with labour, social and environmental standards in its supply chain. When there are longstanding business relationships with suppliers or large turnover volumes, the suppliers will be more motivated to become involved. However, there is no way to guarantee that suppliers will provide decent working conditions, obey all the laws and adopt environmentally sound production practices.

Companies can handle these difficult issues by adopting a systematic strategy for implementing better labour, social and environmental standards. Their actions will always be associated with opportunities and risks. What matters is how they deal with these risks. For certain challenges, additional government measures (especially in the procurement countries) are the only answer, and social developments are significant factors. For these reasons it is important for companies to join forces and work with associations, government authorities and non-government organisations instead of tackling these problems alone.

Sustainable supply chain management is a process that can only succeed if purchasing companies and suppliers work together as partners. This requires persistence and a graduated approach that focuses on identifying and visualising the supply chain as well as analysing existing and possible risks. These risks can then be reduced through joint efforts. The aim should not be to treat sustainability in the supply chain as an “additional” task but to appreciate it as part of everyday business. This process is a voyage of discovery for the companies concerned, and every company that cares about its future in the 21st century should take part in it.

## Glossary

### **Audit**

A methodical study or inspection of a system or situation for the purpose of gathering evidence. Audits must be objective, impartial and independent. The auditing process must be systematic and it must be documented.

### **Corrective action plan**

A plan containing measures to remedy violations within a certain amount of time. Corrective action plans are generally drawn up by the auditor.

### **Core Labour Standards of the International Labour Organization (ILO)**

The administrative body of the International Labour Organization adopted eight core conventions on fundamental principles and rights at work. They include freedom of association, the right to collective bargaining, the abolition of forced labour in all its forms, the abolition of child labour and the elimination of discrimination in employment and occupations. These principles are also listed in the ILO Declaration on Fundamental Principles and Rights at Work (1998).

### **Due diligence**

A process through which a company must identify, prevent and mitigate its negative impact on human rights. It also includes determining how the company will deal with human rights issues. The process must cover the negative effects arising from or exacerbated by the company's own actions as well as the negative effects directly linked to its operative business, products or services.

### **Guidelines for Multinational Enterprises of the Organisation for Economic Cooperation and Development (OECD)**

The OECD Guidelines for Multinational Enterprises are a code of conduct for companies with international operations and comprise government recommendations. The ten sections cover topics such as disclosure, employment, environment, bribery, consumer interests, technology, competition and taxation.

### **Monitoring**

The systematic measurement and analysis of a company's performance (here relating to labour, social and environmental standards) in order to identify risks and violations. Monitoring also provides the basis for decisions on improvements.

### **Self-assessment**

The process through which a company plans, organises, executes and evaluates its actions and judges its level of performance. It involves recording data using a self-assessment questionnaire that is provided to the company. The resulting documents cannot be equated with an inspection by an independent third party.

### **Stakeholder**

An individual, community or organisation that is affected in some way by a company's products, workflows, markets, business sectors and earnings and may also be able to influence them. Stakeholders can be internal (such as employees) or external (such as customers, suppliers, stockholders, unions, non-government organisations, media, the government or the local community).

### **Tier 1 supplier**

A company's direct partner to a contract. As a rule, the company purchases finished products from this supplier for further processing, enhancement or sale. Accordingly, the suppliers of the contract partner are called Tier 2 suppliers. The chain continues down to the producer of raw materials.

### **UN Guiding Principles on Business and Human Rights ("Ruggie Principles")**

These principles were adopted by the United Nations Human Rights Council in 2011. They are a global instrument for preventing the risk of adverse impacts on human rights linked to business activity. Based on existing human rights commitments, they elaborate 31 fundamental duties and responsibilities relating to human rights. The recommendations are addressed to both governments and business entities. This document is regarded as one of the most important international standards for corporate responsibility in the area of human rights.

# Decision matrix

Name of supplier

Location	Strategic supplier	Purchasing volume			Status: sum of the coefficients
		<5%	5-10%	>10%	
OECD	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="text"/>
Non-OECD	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="text"/>
Least developed country	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="text"/>

**Business sector and production process**

**For Tier 1 supplier**

High degree of automation ( e.g. automotive or ICT sector)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="text"/>
Medium degree of automation	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="text"/>
Low degree of automation (e.g. textiles)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="text"/>

**For Tier 2 supplier**

Predominantly high degree of automation	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="text"/>
Predominantly medium degree of automation	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="text"/>
Predominantly low degree of automation	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="text"/>

**Optional:**

High degree of customer sensitivity (e.g. food, toys)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="text"/>
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**Turnover**

**For Tier 1 suppliers**

(Adjust values where necessary)

< 100 million euros	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="text"/>
100 million – 1 billion euros	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="text"/>
> 1 billion euros	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="text"/>

**Grand total of coefficients:**