

# Can a picture say more than a thousand words?

Examining the effectiveness of social compliance auditing

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## **0. Summary**

Audits are a picture in time, a snapshot of a company's performance. An auditor visits a supplier factory, and in one day (sometimes over multiple days) makes an assessment on that company's operations, based upon which he or she writes an audit report. Although an audit is known to be merely a snapshot of a supplier's operations, much is derived from such reports, including the determination to continue working with specific suppliers. This paper challenges the notion that an audit report can be a fulfilling statement about a suppliers' social performance, investigating why companies perform audits and to what effect these audits determine the social performance of suppliers.

Although companies are required to perform Human Rights Due Diligence, social auditing is in most cases seen as a risk mitigation strategy. Even so, social audits in their current form do not seem to allow companies to manage risks properly. This paper argues that in many cases, social audits are not part of an integrated approach towards suppliers, there are no long-term goals that are monitored and evaluated, and audits do not allow for an open dialogue with suppliers.

Social audits as a tool risk being ineffective, due to of inherent flaws in the audit approach as well as a systematic overlooking of businesses' own behaviour in interactions with suppliers. An audit report is just a snapshot of their suppliers' performance, when underneath the surface is a more complex operation that is influenced by many factors. Some of these cannot be influenced directly, including systemic challenges beyond the control of suppliers or buyers.

A factor that can be influenced directly and has a large impact on workers' rights at supplier level, is the business practices of the buyer (brand). Improved practices may include implementing a trust-based relationship with suppliers and integrating Human Rights Due Diligence into the overall business practices of a company. As long as companies do not understand nor use their influence to better operations and working conditions on supplier level, social audits will merely remain a tick-box exercise which does not lead to improvement in business practices nor to effective risk management.

## **1. Introduction**

The instrument of an audit – one to determine the performance of a supplier in terms of social or labour issues in their company – has become an end goal in itself. This idea became increasingly apparent to me after working with and for audit standards, collecting and using data on social audits to determine supplier performance, explaining the importance of audits to clients and recommending approaches to improve certification. It seemed that to many of my clients, an audit report was in and of itself a proof of their suppliers' performance on social (or environmental) issues.

It is exactly this perception that this paper intends to challenge. Does a social audit report indeed make a statement about the compliance level of your supplier, related to e.g. a Code of Conduct? And if it does not, what can you do as a brand or retailer to judge the actual state of labour rights at the factory you source from – or better yet, positively influence these rights?

To answer these questions, we will first need to make a root cause analysis, in other words: what the actual problem that social audits are trying to solve? And does the countermeasure of choice – an audit – solve this problem?

Coming to the root cause of an issue, and subsequently keep on challenging the countermeasures (solutions) you have come up with, are key elements to the principles of Lean.<sup>1</sup> In a lean approach, you first come to the root cause of a problem (which is a more difficult exercise than one would expect).<sup>2</sup> After figuring out what the problem is, you determine different scenarios to solve the problem, leading to a plan of action. Then, the cycle of plan, do, check, act (PDCA) starts, in which you continuously challenge yourself and your team to verify if your actions are in fact effectively contributing to solving the problem you have identified.<sup>3</sup>

For the purpose of this research, it was therefore necessary to be clear about the reason why companies are performing social compliance audits. What issue or root cause do audits try to solve? As explained by Karen Maas, in order to measure impact, companies need to clearly determine *why* they want to achieve a certain impact. Secondly, they should continuously measure results.<sup>4</sup>

Hence, this paper is investigating the following research question:

**To what extent do social audits contribute to the elimination of social risks in supply chains?**

This research question will be answered through the following sub-questions:

- What is the problem that social audits are trying to solve (i.e., what are the reasons to conduct social supplier audits)?
- Are social audits indeed solving this problem?
- What are the reasons social audits are (not) effective?

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<sup>1</sup> Washington State Government, *An Introduction to Lean Thinking*, accessed June 2, 2018, [https://www.youtube.com/watch?v=RxDw0Q\\_gVt0&feature=youtu.be](https://www.youtube.com/watch?v=RxDw0Q_gVt0&feature=youtu.be).

<sup>2</sup> John Shook, *Managing to Learn: Using the A3 Management Process to Solve Problems, Gain Agreement, Mentor and Lead* (Lean Enterprise Institute, 2008).

<sup>3</sup> Freddy Ballé and Michael Ballé, *The Gold Mine: A Novel of Lean Turnaround* (Cambridge, Massachusetts: Lean Enterprises Institute, 2005).

<sup>4</sup> Karen Maas, “Tussentijds bijsturen,” *P+*, Impact, no. November + December 2013 (December 2013): 41–42.

Before diving into the contents, however, the scope of this research should be clearly defined. Social audits, as used in this paper, refer to “independent<sup>5</sup> reviews and examinations of records and activities in order to test the adequacy and effectiveness of procedures, to ensure compliance with established policy and implementation, and to recommend any necessary changes”, as defined by the *Institut für Organisationskommunikation* on behalf of the European Parliament.<sup>6,7</sup>

It should be specified that the audits that will be examined in this paper are specifically focused on supplier performance on social issues such as wages, overtime, child labour, harassment at the workplace and others. The definition for this paper therefore includes both third party audits done to assess compliance with standards such as WRAP,<sup>8</sup> BSCI (amfori),<sup>9</sup> SA8000,<sup>10</sup> industry associations SEDEX<sup>11</sup> and RBA (Responsible Business Alliance)<sup>12</sup> as well as social audits performed by brands themselves to assess their suppliers.

As social audits are based on universal and inalienable human rights<sup>13</sup> and internationally acknowledged labour standards such as the ILO,<sup>14</sup> they comprise requirements that are, indeed, applicable to all human beings and all workers<sup>15</sup>. It has therefore been a deliberate choice not to focus this research on only one sector or industry, but instead to

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<sup>5</sup> As this paper will try to demonstrate, the term ‘independent’ is in practice quite a flexible term as actors in the field of social auditing tend to have contradicting views and interests.

<sup>6</sup> Helmut Werner et al., “Environmental and Social Audit” (Bensheim (Germany): Institut für Organisationskommunikation, on behalf of the European Parliament, Committee on Budgetary Control, April 14, 2004), [http://www.europarl.europa.eu/meetdocs/committees/cont/20040419/EnvSoc\\_en.pdf](http://www.europarl.europa.eu/meetdocs/committees/cont/20040419/EnvSoc_en.pdf).

<sup>7</sup> Neither the renowned standard-setting organization The International Organization for Standardization (ISO) nor the auditing experts at the International Federation of Accountants (IFAC) specified a definition of social compliance or social auditing on their websites.

<sup>8</sup> “WRAP Certification Worldwide Responsible Accredited Production Certification WRAP Platinum Gold Silver Certificate,” accessed June 29, 2018, <http://www.wrapcompliance.org/certification>.

<sup>9</sup> “Amfori,” accessed June 29, 2018, <http://www.amfori.org/content/bsci-code-conduct>.

<sup>10</sup> “Social Accountability International | SA8000® Standard,” accessed June 29, 2018, <http://www.sa-intl.org/index.cfm?fuseaction=Page.ViewPage&PageID=1689>.

<sup>11</sup> “Sedex | Empowering Ethical Supply Chains,” Sedex, accessed June 29, 2018, <https://www.sedexglobal.com/>.

<sup>12</sup> “Responsible Business Alliance Formerly the Electronic Industry Citizenship Coalition,” accessed June 29, 2018, <http://www.responsiblebusiness.org/>.

<sup>13</sup> “Universal Declaration of Human Rights,” Official website, United Nations, October 6, 2015, <http://www.un.org/en/universal-declaration-human-rights/>.

<sup>14</sup> International Labour Organization, “Labour Standards,” ILO Official Website, accessed June 16, 2018, <http://www.ilo.org/global/standards/lang-en/index.htm>.

<sup>15</sup> United Nations, “Guiding Principles on Business and Human Rights” (Geneva and New York: United Nations Human Rights Office of the High Commissioner, 2011).

review how social issues are addressed by companies, NGOs, auditors and other players in general. Although concrete social risks may differ per country and per sector, the norms have been determined on an international level and are not sector-dependent.

## 2. Research method

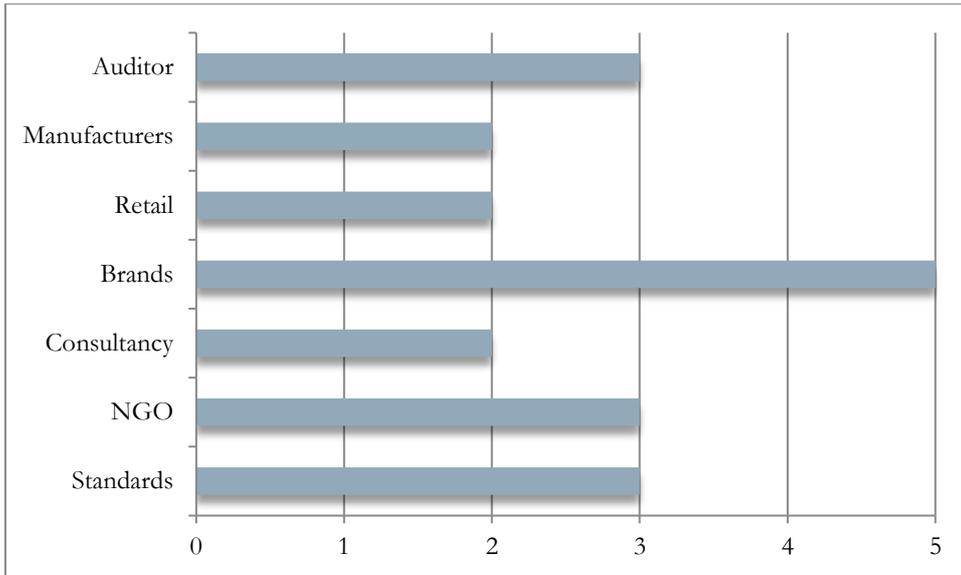
The research method used for this paper can be described as a normative perspective.

**Normative perspective** is an approach in which a current situation is being reviewed and judged by the researcher, and includes a recommendation of how the situation should be improved.

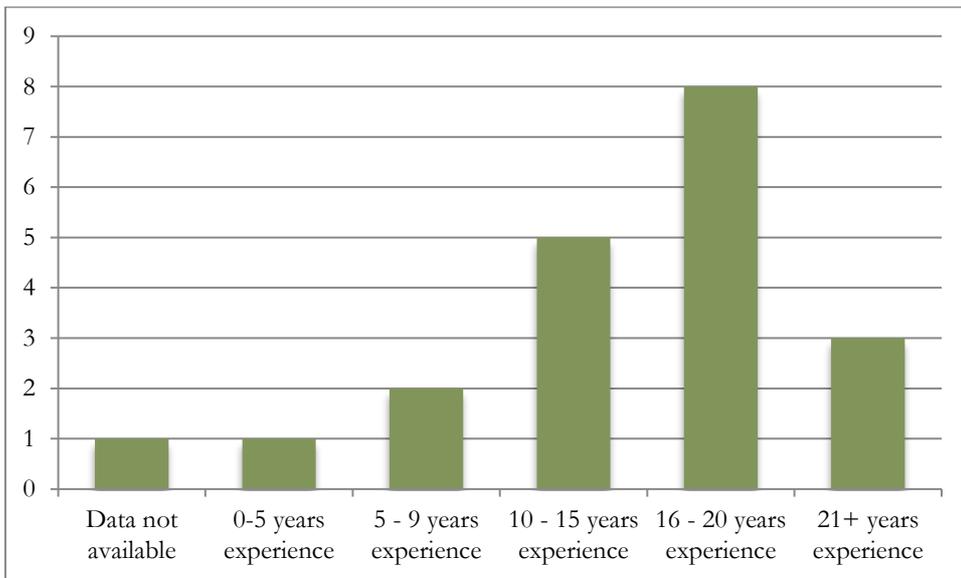
In practice, this meant that the research consisted of the review of current social audit practices through reading several studies, books and articles, conducting interviews with experts in the field, reviewing the information in a critical way and concluding with recommendations for improvement. This paper is a result of that exercise.

I would like to thank the interviewees that made time in their busy schedules to speak to me about their experience and share their opinions and recommendations. These conversations proved to be key to writing a critical, honest and hopefully constructive paper about this topic. The responsibility for any incorrect representation of their contributions is entirely mine.

In total, the information gathered through interviews was comprised in a total of 20 interviews with people from different sectors, all with ample experience in the field of sustainability in general and social auditing in particular. The interviewees were professionals from different industries (including the garment sector, retail, electronics, mobility, horticulture and food), working in different companies: from small start-ups to large multinationals. The chart below shows the amount of people interviewed per category.



In addition, the following graph illustrates the years of relevant work experience<sup>16</sup> of the interviewees:



Not all of the interviewees were comfortable in being mentioned by name and/or a reference to the company they work for. In accordance with their wishes, this report refers to their input where relevant in general terms. The author can disclose the interviewees to individuals challenging the truthfulness of the statements used in this

<sup>16</sup> The years of ‘relevant work experience’ are determined as the years where interviewees worked in the field of sustainability, (social) compliance, human and labour rights or purchasing. In most cases, the interviewees had more years of general work experience than the ones indicated in this graph. The years of work experience as well as the assessment of their relevance are derived from the interviewees’ LinkedIn profiles inasmuch as these are available. Any incorrect representation of the interviewees’ work experience is entirely mine.

report if necessary.

Despite the obvious academic context and requirements of this paper, the author has tried to include – as much as possible – elements of the pyramid principle writing approach in this report.<sup>17</sup> This will be most apparent when looking at chapter 4 (on research results and analysis), where the headings of the sub-chapters answer the sub-questions to the research question. The overall format and layout of this paper, however, followed the outline as requested by the Erasmus School of Accounting & Assurance.

### 3. Existing literature related to the research question

The results from previous research on this topic are summarized in this chapter and grouped under the three sub-questions this paper is trying to answer.

#### 3.1. What is the problem that social audits are trying to solve?

Researchers of the Sheffield Political Economy Research Institute (SPERI) analysed that companies have started to worry about managing their social risks upon negative exposés by NGOs and media, “to position themselves as part of the solution to globalised production challenges”.<sup>18</sup>

LeBaron and Lister continue:

“Central to this has been the adoption of ethical auditing practices that purport to identify, correct and ultimately solve environmental and social problems in supply chains. Brands began to hire independent (but often for-profit) auditors to monitor factories, develop codes of conduct for their suppliers and publish transparency and ethical reports.

Similarly, over the last decade, partly out of frustration with the failings of international organisations and governments to adopt binding global business regulations, NGOs have come to accept industry-led CSR programmes and private audits as legitimate opportunities to detect abuses within supply chains, improve factory conditions and hold corporations accountable. (...)

To monitor and verify standards, NGOs have developed transnational ‘sustainable production’ certification standards (...). These certification standards

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<sup>17</sup> Barbara Minto, *The Pyramid Principle: Logic in Writing and Thinking*, 3rd edition (Harlow, England ; New York: Prentice Hall, 2010).

<sup>18</sup> Genevieve LeBaron and Jane Lister, “Ethical Audits and the Supply Chains of Global Corporations,” SPERI Global Political Economy Brief (Sheffield, United Kingdom: University of Sheffield, January 2016), <http://speri.dept.shef.ac.uk/wp-content/uploads/2016/01/Global-Brief-1-Ethical-Audits-and-the-Supply-Chains-of-Global-Corporations.pdf>.

are voluntary and rely on private audits, designed and paid for by corporations (...). As such, the contemporary governance of global supply chains is increasingly reliant on an ethical and voluntary 'benchmarking regime' supported by both corporations and civil society groups, which has audit inspections as its cornerstone. This auditing regime comprises company codes of supplier conduct, voluntary certifications, standardised metrics (e.g. the Higg Index for 'ethical' clothing) and aggregated indexes for comparing corporate environmental and social performance (e.g. the Global Reporting Initiative).

As such, audits have evolved from a management tool that multinational corporations used to measure, track and enforce internal organisational standards into a central mechanism of global state and non-state efforts to monitor standards within corporate supply chains.”

The goal of social audits, according to Greg Distelhorst, Jens Hainmueller and Richard M. Locke, is “to improve the social performance of upstream business partners, primarily in developing countries, thereby addressing stakeholder concerns about labor (*sic*), environmental, and health conditions in globalized production and reducing social and reputational risk for lead firms (...).”<sup>19</sup>

Audits, in short, were established to manage risks for companies related to potential issues in their supply chains. They are mostly focused on developing or 'high risk' countries, meaning that standards do not focus their efforts on countries with a lower risk to find issues such as countries in the European Union.<sup>20</sup> Companies do this because the uncovering of harmful working conditions in factories that produce for them, such as child labour, unpaid overtime or wages under the minimum wage, can result in reputational damage from which it is hard to recover.<sup>21</sup>

Performing audits, or adhering to a specific social standard for that matter, is voluntary and not a business requirement. However, there is a requirement companies do have to adhere to, which is to practice due diligence when it comes to respecting human rights.<sup>22</sup> This applies to all businesses, regardless of their size, from Small and Medium Enterprises (SMEs) to large multinationals. Unfortunately, many SMEs are not aware of the requirements they need to fulfil and what this means for their business.<sup>23</sup> The same applies to the OECD guidelines for multinational enterprises (“the only multilaterally

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<sup>19</sup> Greg Distelhorst, Jens Hainmueller, and Richard M Locke, “Does Lean Improve Labor Standards? Capability Building and Social Performance in the Nike Supply Chain,” January 19, 2014, 31.

<sup>20</sup> “Country Risk Classification | Amfori,” accessed June 17, 2018, <http://www.amfori.org/resource/countries-risk-classification>.

<sup>21</sup> Business Continuity Institute, “What Are the Effects of Reputational Damage?,” September 29, 2017, <https://www.thebci.org/news/what-are-the-effects-of-reputational-damage.html>.

<sup>22</sup> United Nations, “Guiding Principles on Business and Human Rights.”

<sup>23</sup> Marcel Jacobs, “Comment on OECD Guidelines for SMEs,” June 24, 2018.

agreed and comprehensive code of responsible business conduct that governments have committed to promoting”). Despite the perhaps misleading term ‘multinational’ in the title, these guidelines define multinational as companies working in or sourcing from other countries. In practice, as companies in all fathomable cases source from a different country than their own, this means all companies should adhere to the OECD guidelines.

Due diligence is a complex process which needs continuous revision, and dictates that companies are not only responsible for their own operations, but also for their influence on others through their buying practices. To be clear, their responsibility is not limited to their first-tier suppliers (the suppliers they directly source from), but continues all along the (often highly complex) supply chain down to raw material extraction or production.

At their core, social audits are a tool for companies in the larger process of performing due diligence, by helping them to understand under what circumstances their suppliers are operating.

The problem that audits are trying to solve, therefore, is the potential problem (risk) for brands and retailers of having adverse human rights impact in their supply chains, particularly at first tier supplier level in high-risk countries, as the uncovering of such issues by media or NGOs could potentially harm their brand.

### **3.2. Are social audits solving this problem?**

If, as we have established, audits exist as a tool to avoid adverse risks to business and form part of a companies’ duty to perform due diligence, the question is: do audits indeed avoid adverse business risks, and are they enough to fulfil a companies’ obligation to human rights due diligence?

Existing literature about this topic demonstrates that performing audits alone is not enough, nor do audits play a determining role in finding issues in supply chains. The Shift institute, a renowned name in the field of human rights, published a report in 2013 where they underline this. “Despite the hundreds of thousands of social compliance audits conducted each year to ensure minimum workplace conditions in companies’ supply chains, there is little evidence that they alone have led to sustained improvements in many social performance issues, such as working hours, overtime, wage levels and freedom of association.”<sup>24</sup>

In addition, Geert de Neve argues after his research in the South Indian garment industry that the audit system, in fact, creates a new power paradigm of inequality and diminishes

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<sup>24</sup> “From Audit to Innovation: Advancing Human Rights in Global Supply Chains” (Shift, August 2013), <https://www.shiftproject.org/resources/publications/audit-to-innovation-advancing-human-rights-global-supply-chains/>.

trust and collaboration between suppliers and buyers.<sup>25</sup> The pressure from brands towards suppliers to deliver on time, high quality goods for a very low price – minimizing their profit margin, or even having no profit margin at all<sup>26</sup> – puts a lot of financial and organizational strain on suppliers, who now in addition also need to pay for their own audits to prove compliance with their clients’ code of conduct, or any of the numerous audit standards they have selected.<sup>27</sup> This top-down approach by brands, pushing their suppliers to ‘prove’ they do indeed have everything in order on the social side on one hand, whilst putting them under pressure through purchasing practices on the other, is a contradiction many suppliers face. The wide range of audits available means that suppliers have to undergo several audits per year, from ‘independent third-party audits’ such as WRAP, SA8000 to compliance audits by industry associations or the brands themselves.

Using websites such as Sustainability Map, brands research and choose the audit practice or standard that suits them best, and the social auditing industry now comprises some 241 standards (excluding company-owned audit schemes)<sup>28</sup>. The Global Social Compliance Programme (GSCP) is launching a benchmarking tool this year that should support brands in finding their way through the maze of social compliance standards.<sup>29</sup> The result of this proliferation of schemes and options, and the subsequent diversity in standards chosen by brands, is that some suppliers have to undergo up to thirty audits a year.<sup>30</sup> In most cases, suppliers have to bear the due costs themselves.<sup>31</sup>

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<sup>25</sup> Geert de Neve, “Power, Inequality and Corporate Social Responsibility: The Politics of Ethical Compliance in the South Indian Garment Industry,” *Economic and Political Weekly* 44, no. 22 (2009): 63–71.

<sup>26</sup> Daniel Vaughan-Whitehead and Luis Pinedo Caro, “Purchasing Practices and Working Conditions in Global Supply Chains: Global Survey Results,” Fact sheet (Geneva: International Labour Organization, within the framework of the programme Labour Standards in Global Supply Chains financed by the Government of the Federal Republic of Germany, June 9, 2017), [http://www.ilo.org/travail/info/fs/WCMS\\_556336/lang-en/index.htm](http://www.ilo.org/travail/info/fs/WCMS_556336/lang-en/index.htm).

<sup>27</sup> de Neve, “Power, Inequality and Corporate Social Responsibility.”

<sup>28</sup> “Sustainability Map,” accessed June 17, 2018, <https://sustainabilitymap.org/standard-identify>.

<sup>29</sup> “GSCP Equivalence Process,” accessed June 17, 2018, <https://www.gscpequivalenceprocess.com/>.

<sup>30</sup> Bureau Veritas (October 5, 2017).

<sup>31</sup> It is generally anticipated by buyers that suppliers include the cost of their audits in the price of their products. By not paying for their suppliers’ audits directly, brands want to avoid a potential conflict of interest: the third party performing the audit should remain independent from the interests of the brand for which the audit is ultimately being performed. This attitude is a direct consequence of the risk-based approach companies take towards audits, as decreasing the risk of a potential conflict of interest is in this case deemed more important than performing the supplier audit in an efficient and (cost) effective way.

93% of the suppliers surveyed in an ILO research were expected to follow a Code of Conduct by their buyer.<sup>32</sup> However, the ILO report states that “while this demand on suppliers especially on social standards can only be seen as a positive development, we also tried to see whether the responsibility (and the costs) for the implementation of such codes of conduct were shared by the buyer. The Global Survey results show, however, that nearly half of the suppliers (49 per cent) that are expected to follow a code of conduct receive no help from their buyers in achieving the demanded social standards. The remaining 51 per cent were found to receive some assistance such as staff training or a joint identification of breaches. Only 17 per cent, however, were found to enjoy shared audit costs and even less (9 per cent) to receive financial assistance.”<sup>33</sup>

Suppliers are under immense pressure to prove they are living up to (company) standards. In many cases, brands still have a zero-tolerance approach (meaning: we will no longer source from you if such issues are found) towards suppliers that do not perform well, or increase the pressure to zero-tolerance if there is a heightened risk for brand reputational damage.<sup>34</sup> To make matters more complicated, companies even within an industry association scheme can define their own zero tolerances.<sup>35</sup>

There is reason to believe that the combination of limited time and resources which suppliers have to invest in their operations in a highly competitive global market and the implications for a supplier if indeed the audit is not passed may lead to a heightened risk of audit fraud, auditor bribery and forgery of reports.<sup>36</sup> It also, as De Neve demonstrates, increases the risk of devolving responsibility – and hence risks – to subcontractors, a practice in which brands notoriously have no overview of where and under which circumstances their products are made.<sup>37</sup>

Notwithstanding the challenges for suppliers and brands alike to make audits work, they have taken a strong root in supplier-buyer relationships. Do audit reports, then, give companies information which they can use when assessing their business risks? Chapter 4 will go in to the perception of companies on the trustworthiness of the audits, but scholarly research already reveals that audit reports may not be as complete and trustworthy as one would hope.

In the case of reporting child labour, for example – seen as one of the highest risks for

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<sup>32</sup> Vaughan-Whitehead and Pinedo Caro, “Purchasing Practices and Working Conditions in Global Supply Chains.”

<sup>33</sup> Vaughan-Whitehead and Pinedo Caro, page 10.

<sup>34</sup> Kim Bhasin, “Wal-Mart Sent A 10-Page Letter To Its Suppliers Warning Them Of ‘Zero-Tolerance,’” *Business Insider*, accessed June 17, 2018, <http://www.businessinsider.com/walmart-zero-tolerance-suppliers-2013-1>.

<sup>35</sup> Jacobs, “Comment on OECD Guidelines for SMEs.”

<sup>36</sup> Erica L. Plambeck and Terry A. Taylor, “Supplier Evasion of a Buyer’s Audit: Implications for Motivating Supplier Social and Environmental Responsibility,” *Manufacturing and Service Operations Management* 18, no. 2 (June 2016): 184–97.

<sup>37</sup> de Neve, “Power, Inequality and Corporate Social Responsibility.”

brand reputation and one that should certainly be included in a company's due diligence – a survey amongst 557 auditors in Asia regarding this topic revealed that although 64% of auditors suspected cases of child labour between 2014 and 2016, 30% of these suspected cases were not corroborated and 18% of confirmed cases were not reported on.<sup>38</sup> The reason that not all information can be corroborated, the researchers found, is related to the difficulties auditors have in finding proof to support their suspicions. The researchers also found a relevant relation between the gender of the auditor and the amount of cases of child labour found (with female auditors reporting more cases), as well as the years of experience the auditor has and the training he or she had on the topic (more experience and more training leading to more reporting on this issue).<sup>39</sup>

This means that the question of this paragraph (*are social audits lowering the risk of potential adverse human rights impact of a brand on their supply chain?*) should be answered in the negative: in their current form, audits do not seem to effectively lower risks for brands in their supply chains. The reasons for this appear to be that social audits in and of themselves support an unequal power paradigm between suppliers and buyers, suppliers receive little – if any – help from the buyers to comply with audit standards, and strict consequences of not passing an audit can lead to fraud, bribery, reports forgery and subcontracting, as passing the audit becomes more important than actually improving one's operations. In addition, auditors themselves have indicated not to be able to include all (suspected) issues of child labour in their audit reports, further pointing towards the incompleteness of an audit report as a picture in time.

### 3.3. What are the reasons social audits are (not) effective?

“[A]s a growing evidence base reveals, audits are ineffective tools for detecting, reporting, or correcting environmental and labour problems in supply chains. In fact, they may even be serving to worsen supplier practices as they shape a global business culture of ‘check-box compliance’ to a narrowing set of quantitative ‘key performance measures’.”<sup>40</sup> Despite widespread adoption of social compliance programs, research has repeatedly shown that audits only yield limited improvements in social performance.<sup>41</sup>

There can be several reasons for this. Some of these are summarized below.

**Contents of standards:** Even if audits would go according to the book, and all issues would be uncovered, they still cannot be expected to bring about sustainable change.

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<sup>38</sup> Canaria Gaffar and Ines Kaempfer, “Best Response: Auditor’s Insights on Child Labor in Asia” (Center for Child Rights & Corporate Social Responsibility, June 2016), <https://view.joomag.com/my-first-magazine/0427822001484623722>.

<sup>39</sup> Gaffar and Kaempfer.

<sup>40</sup> Genevieve Lebaron and Jane Lister, “Benchmarking Global Supply Chains: The Power of the ‘Ethical Audit’ Regime,” *Review of International Studies* 41, no. 05 (December 2015): 905–24, <https://doi.org/10.1017/S0260210515000388>.

<sup>41</sup> Distelhorst, Hainmueller, and Locke, “Does Lean Improve Labor Standards? Capability Building and Social Performance in the Nike Supply Chain.”

Susan Evans, in her report of the Economist Intelligence Unit: “Neither industry standards nor government regulations adequately cover the full range of key social and environmental topics identified by the United Nations’ corporate sustainability initiative, the UN Global Compact, and so even full compliance is unlikely to bring corporations up to a standard of behaviour that the average person on the street would consider to be “responsible””.<sup>42</sup>

**Auditors do not share experiences:** There is no systematic compilation of auditors’ knowledge and experiences beyond collecting auditing data for a specific audit.<sup>43</sup> This is problematic, because as the auditors are physically witnessing issues and pitfalls, their knowledge and lessons learned could serve to improve both standards and audit practices.

**Lack of capacity on supplier level:** there is a “lack of capacity among suppliers to address issues that have been identified for remediation in a sustainable way”<sup>44</sup> – this applies to financial capacity as well as time and resources;

**Systemic challenges are beyond the suppliers’ control:** industry-wide issues, social context and governmental regulations all influence suppliers’ social audit score and social performance, but are not within their sphere of influence.<sup>45</sup>

**Relationship, not audits, influence supplier performance:** In research done at Nike factories, the number of visits by Nike personnel and whether or not a factory is a strategic partner are positively associated with their social audit scores.<sup>46</sup> However, the duration of the relationship with Nike and the percentage of capacity dedicated to Nike are negatively related to the audit scores.<sup>47</sup> All four of these are statistically significant.<sup>48</sup> Interestingly, when removing compliance staff from the analyses, the researches still obtained the same significantly positive results, suggesting that the positive relationship is not the result of more frequent social audits and factory inspections.<sup>49</sup> Instead, something else seems to be happening. The researchers suggest two possible explanations. The first explanation is that the factories that have a closer relationship with Nike are also the

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<sup>42</sup> Susan Evans, “No More Excuses - Responsible Supply Chains in a Globalised World,” Growth Crossings (The Economist Intelligence Unit, 2017), <http://growthcrossings.economist.com/wp-content/uploads/sites/47/2017/07/EIU-SCB-RSC-WP.pdf>.

<sup>43</sup> Francesco Perrini and Antonio Tencati, “Sustainability and Stakeholder Management: The Need for New Corporate Performance Evaluation and Reporting Systems,” *Business Strategy and the Environment*, October 2006.

<sup>44</sup> “From Audit to Innovation: Advancing Human Rights in Global Supply Chains.”

<sup>45</sup> “From Audit to Innovation: Advancing Human Rights in Global Supply Chains.”

<sup>46</sup> Richard Locke, Fei Qin, and Alberto Brause, “Does Monitoring Improve Labor Standards? Lessons from Nike,” *Corporate Social Responsibility Initiative Working Paper No. 24* (July 2006): 47.

<sup>47</sup> Locke, Qin, and Brause.

<sup>48</sup> Locke, Qin, and Brause.

<sup>49</sup> Locke, Qin, and Brause.

ones with more face-to-face contact with the Nike sourcing and production teams, and they engage in various initiatives aimed at improving production efficiencies such as Lean, which in turn have positive spill-over effects on labour conditions.<sup>50</sup> The second explanation the researchers offer is that the frequency of visits by production and sourcing staff (but not compliance managers) leads to greater trust and a better working relationship between the brand and its suppliers.<sup>51</sup>

**Buying practices, not social standards, have impact on workers' rights:** the ILO global survey gives an unveiling insight in the influence buying practices have on workers in supply chains. For example, the survey results “(...) indicate that buyers are not always willing to adjust their prices to incorporate statutory increases in the minimum wages of suppliers' countries. On average suppliers reported that only 25 per cent of their customers were willing to do so; however, in Bangladesh, for instance, the figure was much lower (at 17 per cent) (...).”<sup>52</sup>

Other issues, such as buyers not adhering to deadlines themselves but holding suppliers accountable for production deadlines according to contract, unclear technical specifications and prices under a profit margin also have a considerable effect on suppliers' wages and policies towards workers, including unpaid overtime and subcontracting.<sup>53</sup> However, buying practices of brands – and therefore its potential negative effects on workers' rights – are not always included in the supplier assessment or during the audit. In cases where it is, e.g. the Responsible Business Alliance,<sup>54</sup> one can question whether an independent auditor is familiar with the market a brand operates in, let alone a specific product range, and if s/he can make a proper judgement on their supply chain management approach based on the limited time provided during an audit.

**Brands are complacent and choose to only look at the most obvious risks:** researchers from the Economist Intelligence Unit surveyed corporate executives about their supply chain management: “The survey revealed a worrying degree of complacency. Most executives felt confident that their companies' supply chains were responsibly managed—despite evidence that insufficient attention was being given to some key issues, such as child labour, climate change and gender equality. On top of this weak performance, a sizeable proportion of businesses had actually allowed supply chain responsibility to slide as a priority in the past five years.”<sup>55</sup>

The report continues: “Economies in which policies and regulations have recently become more supportive of responsible business behaviour showed a more positive trend. Issues for which it is more straightforward to demonstrate a material business risk

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<sup>50</sup> Locke, Qin, and Brause.

<sup>51</sup> Locke, Qin, and Brause.

<sup>52</sup> Vaughan-Whitehead and Pinedo Caro.

<sup>53</sup> Vaughan-Whitehead and Pinedo Caro.

<sup>54</sup> “Responsible Business Alliance Formerly the Electronic Industry Citizenship Coalition.”

<sup>55</sup> Evans, “No More Excuses.”

or opportunity received more attention than those for which quantification or prediction is more complex. Issues affecting a sub-set of the population, such as women and children, received less attention than those affecting all workers.”<sup>56</sup>

**No transparent supply chains:** “In our discussions with representatives of corporations, financial stakeholders, regulators, international organisations and NGOs, it was striking how often each blamed the others for constraining, or failing to adequately support, their efforts to be responsible. Company executives also pointed to the difficulties of fully understanding and monitoring their supply chains—something which some experts from academia and consultancy disputed, given the possibilities presented by digital technologies and outside specialists.”<sup>57</sup> Lack of business impact on factories (e.g. small orders) is a more prominent reason for non-compliances in China than elsewhere – this suggests a need for collaboration amongst brands with overlapping supply chains.<sup>58</sup> In order to achieve this, transparency about supply chains is an essential first step.

To answer the question of this paragraph: social audits, in their current form, do not seem to be effective. There is an array of reasons why this could be the case, including systemic challenges beyond an auditor’s control, and the determining role buying practices, not audits, have on workers’ rights at supplier level.

## 4. Research results and analysis

### 4.1. Companies need to perform due diligence: identify, prevent, mitigate and account for how they address human rights impacts

States have a duty to respect, protect and fulfil human rights and fundamental freedoms, whereas the role of business enterprises is to comply with all applicable laws and to respect human rights.<sup>59</sup> This means in practice that companies have the responsibility to respect human rights in their operations as well as in their supply chains, even though not all human rights may be implemented in the local law nor respected or protected by the particular state in which the company is operating. Human rights are inalienable and universal, meaning that they apply regardless of the circumstances in legislation or business practice. The responsibility for companies, then, is to identify, prevent, mitigate and account for how they address their adverse human rights impacts.<sup>60</sup>

It is important to stress that these responsibilities go beyond managing human rights impacts on the level of first tier (contractual) suppliers, but goes far beyond and includes human rights impacts all along the supply chain, down to where raw material is extracted

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<sup>56</sup> Evans.

<sup>57</sup> Evans.

<sup>58</sup> Gaffar and Kaempfer, “Best Response: Auditor’s Insights on Child Labor in Asia.”

<sup>59</sup> United Nations, “Guiding Principles on Business and Human Rights.”

<sup>60</sup> United Nations.

or grown. Supplier audits, as such, focus on the first part of the supply chain: first tier suppliers, or when possible up to last stage of production of the final product.<sup>61</sup> Audits can therefore only address part of a larger picture.

When asking the interviewees who participated in my research why their companies tried to manage social risks, the answers did not unanimously point in the direction of the Guiding Principles on Business and Human Rights nor the OECD guidelines.

In fact, most respondents declared that risk mitigation is the reason why brands work with social audits. One of the respondents described companies' objective as "avoiding reputational damage to their brands, whether their brand is consumer facing or whether they are sensitive to investors' opinion. When these things matter to them, they might take action to work on social issues in their supply chains."<sup>62</sup>

Others openly spoke about their challenge to meet the OECD requirements, one of them stating that in terms of due diligence, their company was "still in the start-up phase"<sup>63</sup>.

Alejandro Gonzales from Good Electronics took the clear stance that audits do not work and that companies need to look beyond audits. He argued that companies still chose to audit because it diverted the responsibility away from them in case there were still issues in their supply chain, suggesting that focusing on audits alone is "an easy way out" for companies to withdraw from their responsibilities to perform proper due diligence.<sup>64</sup> While some companies may indeed take legal action to suppliers in case there are issues uncovered that were not shown in the audit report, such an attitude is not how the OECD guidelines and the Guiding Principles on Business and Human Rights describe the responsibility to respect. This requires mitigation and remediation of the issues uncovered.

Most respondents had no problem in explaining the approach they chose to manage their suppliers, most of them clarifying either their own auditing approach or their choice for (a) standard(s). Surprisingly, very few respondents had a clear answer to the question "What are you trying to achieve through this approach?". There seemed to be little consideration given to the objective their company was aiming towards through their actions. Instead, the companies seemed to look at improving current (auditing) practices, not questioning the effectiveness of audits to achieve clear objectives.

Karen Maas writes in her article '*Nieuw model om impact te meten*' ('a new model to measure impact'), that in order to achieve (and measure) impact, you need to start with having (a)

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<sup>61</sup> Joy Geers, "Supply Chain Information Management by SIM - Blockchain Innovation," SIM Supply Chain, accessed July 14, 2018, <https://www.simsupplychain.com/>.

<sup>62</sup> The interviewee who shared this wished to stay anonymous.

<sup>63</sup> For confidentiality reasons, this statement has been anonymized.

<sup>64</sup> Alejandro Gonzalez, Discussion on the effectiveness of social auditing, Skype interview, May 3, 2018.

clear goal(s) to pursue when measuring impact.<sup>65</sup> What do you want to do with the information you gather? Where do you want it to take you? As with all other parts of business, finding data and putting it into context starts with knowing what you need the data for in the first place. It was interesting to see that there was only a handful of companies able to and/or focused on gather(ing) data to measure the impact of their approach towards their suppliers in terms of better protection of human rights.

#### 4.2. Social audits are an insufficient tool to support companies in their due diligence efforts

Social compliance programs – and consequently, social auditing – in most cases do not form part of an inclusive approach towards suppliers. Companies choose to perform social programs and checks *alongside* instead of *integrated with* existing company performance.

This became apparent when looking at the division of responsibilities within companies. With most of the interviewees, their experience was that social audits and supplier performance related to the Code of Conduct was the responsibility of the Corporate Social Responsibility (CSR) department, whereas their purchasing department dealt with the negotiation on price, quality, production and all other elements of the contract. This schism in companies' responsibilities does not reflect the influence both elements of supplier relations have on each other (the Code of Conduct on the one hand and the financial contractual obligations on the other). Nor does it do justice to the importance of adherence to human rights for the business in general (not just in terms of business risks, but also in terms of product quality, timeliness and consistency of the quality and production due to an increased turnover at supplier factory level).<sup>66</sup> Vice versa, it does not do justice to the influence and impact companies' purchasing practices have on social performance, as we have seen in the ILO report in the previous chapter.

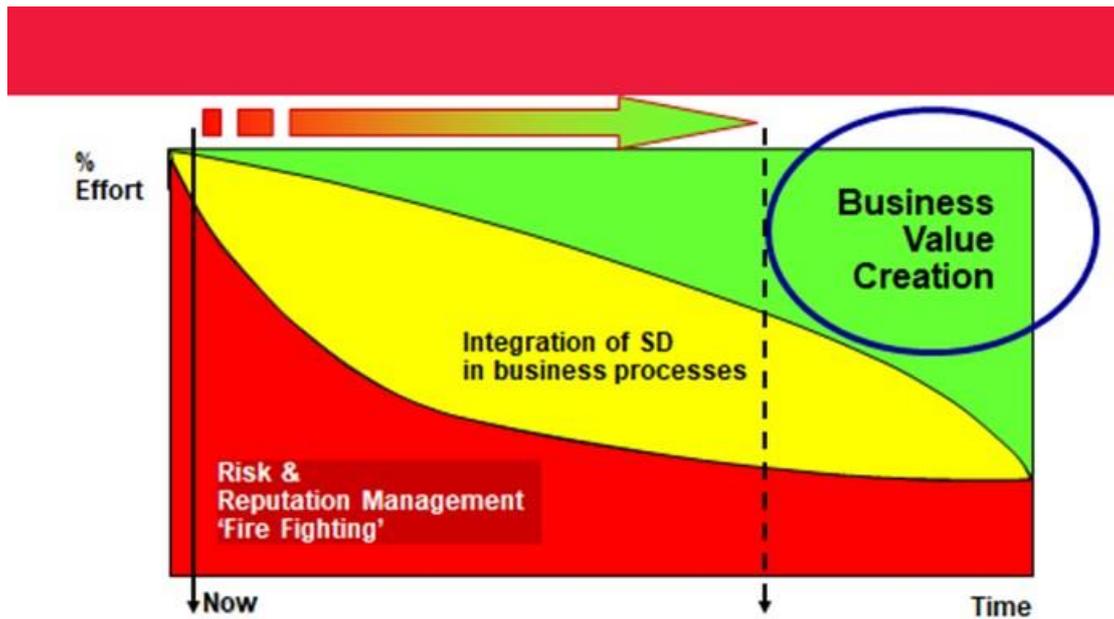
In order to create impact – and to indeed create a social compliance programme for your business that creates business value across the board – companies may need to invest time and resources at first, but it will save you ad-hoc risk management in the long run. The graph below tries to make this clear:<sup>67</sup>

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<sup>65</sup> Karen Maas, “Nieuw model om impact te meten,” *P+*, no. Juli + Augustus 2014 (August 2014): 1.

<sup>66</sup> Ballé and Ballé, *The Gold Mine*.

<sup>67</sup> Philips, “Philips Sustainability Presentation,” (Powerpoint, 2006 2004).



Amongst the interviewees, only a handful were confident that their approach towards their suppliers indeed led to a substantial improvement on social performance. Two of the brands interviewed used a system to track supplier progress on a detailed level (not just on overall audit scores, of which other interviewees kept track to some degree), and linked positive results or outcomes to a less stringent degree of scrutiny in the following year.

Interestingly, the companies who indicated they work towards human rights due diligence and see auditing as a part of their company strategy as a whole all described that a main ingredient to their success and confidence about their social programme was an increase of trust and open dialogue with their suppliers.<sup>68</sup> None of the interviewees believed that positive impact on human rights could be reached through audits alone.

Several interviewees indicated that the focus on compliance meant that audits had a very narrow scope. Audits were likened to tick box exercises, where you either have it ‘right’ or ‘wrong’. This approach is challenging when you want to have a meaningful discussion with your suppliers, and gives no room to assess suppliers’ performance on relevant issues that are not part of the predefined checklist. As one of the interviewees, Joss Tantram, put it:

“I am sceptical about the extent to which [audits] have an impact. (...) Are they going to solve the problems, are they going to give transparency? I doubt it. I do think they can give you a higher degree in confidence [in your supplier’s performance] than not having one.

<sup>68</sup> “Philips Drives Supply Chain Sustainability ‘Beyond the Audit,’” Supply Chain Navigator, accessed January 29, 2018, <http://scnavigator.avnet.com/article/october-2017/philips-drives-supply-chain-sustainability-beyond-the-audit/>.

We have a very transactional approach to business culture: we want to know what the processes are, where the paperwork is [to prove results]. (...) This is a challenge when we talk about human rights, because there is a mismatch between the transactional approach in business and the complex and interconnected issues that relate to human rights. [Human rights issues] by its nature [are] emergent, and do not lend themselves to a linear type of management approach.”<sup>69</sup>

The above leads to the conclusion that there are three main reasons why audits seem to be an insufficient tool in the larger picture of human rights due diligence:

- It does not take an integrated approach to all of the company’s interactions with the supplier; therefore, it cannot mitigate all potential negative effects of a company’s interaction with their suppliers;
- In most cases, social auditing is not put in perspective of a longer-term goal in relation to desired impact, making it impossible for companies to measure if they are making positive progress;
- The focus on compliance – at the very heart of the audit approach – makes an open dialogue with a supplier and an understanding for systemic circumstances outside of their control nearly impossible. It is a one-size-fits-all approach that does not leave much – if any – room for interpretation.

#### **4.3. Social audits are ineffective due to inherent flaws in the audit approach and because brands’ own behaviour is overlooked**

If in the previous section we established that audits seem to be an insufficient tool to perform due diligence, this paragraph illustrates what the reasons are that audits are not effective.

The possible reasons for ineffectiveness, as the title suggests, can be divided in two main categories: inherent flaws in the audit approach and the fact that brands’ own behaviour is overlooked in trying to improve working conditions in the supply chain.

##### **4.3.1. Inherent flaws in the audit approach**

**One size fits all:** By their nature, audits are set up as a list of requirements a supplier should fulfil. This list of requirements is derived from universally accepted guidelines on human rights and social performance such as the OECD guidelines, and is generally similar across the board in terms of contents. All suppliers have to adhere to these requirements, and, as one of the interviewees pointed out: “[Audits are] likely to miss the

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<sup>69</sup> Joss Tantram, Discussion on the effectiveness of social compliance audits, Skype interview, February 12, 2018.

bigger picture, as they are blunt and narrow instruments to manage a complex world.”<sup>70</sup> In an attempt to manage such a complex world, companies often decide to focus their social auditing efforts on ‘high risk’ countries only. By not looking at the context and causes of non-compliances found, such a ‘one size fits all’ approach creates a blind spot for human rights abuses in companies operating in countries that are considered having a lower risk. Similarly, it means companies in developing countries are guilty until proven innocent by default, leaving no room for a more tailored approach.

**Audits are announced, even when they are not:** Audits take place on the premises of a legal entity (a supplier) who will need to grant permission to the auditor to set foot on their property, and to give access to the necessary information (in terms of documents, employees, factory floor visits, et cetera) for the auditor to perform the assessment. This means that audits need to be announced, so that factory management can prepare for an auditor’s visit (e.g. making sure all the documentation is readily available and the auditor does not lose precious time looking for data). In case of bad will, this also means that factories know when they need to cover up bad practices. To avoid missing out on the ‘real’ picture, most audit schemes therefore include unannounced audits that allow auditors to come by to assess a situation without prior notice. Factory management usually gives prior consent to this type of practice through signing a Code of Conduct with their client or with the standard itself. In practice, however, a more appropriate term for these ‘unannounced’ or ‘surprise’ audits would be ‘semi-announced’ audits – since in order for the auditor to have access to the computer systems, files, locked offices and other information necessary to make his/her assessment, the right personnel needs to be at the factory premises to support the auditor in his work. Suppliers will therefore always need a heads up before the auditor arrives – albeit as late as possible, e.g. not earlier than 72 hours in advance.<sup>71</sup> In case of bad will, suppliers can potentially still cover up any bad practices that they want to sweep under the carpet – even if the audit is a surprise audit.

**An audit is only a picture in time:** All interviewees agreed that a challenge in auditing social standards is that audits are merely a snapshot. It is not possible to visit a factory once, a few hours per year (or once per three years, as some audit schemes prescribe) and expect to be able to find structural issues, such as gender-based violence, forced and bonded labour or unpaid overtime. An experienced auditor: “An audit is a picture in time. What I have seen and observed is in my report, what I have not seen is not included. You can never have a full picture, but it gives companies the opportunity to divert the blame in case issues are found later on. “It was the auditor’s fault!” they will say. The auditor will subsequently point to the supplier not showing them what was needed, the supplier will in turn point to *their* supplier who promised them everything

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<sup>70</sup> Tantram.

<sup>71</sup> “UTZ Assurance: Certification Protocol,” Protocol, Version 4.2 (Amsterdam: UTZ Certified, January 2018).

would be fine – all along the chain, until there is a weakest link who does not have their paperwork in order to divert the blame, and this will be the scapegoat.”<sup>72</sup>

**Auditors are the weakest link:** Auditors work under a lot of pressure. The context they have to perform in is extremely challenging: social audits are in most cases only performed in so-called ‘high risk countries’<sup>73</sup> which mean that these auditors need to be able to uncover practices that can occur in these situations such as child labour, payment under the minimum wage, et cetera. It is a common practice in these countries for auditors not to work under contract at the certification body they work for, but that they are hired as freelancers and are paid by the hour (and often not paid for travel and accommodation costs).<sup>74</sup> The workload these auditors work under are often immense, as they need to visit many companies and write multiple reports to work an amount of hours that will pay their bills and other fees. Non-compliances that are found require additional writing work, resulting in overtime that takes place during the auditor’s evening and travel time. It is possible that, because of these circumstances, not all audit results nor non-compliances are properly elaborated on in the report.<sup>75</sup>

It is a life that requires a lot of traveling, late nights and overtime, and more experienced auditors mostly prefer to move to an office job and instead supervise audits done by others. This means that the burden of finding non-conformities with the audit schemes falls on the shoulders of young, relatively inexperienced and usually overworked auditors.<sup>76</sup> It is not uncommon for auditors to be intimidated by factory owners, who at times use their work experience and knowledge to bully auditors into submission, sometimes successfully convincing auditors not to include findings in reports that the same factory – as the auditor’s client – pays for.<sup>77</sup>

**Audits are an instrument of power:** As several interviewees pointed out, social audits have become an industry in their own right. Countless NGOs, audit schemes, certification bodies and business professionals depend on its continuation and success. At its core, it is a business model that allows businesses to continue with harmful business practices (‘business as usual’) while putting the burden of compliance (in terms of costs, time, investment) on their suppliers, in effect using social compliance as a tool of power.<sup>78</sup>

#### 4.3.2. Businesses overlook their own behaviour

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<sup>72</sup> Leen Klaassen, Effective social audits, Skype interview, February 15, 2018.

<sup>73</sup> “Country Risk Classification | Amfori.”

<sup>74</sup> Klaassen, Effective social audits.

<sup>75</sup> Klaassen.

<sup>76</sup> José Manuel González, Discussion on effective social auditing, Face to face discussion, March 5, 2018.

<sup>77</sup> Klaassen, Effective social audits.

<sup>78</sup> de Neve, “Power, Inequality and Corporate Social Responsibility.”

**Schizophrenic business practices:** Most brands do not integrate their social compliance requirements with their business practices.<sup>79</sup> This means that on one hand, suppliers are asked not to subcontract to parties that have not been audited, to pay fair wages to their workers and not allow unreasonable and unpaid overtime, whereas on the other hand, the buyer may still change the requested orders last-minute while demanding the same delivery time and quality from the supplier, which inevitably results in issues such as the ones mentioned above (e.g. overtime, subcontracting).<sup>80</sup>

It is not just about buying practices: product design and unclear technical specifications also play their part in delaying the process and unnecessarily complicating work for suppliers.<sup>81</sup> Interviewees working for companies that onboarded buyers and other departments in their sustainability strategy were comparatively more confident about their company's positive impact on working conditions at supplier level than interviewees from companies that did not integrate sustainability with overall business practices. As many interviewees underlined, such a change in company focus and structure is only meaningful and efficient if it is supported and carried out by top management (on CEO and CFO level).<sup>82</sup>

**Trusting relationship is key:** It may sound like a fluffy notion, but trust is a key element in good working relations.<sup>83</sup> This counts for working relationship inside companies (between managers and employees, and between departments), but certainly also applies to supplier-buyer relationships. It is telling that interviewees mentioned the importance of a good relationship between themselves and their suppliers in order to achieve good and trustworthy audit results. They showed understanding for the difficulties faced by suppliers.

However, many companies still have a 'comply or die approach' towards their suppliers, where they will no longer work with suppliers that have not been able to comply with all audit requirements.<sup>84</sup> Being this strict on suppliers shows a lack of understanding for the context in which suppliers have to work. More importantly, it does not give suppliers any motivation to be open and honest with their clients about the challenges they are facing.

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<sup>79</sup> Liesbeth Unger, Discussion on human rights in social compliance auditing, Face to face discussion, March 7, 2018.

<sup>80</sup> Vaughan-Whitehead and Pinedo Caro, "Purchasing Practices and Working Conditions in Global Supply Chains."

<sup>81</sup> Vaughan-Whitehead and Pinedo Caro.

<sup>82</sup> Anneke Magendans, Effectiveness of social compliance auditing in garment sector, Skype interview, May 29, 2018.

<sup>83</sup> "How To Build High-Trust Relationships," accessed June 17, 2018, <https://www.forbes.com/sites/margiewarrell/2015/08/31/how-to-build-high-trust-relationships/#5d19c5515cfc>.

<sup>84</sup> Ian Spaulding, Call about effectiveness of social compliance audits, Skype interview, March 16, 2018.

A relationship which is not based on trust can have a lasting negative impact on business.<sup>85</sup>

An important element of trust is that it is reciprocal, meaning that suppliers should be able to trust a buyer's word. An example:

“Western brands have a lot to say about ‘partnership’, ‘sustainable relationships’ and more of the like. Interestingly, this seems to be going only one way. Suppliers are made to stick to their contractual agreement – in terms of deadlines, delivery times, et cetera. If they do not, the buyers will have them pay the expenses that were incurred. The buying parties, on the other hand, frequently get away with changing the rules of the game. If they cannot send the designs on the agreed time, for example, the suppliers will have to wait patiently until the designs are ready. In my experience, the client never allows for the delivery time to be adjusted accordingly. It is really a power play with two very unequal players.”<sup>86</sup>

**Capacity building needs to be taken seriously:** Brands have a lot to gain if they truly focus on capacity building at supplier level. Suppliers that are enabled to pay their workers well have lower worker turnover, which means that knowledge and skills do not disappear overnight, increasing the continuity and quality of the products they deliver. There are also possible benefits of supporting suppliers in integrating lean practices in their factories to de facto improve not only productivity and efficiency, but also decrease labour rights violations. A research in the introduction of lean management to Nike suppliers states that “lean intervention produced a significant improvement in a key aspect of factory social performance: participation in the lean program led to a 15-percentage point reduction in serious labor (*sic*) violations.”<sup>87</sup> It would be interesting to assess the root causes as to why certain issues are improved through lean practices.

**Prices are not fair:** “Who pays for compliance? After the Rana Plaza disaster and despite all the improvements made in health and safety, the prices for products from Bangladesh have gone down with another 14%.”<sup>88</sup> The survey from ILO reported that suppliers accept prices below cost price in order to secure future orders or to stay competitive, but also that only 25% of buyers would be willing to increase the price to cover the minimum wage.<sup>89</sup>

**Workers are not involved in a meaningful way:** an issue that is often overlooked is that in most countries and in most factories, freedom of association is seriously

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<sup>85</sup> Magendans, Effectiveness of social compliance auditing in garment sector.

<sup>86</sup> Magendans.

<sup>87</sup> Greg Distelhorst, Jens Hainmueller, and Richard M Locke, “Does Lean Improve Labor Standards? Capability Building and Social Performance in the Nike Supply Chain,” January 19, 2014.

<sup>88</sup> Magendans, Effectiveness of social compliance auditing in garment sector.

<sup>89</sup> Vaughan-Whitehead and Pinedo Caro, “Purchasing Practices and Working Conditions in Global Supply Chains.”

hampered. This means that workers cannot join or form unions and are not represented in a meaningful way in discussions with management. “Workers are the best monitors of working conditions, not the auditor. If you really want to create change, you should organize trade unions and promote freedom of association, or at least don’t hamper it, and involve local CSOs in monitoring this. Workers need to have a more meaningful role.”<sup>90</sup>

**Plan, do, check, act:** most of the interviewees agreed that the company they work for – or the companies they had previously worked for – did not clearly define what impact they tried to achieve when implementing social audits in their company procedures. However, as with all business procedures, determining the aspired impact is a necessary first step in defining a company’s approach and to measure its effectiveness. Implementing a recurring cycle of *plan, do, check, act*<sup>91</sup> when it comes to social auditing helps to determine whether audits have the aspired impact, and if they do not, gives the opportunity to amend the process where necessary.

## 5. Conclusions

The research question that this paper has tried to answer is ‘**to what extent do social audits contribute to the elimination of social risks in supply chains?**’

Social audits are an instrument used to measure the status quo in terms of workers’ rights at supplier level, and form part of a brand’s responsibility to perform human rights due diligence. In practice, the tool itself does not seem to suffice.

In this paper, I argued that the reasons for this are related to two main factors: inherent flaws in the audit approach and a systematic overlooking of businesses’ own behaviour in interactions with suppliers. In addition, companies rarely set objectives for themselves nor do they measure whether their approach has got the required results.

Social audits look at human rights from a compliance perspective, meaning that suppliers need to *comply with* certain standards and checklists to mitigate risks. NGOs and CSOs seem to have accepted this logic and evolved an elaborate social auditing system comprised of standards and third-party audits, which in turn has become a business in itself. Accepting the industry-led CSR programmes and private audits as legitimate opportunities to detect abuses within supply chains and hence being part of the audit business themselves, NGOs are known to partner up with brands rather than provoke them to change their course of action.

This approach, in which the core purpose of auditing is risk mitigation, is widespread and unfortunately does not lead to better business practices. Suppliers are not encouraged to move beyond the ‘tick box exercise’ of an audit and are not rewarded for improving their

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<sup>90</sup> Gonzalez, Discussion on the effectiveness of social auditing.

<sup>91</sup> Ballé and Ballé, *The Gold Mine*.

business sustainably in ways that are not described in the standard they are audited against. It is a one-size-fits-all approach that does not do justice to the specific circumstances suppliers work in. Focusing only on countries that are considered high risk underlines preconceived notions of where issues will be found and inherently creates a blind spot for other supplier and issues.

A crucial element in using audit results to really improve workers' rights in global supply chains, is an open relationship with suppliers that is based on mutual trust. Unfortunately, trust between both parties (buyers and suppliers) is most often lacking, a problem that is kept in place by business practices in which buyers apply pressure on suppliers to comply, but fail to alter their own actions to enable suppliers to implement better business practices. A survey by the International Labour Organization showed how buying practices have a large effect on the implementation of and respect for human rights at supplier level.

There is a strong case for moving the social auditing discourse from risk management to the proper implementation of human rights due diligence. It is an essential first step in defining a company's approach toward social audits to clarify the impact they want to achieve. Doing so would greatly enhance a company's ability to specify if and how they are making a difference, and to indicate what in their business practices may need to be adapted order to achieve sustainable change.

The combination of auditing and capacity building in an open collaboration with suppliers that is based on trust – a move from police to partner – seems to have the strongest chance of positively influencing human rights in supply chains.

Audits are only a picture in time. By failing to put that picture into a larger context and by deriving much crucial information about the supplier's performance from this one picture, companies risk only scratching the surface and missing out on opportunities to actually improve working conditions in their supply chains.

## **6. Recommendations**

“There remain unanswered questions with regard to why certain issues receive more attention by firms, and why certain economies have clearly raised their level of focus on responsible supply chain risks in recent years, while others have stalled. When we asked executives what influenced their firm's approach to responsible supply chains, the top answer—cited by half of respondents—was “company culture”. Given the degree of complacency that our survey has revealed, it is fair to ask

exactly how a strong company culture of responsibility can be nurtured.”<sup>92</sup>

As this quote so aptly illustrates, changing a company culture is a serious – but key – challenge in implementing human rights due diligence, and in finding a meaningful role in it for audits.

Recommendations to brands who wish to make sure social audits *do* contribute to the elimination of social risks in their supply chain are the following:

- Determine what it is you want to achieve. What do you want your impact to be? Create a plan of action accordingly and use other readily available business tools to reach improvement such as Lean to do this properly. Talk to the relevant stakeholders, internally as well as externally, plan your actions, perform them, continuously monitor them and challenge yourself to improve (plan, do, check, act). This also means that brands should qualify and/or quantify the impacts they wish to achieve, so they can measure their progress.
- Make sure your purchasing and other business practices are consistent with the impact you want to achieve. Practice what you preach: do not expect flexibility and understanding from suppliers when your company does not show them the same in return. Make sure your colleagues in all departments understand the implications of their behaviour down the chain – from product design, to logistics, to purchasing. Pushing the responsibility to solve issues on the supplier may seem effective in the short term, but damages your own business in the longer term. Implementing such a change in a company is a tough exercise and support from top management is key to its success.
- Avoid applying a one size fits all approach to your suppliers and be sensitive to their specific circumstances. There is a precarious balance between understanding your suppliers’ issues (e.g. related to the products they make, or the countries they source from) and having a blind spot for issues because they are not common.
- Build trust. Within your company, between departments, but also towards suppliers. Increased visits by specifically production and sourcing staff have shown to significantly improve trust between suppliers and brands. Let them explain to you why things cannot be done or why they need more time, and be constructive in thinking along in terms of solutions. Perhaps most important of all: let suppliers be constructive in improving your business practices as well. It may be uncomfortable to hear inconsistencies in your policies and practices from them, but if you allow it to be a meaningful discourse, you will benefit from better working relationships and you will not be surprised to find out there are

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<sup>92</sup> Evans, “No More Excuses.”, page 31.

indeed issues at supplier level with workers' rights. An added bonus: chances are you will get fewer hiccups along the way in terms of delivery time and quality.

- Do not follow audit results blindly. See them for what they are: a snapshot in time, and a tool in a larger, complex web of discovering how your suppliers are doing, and if there are any potential issues related to human rights. If your buyer-supplier relationship is healthy and indeed based on mutual trust and understanding, audits will become less relevant.

This is not to say, of course, that each company should come up with their own system to manage their suppliers. There is great value in collaboration, not in the least in order to avoid double work and costs along the supply chain. Suppliers are often visited multiple times a year to perform a similar set of checks, which is a highly inefficient way of using time and resources. What it does imply, however, is that companies and NGOs should think of new ways to collaborate when it comes to supplier management, and how to direct supply chains towards maximizing positive impact rather than avoiding risks.

For standard setting bodies, it is therefore advisable to re-assess their *raison d'être* – what is the impact they want to achieve? And how can the findings of this paper support them in better defining *how* to achieve this impact, if the current approach of auditing is not achieving the intended results?

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