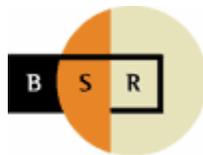
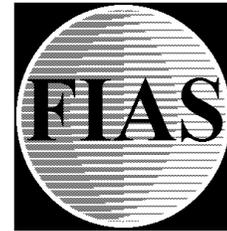


Corporate Social Responsibility in China's Information and Communications Technology (ICT) Sector

July 12, 2007

FIAS

Leaders in Investment Climate Solutions
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Table of Contents

Executive Summary	7
1. Introduction.....	13
1.1 CSR in China’s ICT Industry.....	13
1.2 Purpose of the ICT project.....	14
1.3 Project partners	15
1.4 Methodology	16
1.4.1. Projects metrics.....	17
2. CSR in Shenzhen’s private sector	19
2.1 Current State: Private sector CSR performance in Shenzhen ..	20
2.1.1 Raising awareness.....	20
2.1.2 Supplier performance management	21
2.2 Root-causes of the challenges in the ICT sector	23
2.2.1 Immediate costs but long-term benefits.....	23
2.2.2 Customer incentives for supplier CSR initiatives.....	30
2.2.3 Conflicting messages from customers	32
2.2.4 Media/NGO accountability and involvement	33
2.2.5 Management systems	34
2.2.6 Worker engagement	35
2.2.7 Complexity of the overtime issue	36
2.2.8 Implementation of CSR expectations in supply chains	38
2.3 Private sector recommendations	38
2.3.1 Suppliers	39
2.3.2 Customers	41
2.3.3 NGOs	43
2.3.4 Shenzhen Electronics Industries Association	44
3. CSR in Shenzhen’s public sector	45
3.1 Implementation of relevant laws in Shenzhen	45

3.1.1	Relevant legislation on labor protection	46
3.1.2	Relevant legislation on environmental protection	57
3.2	The All-China Federation of Trade Unions	59
3.3	Judicial law enforcement	62
3.4	Public sector recommendations	63
4.	Conclusions and capability building strategy.....	69
4.1	Summary of recommendations	70
4.2	Proposed capability-building pilot.....	71
4.2.1	Public/private sector workshop.....	71
4.2.2	Capability building pilot	72
	Appendices.....	74
	Appendix 1: Brief overview of relevant international standards	75
	Appendix 2: EICC compared with legal framework in China/Shenzhen	77
	Appendix 3: International good practice on capability building.....	80
	Appendix 4: Summary of cost and benefit data.....	92

Abbreviations

ACFTU – All China Federation of Trade Unions

BSR – Business for Social Responsibility

CPC – Communist Party of China

CSR – Corporate Social Responsibility

EICC – Electronics Industry Code of Conduct

FIAS – Foreign Investment Advisory Service

GeSI – Global eSustainability Initiative

IBRD – International Bank for Reconstruction and Development

ICT – Information and Communications Technology

ICO – Institute of Contemporary Observation

IFC – International Finance Corporation

ILO – International Labour Organization

NGO – Non-Governmental Organizations

PCB – Printed Circuit Board

PPE – Personal Protection Equipment

SACOM – Students and Scholars Against Corporate Misbehavior

SME – Small and Medium Enterprise

Executive Summary

Over the past decade, multinational companies, suppliers, workers, governments and civil society have focused increasing attention on corporate social responsibility (CSR) within global supply chains. CSR efforts have improved social and environmental conditions around the world. There is growing recognition of a connection between CSR and a company's ability to attract and retain international customers.

In particular, companies within the information and communication technology (ICT) sector are increasingly requiring that their suppliers, many of whom are located in China, improve social and environmental standards. The Chinese ICT sector must therefore improve working conditions and environmental standards in order to meet CSR expectations and maintain overall competitiveness. Improved CSR standards among Chinese companies will also help the country achieve the government's goal of a harmonious society and the objectives of the 11th five-year plan. The economic benefits of such an achievement include increased business opportunities, reduced worker turnover and improved reputation of the region and sector. Elements that can help improve the overall soft competitiveness of the industry.

While the ICT sector in China has made much progress, the public and private sectors must now collaborate and focus on long-term capability building in order to achieve sustainable, systemic change. Based on this context, CSR's potential development impact and interest from the Shenzhen government, FIAS launched a project in October 2006 to **develop a capability-building strategy for the ICT sector in Shenzhen to help it meet international social and environmental requirements and improve the soft competitiveness of the industry.**

Overview of Project

The project is designed to identify and test strategies and activities that will most likely improve social and environmental conditions and also provide business benefits to the ICT supply chain. The strategy will initially focus on Shenzhen because it is a popular sourcing destination for the sector and it has already taken steps to improve its CSR environment. The project can potentially be expanded to other regions once its effectiveness is tested.

This project was carefully constructed as a multi-stakeholder initiative to be supported by the government, civil society, industry associations and customers. The partners that are working on this ICT project include FIAS (World Bank Group), Business for Social Responsibility (BSR), Shenzhen Electronics Industries Association, The Electronic Industry Code of Conduct Implementation Group (EICC) and The Global eSustainability Initiative (GeSI). Additionally, research and input were provided by a wider set of stakeholders including suppliers and NGOs, and leadership companies in other sectors.

The project includes four key elements:

- A diagnostic assessment including a private sector root-cause analysis and a public policy and legal review
- A workshop in Shenzhen to discuss assessments, analyze findings and subsequently draft a capability-building strategy
- A final summary report
- A pilot project to demonstrate the implementation of the strategy

Key recommendations

This report includes recommendations for each group of stakeholders that plays an essential role in improving the overall social and environmental conditions in Shenzhen's ICT sector. Each stakeholder must contribute to the changes for any capability-building strategy to successfully combat systemic issues. This report includes detailed analysis and recommendations, the highlights of which follow herein.

- **Suppliers.** Some suppliers realize that they can reap tangible benefits from good social and environmental practices, but many are not yet convinced of the business case for CSR. The difference in perception is often related to the companies' management systems, as well as their ability to measure both the costs and benefits of CSR investments. Furthermore, many suppliers are new to CSR expectations and are merely reacting to customer audits rather than taking ownership of facility improvements. Based on these findings, the mission team recommends that suppliers:
 - ***Conduct a cost-benefit analysis*** to understand the direct and indirect costs and benefits of CSR improvements. Such analysis will result in improved ability to prioritize CSR investments, better data points for negotiation with customers and improved ability to manage the business and monitor progress.
 - ***Implement management and performance measurement systems*** to manage social and environmental issues. Management systems establish processes, procedures and appropriate incentives that eliminate the root causes of non-compliance with standards, and therefore eliminate the need to correct problems after they arise. Suppliers are familiar with management systems used to manage quality; they can apply similar systems to labor, ethics, environment, health and safety as well.
 - ***Improve worker-management communication*** by establishing safe and effective worker grievance channels and other mechanisms that support dialogue between workers and management.

Suppliers should explore opportunities to improve workers' awareness of their rights and responsibilities so that efforts to improve working conditions can be effectively implemented. These activities often result in improved employee retention, increased worker productivity and a more proactive workforce.

- ***Take ownership of improvements and implement CSR with own suppliers.*** Suppliers should take responsibility for improving their own understanding of customer and regulatory CSR expectations, and develop a strategy that aligns with their strategic objectives. Furthermore, suppliers must require CSR performance of their own vendors and find ways to monitor their performance and raise their awareness of CSR expectations and practices.
- **Customers** play an important role in supporting suppliers' abilities to improve CSR practices. Customers have encouraged improved conditions by establishing standards for social and environmental performance. They must also ensure that they improve their own practices so that they can provide appropriate incentives and do not undermine suppliers' progress. Recommendations for customers include the following.
 - ***Provide clear incentives to suppliers.*** Strong, clear customer incentives are essential because they drive senior management attention to CSR. Incentives for suppliers can include continued business, longer contracts, increased price, increased orders/growth in business, public recognition and rewards. Customers must also communicate and follow through on the risks and impacts associated with poor performance.
 - ***Align internal procurement practices with CSR expectations.*** Companies must send consistent messages to suppliers and educate procurement staff about the impacts of CSR requirements. Procurement staff must understand the CSR implications of their sourcing demands so they do not inadvertently place suppliers in situations that would force them into non-compliance with the customer's stated CSR expectations. To ensure consistency, procurement should incorporate CSR metrics into supplier evaluations and decisions.
 - ***Develop standard industry codes and implement them.*** Suppliers, customers and NGOs are supportive of a common industry standard, such as the Electronics Industry Code of Conduct, as opposed to variable standards from different customers.

There is widespread support for a common standard and coordinated implementation in order to avoid duplicating efforts and inconsistent messaging.

- ***Adapt a monitoring model that focuses on improvement, not just compliance.*** Audits or monitoring should not be an “end,” but rather a means to identify issues and areas for continuous improvement. Auditing is most effective when it is part of a larger relationship built on improving overall conditions. This partnership decreases incentives for corruption, enhances open dialogue about challenges and enables opportunities for on-site guidance and knowledge sharing.
- **Government.** Governments, including the Shenzhen government, are increasingly supporting private sector CSR practices, which often results in enhanced private sector compliance with national labor and environmental laws. However, achieving sustainable labor and environmental practices in global supply chains requires an enabling environment that is supported by the government. Experience from a number of countries suggest that governments can choose from a range of public sector roles to encourage business drivers that underpin CSR:

Public Sector Roles			
Mandating	Set standards through laws and regulations	Regulators and inspectorates	Legal and fiscal penalties and rewards
Facilitating	Non-binding guidance and support	Capability building through training	Creating incentives and market stimulation
Partnering	Combining public and private resources	Stakeholder engagement	Dialogue
Endorsing	Political support e.g., through CSR award	Highlighting best practices	Awareness raising

Based on this framework the mission team recommends that the government:

- ***Mandate improvements*** primarily for migrant workers by:
 - a) *Revising the principle of territoriality in the pension insurance plan* to allow migrant workers to withdraw their pension insurance – the portions submitted by both the worker and the employer – when they leave Shenzhen. The administration can deduct a small administration fee, but migrant workers should be entitled to the full insurance.
 - b) *Updating the Synthesized Flexible Working-Hour Law* to ensure that it meets the demand of working hours in export industries and is consistently followed. The government is recommended to consult with the representatives from the exporting industries and ACFTU prior to the review.

- c) *Calculating the number of labor inspectors* based on the number of workers (around 6 million) not the number of permanent residents (around 1.6 million) to ensure effective implementation and supervision of labor law.
 - d) *Assessing the dispute resolution mechanism and providing legal aid.* The arbitration system is not effectively reducing the number of labor dispute cases entering the court system. It is recommended that the Shenzhen Government evaluates the arbitration system and explores options to strengthen the role of the trade union and the employees within the arbitration process. Further, the government can consider improving migrant workers access to financial legal aid.
- ***Facilitate CSR engagement.*** The government took an important step on May 9, 2007 by issuing a policy paper on ‘Suggestions for Promoting CSR’. To ensure broad stakeholder support for the policy it is recommended that the government use this pilot project to consult with the private sector and civil society on the implementation of the policy paper. As part of the consultation, the government is recommended to explore options for capability building and training of both the private sector and civil servants.
- ***Partner with the private sector, ILO and IFC*** to develop a Better Work Program to prevent labor violations and enhance capacity in the private sector. The mission team recommends that the government invites a Better Work scoping mission to Shenzhen to discuss
 - a) The potential establishment of a Better Work Program in Shenzhen to enhance labor conditions in the ICT industry
 - b) The potential public sector application of the ILO Information Management System (IMS) - a software tool that can help make labor inspections more effective.
- ***Endorse company best practice*** through a CSR award. The government is also recommended to increase awareness of the labor law by developing a simplified legal guide to be distributed to migrant workers. The legal guide can include issues on occupational health and safety, legal recourse, medical and injury and illness coverage. It is also recommended to include information on which types of trade union models have been effective in foreign invested companies.
- ***Local NGOs*** play an essential on-the-ground watchdog role and are also in a unique position to provide credible worker education for migrant workers. The mission team recommends that NGOs increase their influence by identifying opportunities to collaborate with the private sector and ensuring that reports are accurate and balanced.

- The *Shenzhen Electronic Industries Association* plays an important conduit role with its membership of small- and medium-sized enterprises in the ICT sector. The Association can help its membership meet customers' CSR expectations and increase export opportunities by educating its membership on international CSR expectations and practices.

Workshop in Shenzhen

FIAS, the Shenzhen Electronics Industries Association, Business for Social Responsibility, EICC and GeSI held a workshop on June 6-7, 2007 to consult with local stakeholders (customers, government, suppliers and NGOs) on the recommendations of this report and agree on a pilot project. Input from the workshop as well as the written feedback have been incorporated into this report. (For additional information on the workshop, please see Chapter 4 below.)

Pilot project

The project also proposes a pilot that will test and support some of the capability-building strategy recommendations above. The description below and in Chapter 4 only represents the initial scope, as specifics of the pilot will continue to evolve in collaboration with local stakeholders.

During the workshop it was agreed to develop a pilot project consisting of a small group of stakeholders including suppliers, buyers, academics, NGOs and government officials, as appropriate. BSR, EICC and GeSI will facilitate the overall process and learning, but it will be up to participants to implement specific recommendations and test different strategies. The pilot will focus on two main areas:

- ***Management systems.*** A subset of the stakeholders will 'test' certain aspects of CSR management systems. The pilot will develop a framework for implementation of a management system and will evaluate the costs/benefits of such implementation.
- ***Worker engagement.*** A second set of stakeholders will test different approaches to worker engagement. This may include worker hotlines, worker councils and worker surveys. A cost/benefit analysis will be conducted as part of the evaluation of each approach.

1. Introduction

1.1 CSR in China's ICT Industry

The information and communications technology (ICT)¹ sector in China has witnessed unprecedented growth throughout the last ten years. In 2006, the sector exported US\$232 billion in goods and employed more than 7.7 million people. Further, it is currently the largest ICT exporter in the world and is expected to continue its growth.²

There has been increased focus on assessing the environmental and social impacts of the industry. The dynamic and complex ICT sector, its large workforce and potential exposure to toxic material present challenges that have to be managed well in order to ensure compliance with national and international standards.

Chinese authorities have recognized that the country needs to balance economic development with environmental conservation and social justice in order to sustain long-term growth. In 2004, President Hu Jintao set the strategic goal of “building a harmonious society.” This concept was expanded in the Chinese government’s 11th five-year plan, where the government committed to sustainable growth by moving away from over-reliance on cheap labor and instead focusing on research, development, worker education and fair treatment.³

The concept of a harmonious society complements the concept of corporate social responsibility (CSR). CSR is the voluntary commitment of enterprises to account for the social, environmental and economic impacts of their business.⁴ Enterprises normally engage in CSR activities to gain a competitive advantage, decrease reputational brand risks, improve productivity and quality and strengthen commercial relationships with both customers and suppliers.

Many international ICT companies are engaged in CSR activities. Increasingly such companies take an industry-wide approach to social and environmental challenges in order to impact their entire supply chain.

¹ The Information and Communication Technology (ICT) sector includes industries primarily engaged in producing goods or services, or supplying technologies, used to process, transmit or receive information. (reference SIC) Companies in the ICT sector or ICT supply chain include original equipment manufacturers (OEMs), electronic manufacturing services (EMS) firms, original design manufacturers (ODMs), component and part manufacturers, ICT R&D companies,

² “*Doing Business*,” the World Bank Group, < <http://www.doingbusiness.org>> and http://www.oecd.org/document/34/0,2340,en_2649_201185_37487522_1_1_1_1,00.html

³ At the third and fourth Plenary Session of the 16th Communist Party of China (CPC) Central Committee.

⁴ Within this context the project will focus on labor, health and safety, ethics and the environment. CSR includes both innovation and compliance with existing laws and regulations.

These companies work together to develop:

- standards-based approaches for improving supplier compliance with codes related to labor, health, safety, ethics and environmental activity (for example, by carrying out joint audits to assess compliance with standards of the Electronics Industry Code of Conduct);
- joint-training programs; and
- information-technology tools to make supply chain management more effective.

The ICT industry is not the first industry to engage in CSR activity in the supply chain. The footwear, apparel, retail and toy industries have worked on this area for around 10 years. Their experience presents an enormous opportunity for the ICT industry to leap ahead by applying the lessons already learned.

One of the most important lessons is that traditional auditing and monitoring of supply chain activities are necessary, but rarely sufficient, to improve social and environmental conditions on a local level. Auditing compliance with codes of conduct is most effective if accompanied by other methods, such as public sector engagement and capability building, including training and education of managers and employers in the supply chain.

Governments are also realizing that CSR efforts are likely to deliver economic and social benefits that contribute positively to national competitiveness. As a result, they actively support CSR initiatives as a means to attract foreign direct investment and position their exports globally.

The local government in Shenzhen, a city in the south-east coast of China, has recognized that CSR can help level the playing field for local companies and international enterprises in the region. The ICT pilot project focuses on Shenzhen because the region has a high concentration of ICT companies and the government has taken the first steps to integrate CSR in its policies.

1.2 Purpose of the ICT project

The purpose of this ICT project is to develop a capability-building strategy that can improve labor and environmental conditions in the ICT industry in Shenzhen. Within a limited geographical area, the strategy can help suppliers learn from best practices, increase productivity, reduce turnover and attract international buyers. The strategy is also in line with the objectives of the 11th five-year plan, by focusing on long-term growth through social and environmental sustainability. It can therefore help the Shenzhen government continue to both increase its GDP and also work toward the goal of a harmonious society. Finally, the strategy can help build a capable network and pool of expertise available to train multiple entities including labor and EHS inspectors, suppliers, workers, etc. The strategy and the pilot project build on:

- **Root-cause analysis:** Analyzes obstacles for improved environmental and labor conditions in China’s ICT supply chain. The analysis focuses on supplier engagement since the suppliers play a key role in code of conduct implementation. (Please refer to Chapter 2.)
- **Public policy and legal review:** Analyzes relevant labor and environmental laws in Shenzhen as well as their implementation in the ICT sector. The chapter provides recommendations to the government and outlines how CSR can help build capacity and promote innovation in Shenzhen’s ICT sector. (Please refer to Chapter 3.)

The root-cause analysis and the legal review provide specific recommendations to suppliers, government, consumers and NGOs. The capability-building strategy will be piloted with a group of suppliers and local stakeholders that can share best practices and test and evaluate approaches on key aspects of the strategy. The primary focus areas will be management systems and worker engagement.

While the project initially focuses on Shenzhen, the recommendations and capability-building strategy are relevant to all regions with a high concentration of ICT supplier companies and can be easily applied elsewhere.

The report also includes an annex that outlines relevant international standards and various best-practice examples of capability building. The annex is a guide for companies, government agencies and consumers interested in engaging in CSR capability building.

1.3 Project partners

The partners that are working on this ICT pilot project include:

- The Foreign Investment Advisory Service (FIAS) of the World Bank Group, which advises governments on investment climates, and has extensive experience garnering public sector support for CSR implementation in supply chain management.
- Business for Social Responsibility (BSR), which is a non-profit business association that serves 250 member companies and has a long history of coordinating multi-company activities to discuss, develop and implement collaborative solutions to emerging CSR issues.
- Shenzhen Electronics Industries Association, which is a private industry association with a number of small- and medium-sized member companies in the Shenzhen region.

- The Electronic Industry Code of Conduct Implementation Group (EICC), which creates standards-based approaches for improving supplier compliance in the areas of labor, health, safety, ethics and environmental activity.
- The Global e-Sustainability Initiative (GeSI), an ICT company initiative with the support of the United Nations Environment Program and International Telecommunication Union. GeSI and its members aim to play a leading role in this project through their commitment to manage their business operations responsibly and promote sustainable business practices around the world.

1.4 Methodology

A mission team consisting of members of FIAS and Business for Social Responsibility met with various government agencies in Shenzhen and Beijing to gather information for the report. Meetings were held primarily with labor and environmental agencies, as well as the All-China Federation of Trade Unions (ACFTU).⁵

The team visited 15 suppliers and conducted additional interviews with six more suppliers after the mission. Suppliers were either identified by their membership in the Shenzhen Electronics Industries Association or invited to participate directly by a customer. Interviews were typically held with general managers, human resource professionals and environment, health and safety (EHS) representatives. The suppliers represented a range of sizes, with approximately 20% having less than 1000 employees, 50% having between 1000 and 10,000 employees and 30% having more than 10,000 employees. Suppliers also represented a variety of ownership models including Taiwanese, Chinese, Singapore, Hong Kong, or foreign owned Joint Ventures.

The following first- and second-tier suppliers participated: Acbel, Bestec, BYD, Celestica, Flextronics, Foxconn, Gatehill, Hipro, Hivac, JingFeng, Johnson Electric, JPC, Kingdom, Kinpo, Longwell, LYD, Moduslink, Precision Plastic, Swenco, Vigorhood, and Volex.

At least six were component suppliers, while the others were dedicated to contract manufacturing, contract design, assembly, etc. Almost all of the suppliers sell directly to major brands or their contract manufacturers.

⁵ Meetings were held with: Shenzhen Bureau of Labor and Social Security, Shenzhen Legal System Office, All China Confederation of Trade Unions, Shenzhen Labor Dispute Arbitration, Shenzhen Bureau of Trade and Industry, Administration of Work Safety of Shenzhen, Bureau of Science Technology and Information and Shenzhen Bureau of Environment Protection. Since one of the objectives of the project is to potentially increase its scale, the project team also conducted several meetings in Beijing, including those with the Department of Social Development of the Development Research Center of the State Council, the China Electronic Chamber of Commerce, the China Enterprise Reform and Development Society, the Ministry of Commerce, the Ministry of Labor and Social Services, the National Development and Reform Committee, China Electronic Enterprise Association and the National Bureau of Science Technology and Information.

In addition, BSR spoke with eight customers who have ongoing and prospective procurement relationships with ICT manufacturers in China.

The team interviewed the following ICT companies in their role as customers: Adobe, Hewlett Packard, Microsoft, Motorola, Nokia, Philips, STMicro and Vodafone. The team also incorporated perspectives from the GeSI/EICC Learning and Capability Building Work Group. To supplement this research, the team asked leading companies such as Disney, Gap, Nike and Novartis to comment on their capability-building activities in China. Finally, the team met with KTS, a footwear factory with leading age CSR programs in Shenzhen.

Ten local NGOs were also interviewed to provide input into the report and also to identify ways they might contribute to capability building in the future. These included: Asia Monitor Resource Centre, ASrIA, China Labour Bulletin, China Labor Support Network, The Chinese Working Women Network, , Greenpeace China, Institute of Contemporary Observation, Labor Action China, Verite, Students and Scholars Against Corporate Misbehavior (SACOM),.

In addition a small roundtable of academics, CSR organizations and donors in Beijing was held during the mission to provide high level guidance and ensure coordination. The following institutions participated in the round-table discussion: German Technical Cooperation, China Institute of Industrial Relations & China Institute of Industrial Relations, Research Management Department Institute of Economic System and Management National Development and Reform Commission, Fair Labor Association, Institute for International Labor Studies under Ministry of Labor and Social Security, Global Compact Promotion Office, China Enterprise Confederation, China Enterprise Directors Association, ENSR, Chinese Productivity Distribution and Regional Economic Development Committee, Chinese Productivity Distribution and Regional economic Development Committee, Development Center of Chinese CSR of China and WTO Tribune under Ministry of Commerce.

Further input from a wider set of government representatives, local suppliers, international customers and society organizations was attained during the Workshop in Shenzhen.

1.4.1. Projects metrics

Metrics were developed in the beginning of the project to define success. It was agreed among the project partners that: *“The project will produce a capability building strategy with specific recommendations to the public as well as the private sector. The recommendations will be a) implementable; b) achieve a high level of ownership from relevant stakeholders; c) replicable and scalable.”* The following is a brief evaluation of these indicators and lessons learned for next steps.

a) Implementable

It is estimated that the recommendations in the capability building strategy are both

realistic and implementable. There is, however, a difference in the complexity of the recommendations. Some are easier to implement, while others relate to structural challenges in the Chinese ICT industry and may require extensive investments of funding and time. It will be up to each stakeholder to prioritize the recommendations based on their own needs, priorities and available resources.

b) Achieve a high level of buy-in and ownership from the relevant stakeholders

The project team has consistently reached out to relevant stakeholders to include their viewpoint and obtain buy-in. Interviews have been carried out with a wide range of suppliers, government agencies, non-governmental organizations and international customers and a draft report was discussed at the stakeholder workshop in Shenzhen.

Some local suppliers, international customers, the Shenzhen Electronic Industry Association and NGOs have clearly indicated that they support the recommendations and are interested in participating in the pilot project. The government has been supportive during the project and the project team will reach out to local government and explore the potential for public-private partnerships.

While input into the project has been substantial, a true measure of buy-in and ownership will be determined by whether some of the recommendations are taken on and implemented by different stakeholders in the future.

c) Be replicable and scalable to other regions

Since many of the root causes found in the diagnostic assessment are the same in other regions, most of the recommendations in the capability building strategy are relevant for other industry sectors and regions, inside as well as outside China.

The strategy provides context, identifies incentives for small medium and large suppliers and makes high level recommendations. Stakeholders will need to identify resources and develop action plans to further implement the recommendations.

To ensure scalability of the recommendations, the public and private sectors will need to collaborate. The purpose of the upcoming pilot project is not to facilitate the implementation of all recommendations in the report, but to prioritize a smaller set of recommendations and demonstrate impact by testing various tools for effective management systems and improved worker engagement.

d) Lessons learned for next steps

Based on the lessons learned it is important to i) have a continuous dialogue with local stakeholders ii) prioritize recommendations based on short and long term effort and impact iii) develop clear success metrics and iv) be as specific as possible in the design phase. These lessons have been integrated into the pilot project. Please see chapter 4, for additional information on the pilot.

2. CSR in Shenzhen's private sector

Shenzhen is located in the Guangdong Province, which is in the south-eastern region of China near Hong Kong.⁶ As its geographical location is advantageous for export, Shenzhen has established the largest special economic zone in China, with an export value exceeding US\$100 billion in 2005.



The private sector has taken a lead role in defining and implementing a CSR agenda among manufacturers in Shenzhen. It is important for all public and private sector players to understand the current state of private sector activities and how these efforts contribute to building manufacturers' capabilities that meet CSR expectations. It is also important for all stakeholders to understand the challenges that may be preventing suppliers from meeting their customers' CSR expectations. If the public and private sectors thoroughly comprehend such root causes of the challenges, they can recommend solutions to positively impact working conditions in the long term. This chapter therefore explains the current state of CSR for the private sector and the causes of challenges that face the industry. The chapter then includes recommendations for how private sector players can improve CSR performance.

⁶ Picture below from: <http://www.travelchinaguide.com/cityguides/guangdong/shenzhen/>.

2.1 Current State: Private sector CSR performance in Shenzhen

Private sector CSR activity in Shenzhen's ICT sector has been increasing rapidly over the past few years. Customers, local government, NGOs, the media and other entities are paying more and more attention to ICT suppliers' CSR issues. The increased attention is driven by workforce issues, changing societal expectations and the economic integration of China into the global economy. All of these factors have combined to increase both the awareness and pressure for improvements in CSR standards among suppliers of all sizes.

Despite substantial progress, companies in the ICT sector still face several CSR challenges. The most common is that of excessive overtime, which continues to be a challenge in most export-heavy industries in China. There is also an overall lack of management systems to appropriately handle labor, ethics, health and safety issues. These and other challenges will be addressed later in this chapter.

Most private sector activity to date has focused on customers raising CSR awareness among their suppliers and auditing their performance. These activities are described in below.

2.1.1 Raising awareness

Most CSR activity among customers has focused on raising supplier awareness of CSR standards. Such efforts include introduction of CSR standards, CSR implementation clauses in contractual agreements, supplier assessments, supplier forums and introductory CSR training to their key suppliers in China.

For example, some ICT companies have required compliance with international standards such as ISO⁷ and SA8000⁸, some have introduced their own company codes of conduct and others require implementation of the Electronic Industry Code of Conduct (EICC).⁹ These customer requirements relate to labor, ethics, environmental, health and safety.

Some customers have facilitated one-on-one meetings in order to raise awareness and introduce these standards to suppliers. Others have provided training sessions and large-scale seminars for their suppliers to explain the customers' expectations, rationale for those expectations and the benefits of improving conditions. Most first-tier suppliers interviewed were familiar with their customers' CSR requirements.

⁷ www.iso.org

⁸ <http://www.sa-intl.org/>

⁹ www.eicc.info

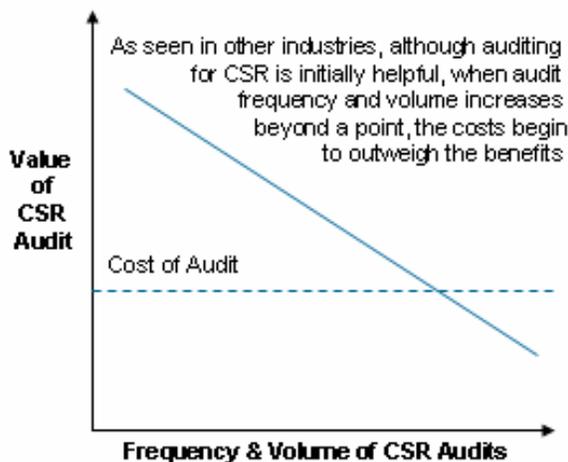
Awareness-raising is far from complete despite these efforts. Most organizations at lower levels within the supply chain, particularly smaller firms, have not been exposed to CSR topics. The suppliers included in this report are likely to have a greater understanding of CSR and customer requirements because companies participating in the mission team’s research (customers) proposed them for inclusion.

2.1.2 Supplier performance management

While assessing supplier performance against CSR expectations is in its initial stages within the ICT sector, most of the suppliers interviewed found the audit process to be somewhat helpful – the external perspective on factory management regarding CSR issues gave some suppliers ideas for improvement at their respective facilities.

Further, supplier auditing fatigue from large numbers of audits and fraudulent bookkeeping has not yet become an issue. Most suppliers have not yet experienced the frequent monitoring that is prevalent in the retail, footwear and apparel sectors that tend to be audited between one and four times per year. Only one or two of the suppliers interviewed had been audited for more than three years and less than half of the suppliers had been audited exclusively for CSR rather than as part of a quality audit. This response was consistent with activity that the customers reported. A recent survey of EICC companies found that 20% of the member companies conduct no audits and another 20% conduct less than 10 total audits per year. However, ICT customers are increasingly devoting resources to monitoring suppliers and beginning to scale up their monitoring activities.

Figure 1: CSR audit frequency



As seen in Figure 1, it is important for ICT customers to strike the right balance between initial constructive auditing and “excessive” checklist or simple compliance auditing that does not achieve additional benefits for either the buyer or supplier. Lessons from other sectors indicate that initial audits serve to introduce expectations, identify areas for improvement, provide suppliers with the tools for self monitoring for CSR and provide an incentive for suppliers to make such improvements. When audits become more frequent, not only do monitoring costs rise, but the time burden on suppliers directs attention away from making improvements and integration into management systems. Fear of non-compliance consequences has also led to more corruption on other sectors as some managers want to quickly pass an audit rather than make impactful changes.

To help curtail excessive auditing, customers are developing ways to jointly audit common facilities; they use external auditors, share audit results and monitor auditor quality. Suppliers see this as a positive development.

Common supplier complaints regarding audits were that audits are too subjective, follow too closely the “letter of the law,” and prevent opportunities for discussion and real learning. Many suppliers felt that too often auditors point out problems but do not provide guidance or suggestions on how to make changes. One general manager said, “auditors don’t have a management philosophy; they only find problems. They may give a chance to explain but their job is to mark non-compliance.”

Still, most of those interviewed felt that audits have the potential to be a positive tool. One medium-sized contract manufacturer stated that audits “put positive pressure on improving practices and raising our awareness.” Another larger company thought that audits helped it “spot areas [it] didn’t see before.” The overwhelming recommendation from suppliers is that audits should not be used as a policing or monitoring mechanism that could undermine trust, but rather, they should be used as a platform for increased dialogue, strengthened partnerships with suppliers and continuous CSR improvement.

Using auditing as a means of identifying areas for continuous improvement will help avoid incentives for corruption that exist within other sectors in China. Reviews of recent sector reports as well as discussions with audit firms highlight that many companies hire “consultants” that provide services that are counter-productive to CSR goals. Not only do some companies waste resources figuring out how to pass an audit rather than understand performance and make investments in improving performance, but this CSR approach ruins relationships between suppliers and customers. The level of trust between suppliers and customers suffers, and consequently more time needs to be spent changing management attitudes and determining true facility performance, rather than improving conditions.

Suggestions to make audits more effective:

- Focus on continuous improvement rather than pass/fail compliance.
- Advise suppliers on *how* to make changes and meet expectations – provide more advice and information regarding best practices during the audit so that suppliers learn how to improve.
- Assess management systems rather than identifying specific incidents – management systems will help the supplier prevent and/or effectively manage problems over the long term.
- Provide more specific guidance regarding how to prepare for audits and customer visits regarding CSR
- Allow suppliers more time to meet expectations as long as it is appropriate given the severity of the non-compliance.
- Facilitate more open and honest dialogue between auditor, customer and factory.

The suggestions above are similar to those of leading companies in the ICT and other sectors that have many years of experience running monitoring programs. Rather than seeing monitoring as an end, these seasoned companies now see monitoring as one tool among several that contributes to continuous improvement at supplier facilities. These companies recommend that others place monitoring in the larger context of incentives for suppliers, customer procurement processes, government regulations and worker empowerment.

2.2 Root-causes of the challenges in the ICT sector

Despite the increased private sector activity and rising public, NGO and media pressure, many challenges continue to limit the success of current initiatives and prevent suppliers from meeting CSR expectations. By understanding the root causes of poor labor and environmental conditions, all related stakeholders – suppliers, customers, government, associations and NGOs – can work more efficiently toward overcoming such challenges and successfully improving the conditions within the ICT sector supply chain.

2.2.1 Immediate costs but long-term benefits

The most consistent challenge articulated by suppliers is that the costs of implementing CSR standards are immediate, while potential benefits are long term. Further, most factories do not have the systems in place to track relevant data and measure the costs and benefits of their CSR investments. It is therefore difficult for suppliers to make strategic decisions in this regard. The few companies that are tracking data on CSR standards report anecdotal evidence of the following benefits:

- Securing more orders from international customers

- Establishing a strategic partnership with key customers
- Increased retention of workers (a major benefit due to the high turnover rate in the industry)
- Increased productivity and quality

Despite this evidence, suppliers overwhelmingly believe that there is not a clear, demonstrable business case for driving social and environmental improvements and that the costs of those improvements tend to outweigh the benefits. This perception stems from CSR costs that are more quantifiable whereas benefits are generally intangible. While suppliers may envision a potential pay-off, they see it as long-term and by no means guaranteed. Additionally, suppliers do not collect and measure the necessary data to make truly informed decisions on this front. Finally, as the time horizon for returns on investments in areas such as personnel, systems and equipment is longer than usual customer contract lengths, there is even less incentive for suppliers to invest in CSR.

Lack of available data indicates the need for educating factories on the benefits of code compliance as well as developing requisite tools to collect cost-benefit information. This data will also be valuable for customers, as it may emphasize the need for customers to increase and/or better align incentives for suppliers to embrace social and environmental requirements.

The timeline for returns on investments is similar to the Total Quality Management (TQM) movement in the 1980s. The tangible benefits took time to realize but once they were, the quality, productivity and delivery benefits were dramatic.

A list of potential benefits and costs of driving social and environmental improvements is provided below.¹⁰ This data should be gathered and included in a cost-benefit analysis.

¹⁰ Note: While certain social and environmental improvements may have directly-associated costs and benefits (i.e., infrastructure costs related to compliance with waste water standards or potential energy savings), the benefits most frequently named as being important to suppliers are derived from overall code compliance. Hence, the list of costs and benefits are based on the assumption that suppliers either meet or do not meet buyer expectations with respect to CSR.

Benefits of CSR Improvements

Following (Figure 2) are the most frequently-cited benefits that suppliers would like to see upon making CSR improvements.

Figure 2: Benefits of CSR improvements

Tangible External Benefits		
Retention of orders	Increase in orders	Price Increases
Tangible Internal Benefits		
Improved product quality/ Reduction in errors	Reduced human resource costs (less staff turnover, enhanced retention, reduced training and hiring expenses, reduced medical/insurance costs)	Reduced CSR audits due to improved relationships with customers
Intangible Benefits		
Improved relationship with shareholders, government regulators, media, NGOs. Enhanced brand reputation		Improved collaboration and communication with customers

The most frequently-cited benefits that suppliers would desire are those defined as *tangible* (easy to quantify) and *external* (customers alone have the power to crystallize these benefits). Compliance with customers' current social and environmental requirements helps increase order retention, but order retention and improved price are by no means guaranteed since many contractual relationships do not last more than a year. However, the ICT industry tends to have longer term and more strategic relationships with their suppliers than other industries. Suppliers would also like to see more business or receive better prices after investing in social and environmental requirements. As suppliers do not currently believe they will receive these benefits, they have less incentive to embrace company codes of conducts or industry specific codes of conducts such as the EICC.

A second category of benefits can be defined as *tangible* and *internal* because they are driven by operational compliance at the factory level. The hypothesis of these benefits is that implementing CSR strategies such as meeting labor standards, improves product quality, boosts staff morale, reduces injuries and thereby enhances overall productivity. That is, a safe and healthy work force may reduce errors and improve overall quality.

Correlating production quality with sound labor conditions would help cement the business case for compliance with suppliers. For example, a few suppliers in our surveys noted seeing a decline in quality when overtime went above 80 to 100 hours. Thus, by way of illustration, reducing and controlling overtime and ensuring that workers have one day off per seven-day week may lead to productivity improvements. Although both customers and suppliers have anecdotal evidence of such linkages, the current lack of data makes it difficult to capture the true internal business benefits of sound labor practices.

Finally, compliant suppliers expressed a hope that deepening trust and collaboration with governments and customers would reduce the total number of CSR audits and thereby free the suppliers’ resources to focus on additional opportunities for improvement.

The other category of benefits encompasses intangible benefits such as an improved relationship with shareholders, media, NGOs, consumers, regulators and customers. Since these intangible benefits are harder to quantify, outreach and education to suppliers on this front would be most effective. Additionally, case-study examples of non-compliance costs such as increased government fines or decreased orders would help validate the intangible good will generated by improving CSR performance.

Costs of CSR improvements

A few suppliers estimated a 3-5% overhead cost increase associated with their investments in customers’ social and environmental requirements. However, these percentages bundle both upfront capital investments and recurrent costs into one category. By breaking out compliance costs into capital and recurrent costs, suppliers would be able to better assess the return on their capital investments. Moreover, by tracking recurrent costs separately, suppliers may see a downward trend in total costs after the initial infrastructure and equipment investment. Therefore, breaking out CSR costs as illustrated below (Figure 3) shows suppliers the decreasing costs of CSR improvements over time:

Figure 3: Illustrative list of costs of CSR improvements

Capital Cost
Investment in new equipment (e.g., environmental health and safety (EHS) system, waste-water systems, upgrades such as machine guards)
Infrastructure development for internal management <ul style="list-style-type: none"> • Tools • Processes • Human resources
Recurrent Costs
Labor cost (currently estimated at around 5% of total costs) include: <ul style="list-style-type: none"> • Wage increases • Overtime payments

<ul style="list-style-type: none"> • Increase in management time • All forms of social insurance • Meals • Dormitory • Training (estimated at around 100 RMB per person per month)
Maintenance and updates to equipment (e.g., A/C testing)
Medical expenses (e.g., first aid kits, onsite medical facilities)
Dorm/facilities improvement
Cost of monitoring: <ul style="list-style-type: none"> • Hours spent during audit / visits • Cost of document collection

Additionally, operating costs are increasing in China due to an increase in minimum wage and social insurance. By tracking costs and impact on margins, suppliers will be able to engage in a more informed dialogue with customers regarding plans for meeting current and future challenges.

Costs of poor social and environmental conditions

The business case for CSR can also be illustrated in terms of the costs of poor social and environmental conditions. For example, poor labor conditions generally result in higher turnover, which is becoming increasingly costly due to the current labor shortage in the Shenzhen region. Supplier interviews revealed an average turnover rate of 8% per month, with larger facilities experiencing closer to 6 % turnover and smaller facilities¹¹ experiencing as high as 20% turnover per month. High turnover drives up costs in a number of ways, as illustrated in the illustrative case study¹² below.

Illustrative case study: Factory X and reduced turnover

Factory X is a mid-sized facility with 10,000 employees on payroll. This factory experiences an average of 9% turnover per month. To better understand the costs associated with turnover, Factory X begins to collect monthly data on all costs associated with losing employees, including time spent on recruitment and training. Upon collecting this data, Factory X determines that losing one employee costs approximately 2,673 RMB (or US\$ 344) as illustrated in the breakout in Figure 4.

¹¹ Small factories are defined as those with up to 500 employees; medium = 501-15,000; large = 15,000+ employees.

¹² Data is based on average approximations collected during supplier interviews. RMB numbers are converted into USD at a rate of 0.1289.

Figure 4: Factory X illustrative costs of employee turnover

Cost Type	Item Description	Cost (¥)	Cost (USD)*
Separation Costs	Cost of exit interviewer's time (assumes a thirty-minute conversation per worker with a line supervisor who makes 1,500 RMB per month)	2	0
	Administrative functions related to termination (assumes thirty minutes spent by line supervisor who makes 1,500 RMB per month)	2	0
Vacancy Costs	Cost of additional overtime for other staff (assumes a worker within the same job band works one week of overtime)	304	39
	Wages and benefits saved due to vacancy (a week worth of wages saved from the worker that is no longer on payroll)	-203	-26
Replacement Costs	Cost of attracting applicants (assumes four hours of human-resource manager's time at the rate of 1,500 RMB per month)	19	2
	Cost of interview process for human-resource manager (assumes 4 hours of manager's time at the monthly rate of 1,500 RMB)	19	2
Training Costs	Trainer salary for orientation training (assumes trainer salary for a three-day training session at a monthly rate of 1,500 RMB)	161	21
	Trainee salary for orientation training (assume three days of salary for worker at the rate of 810 RMB per month)	81	10
	Trainer salary for on-the-job training (assumes one week of salary at a monthly rate of 1,500 RMB)	375	48
	Trainee salary for on-the-job training (assumes salary for one week at a monthly rate of 810 RMB)	203	26
Opportunity Cost	100% lost productivity during orientation and initial training (based on first month's salary of 1,215 RMB, which includes 810 RMB minimum wage plus regular day 1.5x overtime)	1,215	157
	Increased errors in the first month (assumes 33% increase in errors per 1,500 units of output costing 1,500 RMB)	495	64
Total Turnover & Replacement Cost Per Employee		2,673	344

* Converts RMB to USD at a rate of 0.1289

Following is the summary of the salary assumptions.

Assumption	Monthly Salary (¥)	Monthly Salary (USD)
Trainer/ Line supervisor / Human resources manager salary	1,500	193
Worker overtime (assumes regular-day overtime rate of 1.5x)	1,215	157
Worker minimum wage	810	104

The factory realizes when an employee leaves the company, the following costs are always involved: separation costs, the cost of filling the position and costs associated with training the new hire. An additional cost is the opportunity cost of bringing the new hire up to speed. The factory consistently finds that the opportunity cost is the biggest line item, as new hires take an average of a month to become productive and cost the factory money in terms of increased errors during the first month of employment.

Factory X then calculates that with a monthly turnover rate of 9%, the factory is spending 2,405,250 RMB (310,037 USD) per month on turnover. To combat the growing cost of turnover, the factory improves working conditions and strives to improve its relationship with workers. These efforts pay off and turnover drops by one percentage point, which translates to savings of 267,250 RMB (USD 34,449) for that month, as illustrated below.

Assumptions:

- 10,000 total employees (mid-sized factory)
- Monthly turnover of 9% = 900 employees

Item	Cost (¥)	Cost (USD)*
Total turnover and replacement cost at 9% turnover rate	2,405,250	310,037
Total turnover and replacement cost at 8% turnover rate	2,138,000	275,588
Total savings if turnover is reduced by 1%	267,250	34,449

Hence, by tracking the cost of turnover and computing the savings generated from increasing the retention rate, Factory X is now convinced that there is indeed a business case for CSR. Furthermore, the factory recognizes that as the savings above are on a monthly basis, the potential annual savings is much greater.

Emphasizing the cost of not meeting legal or customer requirements is another way to clarify the business case of CSR. For example, poor labor conditions can result in increased injuries, which can increase the cost of doing business by up to 5% of revenue. If more workers are injured due to poor health and safety conditions at a factory, it will face an increase in medical expenses and costs related to production disruptions. Accidents on the factory floor can also influence quality and reduce overall production volume.

Additionally, suppliers provided the mission team with anecdotal evidence that consistent lack of commitment to improve social and environmental conditions can result in customers canceling current orders and decreasing the placement of new orders.

Continual poor working conditions and subsequent labor disputes can also result in government-imposed fines and increased legal arbitration. Suppliers estimate that there are around 10,000 labor disputes annually in Shenzhen. As there are about 8 million workers in the region, this estimation means that one in every 800 workers may end up in a labor dispute.

Thus while the cost of improving social and environmental conditions may be easier to quantify up front and the benefits are realized over a longer time period, the cost of poor performance can result in immediate ramifications and undermine a factory's ability to remain competitive and grow its business. All of these costs and benefits should be considered and collected in order to help customers and suppliers better understand the business drivers for CSR.

2.2.2 Customer incentives for supplier CSR initiatives

Many suppliers feel that pressure from international customers is the main driver for making CSR improvements within their company. Suppliers consistently stated that they needed customer incentives such as rewards, orders, higher prices or longer contracts, as well as consistent messaging from the customers' compliance and procurement departments.

Almost all suppliers stated this strong need for clear incentives from customers. They felt that the incentives were essential to convince management to drive the necessary changes. This sentiment was linked to the perceived conflict that customers are trying to push down prices without attributing any value to the reduced risk that improved supplier conditions provide. Most suppliers agreed that the greatest incentives for improvement would be more orders or longer contracts rather than price increases.

The main findings regarding customer incentives are as follows:

- **Mixed perception among suppliers regarding whether or not CSR helps retain orders.** Factors that may contribute to this mixed perception include the size of contract and whether or not the product is easily available from alternative suppliers at a competitive price and quality. Most suppliers felt that CSR must be included in vendor requirements and the vendor scorecard for it to weigh heavily in their evaluations of possible CSR investments.
- **Customers incorporate CSR criteria in evaluations of existing suppliers.** Customers more consistently state that CSR performance *was* a consideration in the evaluation of business relationships with existing suppliers. A survey of EICC members found that 15 out of 20, or 75%, of companies surveyed use CSR criteria in periodical performance reviews of existing suppliers. The gap in understanding the real risks of poor social and environmental conditions emphasizes the need for better communication between customers and suppliers and more clarity around incentives or risks.
- **Focus is often on continuous improvement, not termination of suppliers.** 35% of EICC respondents said their company had terminated a supplier based on CSR performance. Most companies are committed to working with suppliers to improve CSR performance when poor social and environmental conditions are found. Termination is a last resort when suppliers demonstrate that they are not willing to make improvements. As customers increase their focus on CSR standards and expectations, the ramifications of failing to improve upon poor social and environmental conditions will become a more significant business risk for suppliers.
- **CSR is increasingly a criterion in achieving new sales.** While many suppliers felt that CSR was not a criterion in the sales process since factories are approved before they are audited, the EICC survey found that 65% of members surveyed plan to use CSR criteria to select new suppliers. Customers may need to better communicate with suppliers to ensure that the latter understands the value of meeting CSR expectations.
- **CSR is becoming a means of competitive advantage for larger suppliers.** While smaller suppliers did not believe that CSR could directly increase their competitiveness during the sales process, larger contract manufacturers were starting to view CSR as a means of competitive advantage. In fact, CSR was a key contributing factor to one supplier recently securing a large contract. The supplier's CSR team was actually part of the company's business development pitch. This supplier's top five customers are members of the EICC and represent 50% of the supplier's sales. This supplier believes that contract manufacturing is "moving to a stage where customers prefer to work with a responsible supplier and where brands are not willing to take the risk of only focusing on lowest cost."

- **Opportunity for intangible incentives.** Suppliers also recognized that improved performance could increase customers' trust and result in a more strategic partnership. Such partnerships would benefit both suppliers and customers and further enhance suppliers' abilities to meet CSR expectations. A few suppliers even suggested intangible incentives or rewards such as a high supplier ranking, gold star, a visit from a senior management representative or preferred-supplier status. Such rewards would also help suppliers in marketing their CSR performance to other customers.
- **Need for industry-wide incentives.** Many suppliers were only receiving pressure or hearing about CSR expectations from customers representing less than 25% of their sales, or 1 or 2 key customers. These suppliers felt they would be more motivated to make CSR investments if pressure was coming from the entire industry. Many suppliers sold to a large number of Japanese as well as U.S. and European customers. There was a consistent response that generally Japanese and Korean customers do not convey CSR expectations. Suppliers viewed this inconsistency of expectations as a challenge because they need to justify cost increases based on CSR investments to customers that do not communicate such investments to be a value-add.

2.2.3 Conflicting messages from customers

Almost all of the contract manufacturers and many component suppliers raised concerns regarding the lack of alignment among the internal departments of their customers.

- **Suppliers receive conflicting messages from customers' procurement and CSR representatives.** Such conflicting messages dilute the weight of the CSR expectations and establish a perceived conflict between business and CSR. Suppliers perceive that "procurement does not have good communication with CSR and CSR does not have power over orders." Therefore, CSR is not fully integrated into sourcing decisions.
- **Customers (brands) need to educate internal procurement teams.** While most *customers* interviewed said that discussions about CSR performance are part of regular business reviews and that procurement and CSR functions are "joined up," suppliers and customers alike believe that CSR representatives need to better educate internal procurement teams. Procurement teams need to understand their companies' CSR expectations and how they may be impact certain business decisions. Several customers interviewed emphasized the importance of ensuring that corporate responsibility issues are discussed at the right level between the right people at the right time.

- **Companies need to further integrate CSR into business practices.** At least five of the larger suppliers complained that some customers' business practices prevent or inhibit progress to meet CSR expectations. Some CSR inhibitors include expectations about delivery speed of products, cost structures, profit margins and CSR outcomes that may not always be feasible in practice. The impact of rush orders on overtime is a primary example. One major manufacturer said that a common comment heard from buyers of some leading CSR customer companies is, "I don't care what you do – just get us the orders." At a minimum, suppliers want procurement representatives to be educated about their own companies' CSR expectations and they want to be able to be open and honest with customers about conflicting messages. Most suppliers felt that such dialogue is not yet possible on a consistent basis.

2.2.4 Media/NGO accountability and involvement

NGOs and the media are increasingly focusing on the social and environmental performance of the ICT industry in China. Some NGO and media campaigns are investigating the activities of specific customers and suppliers. Recent ICT-focused campaigns include the following.

- In November 2006, Hong Kong-based Students and Scholars against Corporate Misbehavior (SACOM) launched the "Clean up your Computer" Campaign and published findings from an investigation of 13 Shenzhen electronics factories that produce components for many well-known brand names. The investigation claimed widespread labor abuses, including child labor, excessive overtime, health and safety problems, among others.
- In November 2006, the Centre for Research on Multinational Organizations (SOMO) published a report, called "The High Cost of Calling," detailing hazardous working conditions, pay below the minimum wage and other labor abuses.
- In August 2006, *The Mail on Sunday* reported on labor conditions and wages at facilities that manufacture Apple's iPod digital music player. The story was picked up by many news organizations and prompted Apple to investigate labor conditions and issue a report on how the conditions compared to Apple's "Supplier Code of Conduct."

As such activities place significant pressure on customers, NGOs can play an important watchdog role. To effect the most on-the-ground change, reports should be accurate and should reflect progress made on certain issues or problems. Organizations should also be transparent regarding research methodologies. Since brands' key drivers are reputation, some campaigns unfortunately drive customers to make decisions based on media and not necessarily actual conditions. Further, campaigns may increase direct brand and supplier resources toward responding to the media and away from improving actual conditions. *NGOs and media must therefore ensure that reports are accurate and look for ways to collaborate with brands and suppliers in order to collectively improve conditions in the sector.*

NGOs in Southern China and Hong Kong have increasingly provided critical resources on worker rights, worker education and empowerment. Many such organizations act as a key intermediary to educate migrant workers and help improve labor conditions. NGOs also provide a variety of programs focused directly on workers. These programs include informational resources and training on issues ranging from occupational health and safety to resources and rights under local labor law. Some organizations provide more individualized support such as worker hotlines to answer questions or counseling to explain procedures to deal with worker grievances. Others also focus on life-enablement skills to support migrant workers in their transition to working life. Such trainings operate on the premise that workers should know their rights and legal remedies and have access to decision-making processes in the workplace. This training can also include direct support to companies that are interested in establishing worker committees.¹³ Overall, NGOs provide a safe, independent resource to workers who may be intimidated by raising issues with factory-sponsored grievance systems.

NGOs face challenges of their own in trying to support workers in China. Many of the NGO programs described above are based in Hong Kong and are not recognized by the government; there is a long and difficult process to become a government recognized NGO and their scope and impacts are often quite different. There is also a limited number of cooperative and qualified resources that truly understand the issues and business context and are available to help with capability building.

Still, by helping to ensure that workers are protected and their voices are heard, NGO involvement also increases credibility in the eyes of the external stakeholder community. As companies increase the transparency of their activities, NGO roles will continue to evolve toward more collaboration and active participation.

2.2.5 Management systems

Suppliers and customers agree that management systems are essential to meet CSR expectations, and the suppliers that the mission team visited used a variety of levels of systems. Different management approaches are caused by differing levels of involvement in CSR, and by the management style and the size of the company. Smaller companies have more difficulties of complying with international standards and do not receive the same external pressure.

Many suppliers provided good examples of how management systems can be improved to help companies meet customer expectations. One medium-size supplier commented that management systems move away from focusing on specific CSR examples to processes, policies and procedures that prevent future incidents over the long term. There was also strong evidence that CSR success must be driven by top management. Facilities with the strongest performance believe that support from their general manager had been critical to their success.

¹³ See below section 2.2.6. for additional information on worker engagement.

Key elements of successful management systems may include:

- Key performance indicators linked to compensation for managers;
- Effective grievance system;
- Root-cause analysis of problems and incidents;
- Safety and worker committees;
- Transparency and discussions of injury logs; and
- Training and education for workers.

Greater managerial experience and internal coordination on the part of suppliers is greatly needed in order to balance and respond to conflicting demands. For example, supplier sales teams often do not coordinate with production teams effectively – some sales teams take orders before they confirm two important facts with the production team: (1) the capability to fill the orders in-house, and (2) the ability to fill orders in-house without exceeding working hour limitations. Companies admit that it is difficult for them to accurately predict product demand. In some cases, suppliers must scale up production rapidly and have workers work excessive overtime to meet unplanned orders. Suppliers need to be empowered to push back on CSR issues and to plan appropriately in order to avoid such events.

Essentially, factories that can successfully manage CSR issues are overall better-run factories. A factory that can not manage CSR issues demonstrates an inability to do one or more of the following: (1) understand customer expectations, (2) translate customer expectations into reality and (3) pro-actively adjust its own business process in order to take changing customer expectations into account. Management systems will improve not only CSR but also quality, delivery timelines, development processes, etc. Just as many companies already have management systems to address quality, companies can implement similar systems and processes to manage labor, EHS and ethics issues in a systematic way.

2.2.6 Worker engagement

Worker engagement is seen by customers, NGOs, workers and suppliers alike as a critical component of a responsible supplier, especially given that workers are key beneficiaries of responsible supply chain management. Further, they believe that an informed, participatory workplace with an effective worker-management relationship is essential to manage CSR issues within a factory. Activities that can effectively improve worker conditions include increased worker education regarding worker rights, grievance systems and secure communications channels between workers and management. *A communication system must establish trust in worker-management relations.*

Many of the factories visited had limited approaches to enable worker engagement. Most factories had only one of the following approaches: suggestion boxes, feedback to line managers, hotlines, grievance personnel and annual worker satisfaction surveys. In one medium-sized company, the human resources department conducts both annual surveys and resigning-worker interviews, and creates an action plan based on each survey. Another approach included inviting 20 workers to participate in regular management meetings. Another company provided training during orientation on how “to speak up on issues”. More empowering approaches included worker committees or unions. At least three of the participating suppliers had worker committees and another three had unions.

Many local organizations are working with suppliers, brands or workers themselves to improve worker education and participation. Additionally, the formation of Worker Committees by democratic election within the context of corporate responsibility has created a new space for the Chinese migrant worker voice.

A Worker Committee is an elected body recognized by factory workers and management.¹⁴ A well-functioning Worker Committee at the workplace level is also seen to help achieve the government’s broader goal of nurturing a ‘harmonious society’ in a global economy.

Please refer to Section 3.2 on the All-China Federation of Trade Unions for more information on worker engagement.

2.2.7 Complexity of the overtime issue

The issue of working hours and excessive overtime is the issue that most challenges suppliers’ CSR performance. Many suppliers stated that while they may not yet meet all expectations, working hours was the only expectation that they felt might be impossible to achieve. For example, many managers felt that while they could comply with a maximum of 60 hours per week (which is the standard in many codes of conducts as well as the EICC), they could not comply with the national Chinese law on working hours.

Excessive working hours is a complex problem that stems from laws and regulations, sustainability and industry context, local culture and customer and supplier management practices. Furthermore, the issue of working hours is not unique to ICT; it is perhaps the most difficult issue to manage in any emerging market country with poor law enforcement. Still, it is widely known that the government provides exemptions to the labor law and does not enforce the limit on working hours. As described in Section 3.1.1.2, most companies are exempted and the exception to the law has become the rule.

¹⁴ In some cases the Worker Committee is also recognized by the factory’s major buyers, and independent labor NGOs.

Furthermore, it is argued that most migrant workers want to work overtime because they try to make as much money as possible before returning to their villages. Many parties say that workers' main complaint is delayed payments of overtime and not enough overtime. Most suppliers are concerned that if they reduce the number of working hours, they will have difficulty retaining workers. Interviews with workers confirmed this sentiment.

Since employee retention is a major challenge in Shenzhen, factories are extremely concerned with losing workers due to insufficient overtime. Among the suppliers interviewed, turnover ranged from 3% to 20% per month. Many suppliers felt that workers demanded at least 60-80 hours of overtime per month, and that overtime only became unwelcome above 100 hours per month. Furthermore, several suppliers felt that even at such higher numbers, workers preferred to earn more money than having the time off. The counter-argument is that the workers would work less if they were paid a higher salary. Thus, there must be a balance between wages, benefits, hours and take-home pay. The need for such balance needs to be achieved at a regional level as well, otherwise, workers may just move to another factory where they can work more overtime.

Other factors that contribute to excessive overtime can include changes in the labor market, global pricing changes for raw materials, last-minute changes in customer orders, and inconsistent enforcement of government policy on minimum wage, among others.

To add another layer of complexity, even "within the factory walls," it can be difficult to efficiently analyze and manage the cost of changing overtime. A factory could use work hours to measure whether or not overtime standards are met, but in changing how a factory addresses this issue, several other factors such as production volume, sales forecasting, delivery time, labor cost, productivity, use of temporary workers, process efficiency, overall competitiveness and other factors are greatly impacted. Aspects of issues like overtime can be within a factory's control, but because the issue is so deeply entrenched in a factory's operations, managing it effectively requires shifting the way the entire business operates. This issue is further complicated by the size of several suppliers in China's ICT industry. The scale of change required at a supplier that employs tens of thousands – and sometimes even hundreds of thousands of workers – is quite significant. Some suppliers are building in control mechanisms to measure, monitor and inform supervisors when workers exceed specific overtime limits. If these measurements are linked to supervisor performance, they can be an effective way of managing worker hours.

2.2.8 Implementation of CSR expectations in supply chains

Both customers and suppliers recognize that the best way to impact organizations at deeper levels of the supply chain is through the direct customer-to-supplier relationship. International customers tend to focus on direct suppliers because of existing business relationships. Several customers said that each tier of suppliers needs to manage its own direct suppliers. The idea is to “cascade” requirements and accountability for meeting those requirements throughout the supply chain. Corporate responsibility needs to be fundamentally integrated into direct business relationships; top-tier companies cannot accomplish this alone as they may not have a direct business relationship or even be aware of a company several levels down in the supply chain.

However, since many first-tier suppliers are still in the process of implementing CSR themselves, most have yet to require such expectations of their supply chain. Only five large contract manufacturers interviewed had already begun this process.

For the suppliers who have begun to implement CSR among their own suppliers, a few had included requirements in their supplier contracts. Instead CSR activities included informing suppliers of new expectations, auditing strategic suppliers, self-assessment questionnaires, training internal auditors to include CSR and supplier training. One company is training procurement staff, internal auditors and management and focusing on strategic suppliers that comprise 75% of their supply base. The challenge is that for smaller suppliers, monitoring is more resource intensive and setting up a management system is costly. Larger companies are considering supplier meetings or sending representatives to help smaller suppliers.

2.3 Private sector recommendations

Based on its key findings, the mission team has developed several recommendations to help improve CSR performance among ICT companies in Shenzhen. Success will be based on improved collaboration and dialogue among stakeholders in both the private and public sectors, but each group has the opportunity to directly impact its own performance. This section outlines recommendations for suppliers, customers, NGOs and the Shenzhen Electronic Industries Association. The capability-building strategy in the last chapter is a collaborative strategy, which will be piloted by this project. Each of the following recommendations involves related costs and potential benefits that must be considered when determining implementation plans.

2.3.1 Suppliers

- **Cost-benefit analysis:** Since most factories do not have the systems in place to track relevant data to measure the costs and benefits of CSR compliance, it is difficult for them to make strategic decisions in this regard. *Factories should begin to track data and conduct financial analysis to determine the actual costs of performing poorly on CSR expectations as opposed to meeting or surpassing legal compliance.* Factories that have been successful in realizing benefits from CSR implementation have spent time analyzing both the direct and indirect costs and benefits. While the main cost of such analysis is manager time and developing or sourcing data collection systems, the benefits include improved ability to prioritize CSR investments, better data points for negotiation with customers and improved overall ability to manage the business and monitor progress.
- **Management systems and performance measurement:** Both customers and suppliers agreed that developing management systems is the most important element to ensure long-term conformance with CSR expectations. Management systems establish processes, procedures and appropriate incentives that eliminate the root causes of non-compliance rather than correct problems afterward. Suppliers are familiar with management systems used to manage quality (e.g. ISO9000) they now need to apply similar systems to labor, environment and ethics as well. While upfront costs include investment in such management systems and initial increases in manager time to establish the processes, the long-term result is more efficient and productive management. Specific management systems include ISO14001, SA8000 and OHSAS18001. These are often referenced in international customers' or investors' codes of conducts. Additionally, the best-practice examples that were found in the ICT, retail, footwear and apparel sectors involve incorporating key CSR performance indicators in managers' performance measurement and compensation. This approach aligns the incentive structure to ensure that managers work toward both production and CSR performance goals.

- ***Worker engagement:*** An informed, two-way, participatory workplace with an effective worker-management relationship is essential to manage CSR issues within a company. Suppliers should ensure that they establish safe and effective worker grievance channels as well as other mechanisms for dialogue between workers and management. Supplier need to establish a range of options to collect workers' issues confidentially, including worker surveys, hotlines, worker committees and third party representation. Suppliers should also explore opportunities to improve workers' awareness of their rights and responsibilities so that efforts to improve working conditions can be effectively understood and implemented. There are some upfront costs in terms of implementing such a worker grievance system, but benefits realized by suppliers include improved employee retention, increased worker productivity and a more proactive workforce.
- ***Supplier ownership:*** Rather than only responding to customer expectations, suppliers should know how to identify and address the root causes of poor conditions and establish processes that fit in the company's context. Suppliers can take ownership and accountability for improving their own understanding of customer and regulatory expectations on CSR, and develop a strategy that aligns with their strategic objectives. The factory itself can focus on policies, practices and people to manage CSR issues in a way that meets and exceeds customer expectations. Including appropriate and skilled resources in factory management, sales, production, human resources and environment, health and safety enables the supplier to prioritize activities and track progress internally and externally. A proactive approach to CSR will enable suppliers to effectively handle customer requests that may conflict with CSR expectations. For example, suppliers must be able to identify scenarios where they need to "say no" when orders exceed capacity and might result in excessive overtime. Finally, supplier ownership will enable the supplier to build more trust and credibility with their customers.
- ***Implementation in the supply chain:*** Companies have to balance managing their internal CSR implementation while also ensuring the CSR performance of their direct suppliers. Most companies interviewed believed that the best source of guidance and information was tangible examples. The mission team therefore recommends that, as part of supply chain implementation, companies invite their direct suppliers to their own facilities and teach the suppliers about effective processes and management systems using their first-hand experience. Furthermore, suppliers need to require CSR performance of their own vendors. Suppliers also need to find ways to monitor performance as well as raise awareness of CSR expectations and practices.

- ***Participation in supplier training/guidance:*** While few suppliers were interested in classroom training on specific skills such as human resources or environment, health and safety, there are several potential areas of training and guidance that would enhance suppliers' overall abilities to meet CSR expectations. These areas are less focused on skills transfer and more focused on tools to support overall implementation and management systems. Furthermore, it is critical that suppliers do not just depend on training, but instead identify the key CSR issues and dedicate the appropriate resources to make internal change.

Recommended training could include the following topics.

- Cost-benefit analysis class with sample worksheets and follow-up on performance tracking, development and tracking of specific metrics
- Worker training to improve awareness of worker rights
- Productivity and Overtime
- Best-practice session on how to set up two-way worker management communications and worker grievance systems
- On-site factory training to provide the necessary skills or best practice guidance to correct specific challenges found at the factory

Costs of providing such training may include logistics, trainer and curriculum development if it does not already exist. Suppliers are often willing to pay for such training, typically at a rate of approximately \$100 a day.

2.3.2 Customers

- ***Strategic partnership:*** As with other types of business relationships, the greatest CSR progress tends to occur when the customer and supplier are able to develop a strategic partnership. Strategic business partnerships are already a key element of the electronics industry from a development perspective; they can be leveraged for CSR purposes. A strategic partnership may include a longer contract or at least more frequent interaction and on-site support from the customer. When the relationship is more stable and long-term, suppliers have more motivation to invest in meeting customer CSR expectations. Furthermore, a strategic partnership supports knowledge transfer between customers and suppliers and enables a trusting relationship that can focus on continuous improvement. Best practices from other sectors such as footwear demonstrate that the strong presence of the customer and ability for ongoing knowledge transfer were key ingredients in CSR improvements.

- Customers incentives for suppliers:*** Supplier interviews revealed that strong, clear customer incentives are a primary driver for supplier CSR performance. It is also essential to drive senior management attention at the supplier level. Customers should determine which incentives they are willing to provide, clearly communicate those both internally and with suppliers and then follow up on such commitments in a timely and consistent manner. Incentives can include continued business, stable orders, increased price, longer contracts, increased orders (growth in business), public recognition and/or rewards. While this approach offers a “carrot” to suppliers, the “stick” should also be clearly understood. That is, customers must clearly communicate the risk and impacts associated with poor performance and they should follow through by taking action. The disconnect in messaging from customers and suppliers regarding these risks emphasizes a strong need for better communication. Implementing incentives can be supported by incorporating CSR expectations in sourcing scorecard evaluations or sourcing strategies. While offering greater incentives such as increased orders or price presents some hard costs for customers, the benefits of improved CSR performance in the supply chain include more stable supply, improved quality, reduced reputational risk, less need for monitoring and better-managed factories.
- Internal alignment between procurement officers and CSR compliance staff:*** The lack of consistent messages from procurement and social compliance staff is another common factor that inhibits improved CSR performance by suppliers. Procurement can partially address this issue through incorporating CSR metrics in the initial selection process as well as in supplier evaluations. CSR can also be included in the procurement manager’s own targets. Additionally, for such changes to be effective, companies must better educate their procurement representatives on the company’s CSR expectations and the impacts on suppliers. Inconsistent messages to suppliers often occur in a “firefighting” context in which last minute changes to orders are made. Customers must be consistent with their commercial goals and their calls for improved labor and environmental conditions. Procurement staff must understand the CSR implications of their sourcing demands so they do not inadvertently place suppliers in situations that would force them into non-compliance. Customers can foster greater action by suppliers if they address economic disincentives to good working conditions. Customers will likely face costs in terms of training procurement staff, scorecard development and data system integration, but they will benefit from reduced reputational risk and reduced need for remediation due to their suppliers’ improved CSR performance.

- ***Standard industry code and implementation:*** The suppliers that the mission team interviewed were supportive of a common industry standard, such as the Electronics Industry Code of Conduct, as opposed to variable standards from different customers. Almost all suppliers interviewed felt that the EICC was a reasonable industry standard that they could use to drive implementation. In some cases, suppliers get mixed messaging on the importance or seriousness of the issues depending on the customer. Furthermore, over 80% of the suppliers who sell directly to brands stressed the importance of a common standard to reduce duplication of efforts and inconsistent messaging. Companies that were responding to multiple standards found that different priorities and questionnaires caused them to focus more on responding to customers than on improving conditions. This strong interest in a common industry standard went beyond a common code to the need for coordinated implementation. The suppliers welcomed and encouraged a continued focus on joint implementation such as joint assessments and audits in order to reduce the burden of audits and focus resources on improvements.
- ***Audits for improvement, not compliance:*** Lessons from other sectors that have been monitoring for over a decade, as well as from the supplier perspective on auditing, recommend a modified approach to auditing. Audits or monitoring should not be an “end” but rather a means to identify issues and areas for continuous improvement. There could be several potential benefits associated with conducting audits that are less focused on compliance versus non-compliance, and instead part of a larger relationship to improve overall conditions. First, the incentives for deception during the audit would be reduced. Second, the probability of increased trust and openness about challenges that the supplier faces could be increased. Finally, the audit itself could be used as an opportunity for on-site training, guidance and corrective action. Best-practice examples could be shared during the audit itself, with the people who are responsible for implementation. This type of audit might require training or education of audit firms. See the Best-Practice Example on Auditing: Ethical Trading Initiative Recommendations, Annex 3, Section 3.2.2 for additional information.

2.3.3 NGOs

- ***Provision of worker training/education:*** Local NGOs can play a crucial role in providing much needed worker education and training so that migrant workers understand their rights and learn how to effectively express grievances. NGOs can play a trusted role in protecting workers by providing clear and transparent engagement and communication. They can also be very good audit and monitoring partners as they are more likely to be successful in accurately identifying and obtaining real issues from workers. Organizations should look to identify customers or suppliers who are interested in partnering to provide such worker education.

- ***Partnership for accountability:*** NGOs that are active in this sector should ensure that their reports are accurate and they should be willing to collaborate with companies to find solutions. As much as possible, NGOs should also report on companies' improvements, as taking this step will garner trust from companies and also highlight positive examples for other suppliers to learn from. Brands and suppliers are more likely to be transparent and collaborate with NGOs if they can play the role of a fair and accurate watchdog.

2.3.4 Shenzhen Electronics Industries Association

- ***CSR awareness training:*** Since most of the association's members are small- and medium-sized companies (SMEs), there is currently a lack of awareness regarding CSR expectations and how better labor and environmental conditions can improve a company's competitiveness with international customers. Due to the size of the member companies, they have less resources and less opportunity to engage directly with international customers on these issues. The association provides workshops that can enhance the export opportunities for its membership. A workshop or seminar to introduce CSR, examples of labor, health and safety and environmental standards, and high-level trends and benefits would raise overall awareness among SMEs in the ICT sector in Shenzhen. This education would ease implementation within lower tier suppliers, improve export opportunities and help the association retain members and stay current with customer trends and demands. Opportunities to share tools, processes, methodologies and other resources could also help companies in a practical way. The Shenzhen Electronics Industries Association is recommended to reach out to members of the EICC and GeSI and leverage their influence with member companies.
- ***Survey of association members:*** The association is also in a unique position to have a substantial membership of small- and medium-sized suppliers in the local ICT sector. Since data availability and benchmarking are a challenge for suppliers, the association could conduct a survey of its membership to establish a baseline of data on current investments, levels of performance, challenges and benefits realized. This survey could be used as a platform for engaging with customers and/or the government regarding this segment's specific challenges and needs.

3. CSR in Shenzhen's public sector

Pursuing a strong GDP has been a primary goal for the Shenzhen government in the past 10 years. Social and environmental responsibilities had been somewhat ignored or considered an element that was impeding economic development until 2004 when the national government developed the new goal of building a “harmonious society”. The Shenzhen government has changed its development strategy from economic development at the cost of social and environmental welfare to a more balanced economic, social and environmental development strategy. Shenzhen is the first city in China to make this shift.

The Shenzhen government recently issued a policy paper on ‘Suggestions for Promoting CSR’. Mr. Zhang Guojiu, the Deputy Director at the Shenzhen Municipal Bureau of Labor and Social Security, has outlined eight components of Shenzhen's future CSR institutional framework:¹⁵

- Promotion of balanced economic and social development.
- Strengthened and more effective law enforcement effort.
- Establishment of a government leadership mechanism that clearly defines the roles and responsibilities of government departments.
- Improved access to CSR information and the creation of an evaluation mechanism.
- Establishment of local CSR standards.
- Establishment of an incentive mechanism to reward excellent CSR performance.
- Improved internal company CSR management mechanisms.
- Enhanced participatory mechanism for different civil society organizations.

The proposed strategy outlines a sound framework for CSR and the mission team commends the government its initiative. This chapter complements the government's strategy by analyzing the existing legal framework and enforcement mechanisms relevant to the ICT industry in Shenzhen. The chapter also provides specific recommendations that can help the government further develop and implement its framework and leverage the influence of the parties involved in the pilot project.

3.1 Implementation of relevant laws in Shenzhen

The regulatory framework in Shenzhen covers most social and environmental areas that are relevant to CSR. *The challenge is therefore not the regulatory framework, but the implementation and enforcement of this framework.*

¹⁵ CSR: New Governance Idea of Shenzhen, P82, <China WTO Tribune>2006, Volume 12.

This public-sector analysis has three purposes.

- First, it outlines the legal framework in relation to national labor and environmental standards.
- Second, it analyzes law implementation and enforcement within the ICT industry in Shenzhen.
- Third, it includes recommendations to relevant government agencies.

The mission team selected the areas analyzed below based on what local stakeholders highlighted as the most important CSR issues in Shenzhen. This is therefore not an exhaustive analysis of the regulatory framework in Shenzhen or a detailed description of all challenges in the ICT industry. Instead, it aims to provide an *overview of key areas where the public sector can most effectively focus its resources in order to build a sound CSR framework in Shenzhen and establish best practice in China.*

3.1.1 Relevant legislation on labor protection

In terms of international standards, China has ratified four of the eight core ILO Conventions, including:

- Equal Remuneration for Men and Women Workers for Work of Equal Value (C100);
- Elimination of Discrimination in Respect of Employment and Occupation (C111);
- Minimum Age for Admission to Employment (C138); and
- Prohibition and Immediate Action for the Elimination of the Worst Forms of Child Labor (C182).

According to the ILO, China will also ratify the core conventions on elimination of all forms of forced labor or compulsory labor (C29 and C105). China has not ratified the convention on Freedom of Association and Protection of the Right to Organize (C87) or the Application of the Principles of the Right to Organize and to Bargain Collectively (C98).

3.1.1.1 Anti-discrimination and social benefits

Legal framework:

Anti-discrimination is a key CSR area of concentration in Shenzhen, especially as it relates to the treatment of migrant workers. Migrant workers in Shenzhen have outnumbered permanent residents – there are around six million migrant workers, compared to only around 1.6 million permanent residents.

The “Labor Law of the People’s Republic of China” (Labor Law), effective as of January 1, 1995, establishes the most comprehensive legal protection for workers, and states that “Employees shall not be discriminated against in employment, regardless of their ethnic community, race, sex or religious belief.”¹⁶

The Standing Committee of Shenzhen Municipal People’s Congress has adopted several regulations that focus on the rights of migrant workers.¹⁷ The “Regulations on Migrant Workers in Shenzhen Special Economic Zone”, one of the first such laws, states that all migrant workers are entitled to a contract and that they will be compensated if their contract is unlawfully terminated.

Further, the Labor Law states that “employees shall, in accordance with the law, enjoy social insurance benefits under the following circumstances:

- retirement;
- illness or injury;
- disability caused by a work-related injury or occupational disease;
- unemployment; and
- child-bearing.”¹⁸

Specifically in relation to migrant workers, the Shenzhen municipal government promulgated the “Shenzhen Municipal People’s Government to Further Strengthen the Rights of Migrant Workers” on December 2, 2006. It is a comprehensive legal framework that promotes sound working conditions for migrant workers in Shenzhen. The goal is to allow migrant workers to share Shenzhen’s fruits of reform and development by ensuring equal treatment of migrant workers and their families and providing them with social security.

¹⁶ Labor Law, Article 12.

¹⁷ Regulations include: Labor Law, Women’s Rights Guarantees Law, Regulations on Migrant Workers in Shenzhen Special Economic Zone, Statutes in Implementing Women’s Rights Guarantees in Shenzhen Special Economic Zone.

¹⁸ Labor Law, Article 73.

Implementation in the ICT sector:

The legal framework has improved for migrant workers. However, in practice *it will be a long-term effort to ensure that migrant workers have the same working conditions and receive the same social benefits as permanent residents.*

Shenzhen has been a pioneer in establishing a social insurance plan for migrant workers, including pension, medical, industrial injury and unemployment insurance. Currently, over three million migrant workers participate in Shenzhen's labor pension insurance, and they have set a precedent for the nation.¹⁹ However, if a worker leaves Shenzhen, it is difficult to withdraw the pension insurance and transfer it to another province.

Migrant workers also find it difficult to obtain unemployment insurance since employers do not always provide new employees with labor contracts. As a result, they can not prove that they held a previous job.

Recommendations:

- ***Implement migrant workers laws:*** While Shenzhen has developed a sound regulatory framework, implementation falters in some areas. The team recommends that the government expedites implementation of the “Shenzhen Municipal People's Government to Further Strengthen the Rights of Migrant Workers” initiative.
- ***Revise the principle of territoriality in the pension insurance plan:*** The team recommends that the government allows migrant workers to withdraw their pension insurance – the portions submitted by both the worker and the employer – when they leave Shenzhen. The administration can deduct a small administration fee, but migrant workers should be entitled to the full insurance.
- ***Assess unemployment insurance:*** The team recommends that the Shenzhen government conducts an assessment of unemployment insurance in order to ensure that it effectively meets the needs of migrant workers.²⁰

¹⁹ http://shenzhen.cn/xwfbh/xwfbh_7/

²⁰ <http://www.ahnw.gov.cn/2006nwkx/html/200610/{60E731A9-28BF-44B4-9363-3C7FBDE7383B}.shtml>

3.1.1.2 Overtime hours

Legal framework:

The laws and regulations stipulate that employees shall not work more than eight hours per day, nor more than 44 hours per week.²¹

Employees are also entitled to at least one day of rest per week. Further, extended working hours shall not exceed three hours per day and the total extension in a month shall not exceed 36 hours.

The law clearly stipulates the following regarding labor remuneration for working-hour extensions. The employer shall:

- pay no less than 150% of normal wages if the extended working hours are arranged on weekdays;
- pay no less than 200% of the normal wages if the extended hours are arranged on days of rest; and
- pay no less than 300% of the normal wages if the extended hours are arranged on statutory holidays.²²

Implementation in the ICT sector:

The Chinese Labor Law was drafted more than 10 years ago, when economic development was not as rapid as it is now. In an export-oriented area like Shenzhen, it is a major challenge to comply with the Labor Law in relation to overtime.

In the ICT sector, employees often work long hours – in the delivery season, overtime work can be more than 80-120 hours per month.²³ The government has introduced a Synthesized Working-Hour Law in order to adapt to the current situation. It establishes a system of flexible working hours that permits extra overtime hours in the peak season if the company has fewer working hours in the low season. Even with the flexible working hour system, overtime shall generally not exceed three hours per day and the total extension shall not exceed 36 hours per month.

²¹ Labor Law, Article 36. Other relevant laws include: The State Council Rules on Working Hours for Staff and Workers, the Notice on Approval Procedures for Enterprises Implementing Flexible Working Hours or Overall Average Working Hours Systems for Calculating Working Hours, and Regulations on Migrant Workers in Shenzhen Special Economic Zone.

²² Labor Law, Article 44.

²³ Information based on interviews with ICT enterprises and their employees.

To establish a flexible working-hour system, the employer must request the Labor Administrative Department for approval and consult with the trade union and migrant workers. Based on interviews from the field mission, it appears that most exporting companies in the Shenzhen region do receive approval from the Labor Department and follow the Flexible Working-Hour System.

Payment for overtime is another challenge. Many companies do not pay employees overtime wages or delay the payment for the extra hours that they spend in the factories. The national law does not clearly indicate when the overtime wages should be paid. The Shenzhen government is trying to solve the problem through promulgating “Regulations of the Shenzhen Municipality on Wage Payment to Employees”.

If an employer violates the overtime rules, the laws dictate that the government should order the employer to make an immediate correction and fine the company 10 RMB per hour per the number of workers. However, the law is not rigorously implemented.

Recommendations:

- ***Update the Synthesized Flexible Working–Hour Law:*** While the Law aims to solve a complicated challenge, it is not meeting the demand of working hours in the ICT industry. The mission team recommends that government considers revising the Law in order to ensure that:
 - the law is *consistently followed*, rather than following an exception to the law;
 - the specific challenges of the exporting industries are taken into consideration; and
 - the law is based on consultations with the private sector, workers and trade unions.
- ***Create incentives for employers to follow the revised labor law:*** The challenge of overtime is not exclusively the responsibility of the government. It requires that employers manage and plan production more efficiently, increase productivity and establish a better communication with customers to avoid last minute placing of orders, as described in Chapter 2.2.7. ‘Complexity of Overtime Issues’ However, the government can create incentives to increase compliance with the law, such as:
 - Increased inspection of compliance with a revised flexible working-hour system.
 - Increased taxes or fines on employers that are not willing to plan their production in a manner that prevents excessive overtime.

- Media exposure of non-complying companies. The government could also consider showcasing and rewarding companies that consistently comply with the labor law.

3.1.1.3 Occupational health and safety

Legal framework:

Occupational health and safety are key CSR concerns in China. They are covered in different laws and regulations, both on a national level and at the Shenzhen Municipal level.²⁴

The main health and safety laws are:

- The Labor Law and “Production Safety Law” that set standards regarding working conditions, protection gear and funds management.
- “The Code of Occupational Disease Prevention”, which requires enterprises to implement procedures that prevent and manage occupational injuries and diseases.
- “The Law on Management of Safety in the Shenzhen Special Economic Zone” that requires enterprises to implement emergency preparedness and response policies.
- “The Production Safety Law” stipulates that the enterprises should service, maintain and regularly check their safety facilities.

Employers hold primary responsibility for their employees’ occupational health and disease prevention. The government is responsible for supervising the enterprises to ensure compliance with the law.

Implementation in the ICT sector:

Occupational health and safety are concerns in the ICT industry, especially because of inconsistent or inadequate employee training and protection, particularly for workers that may only work in peak seasons. The industry grows and automates rapidly and much of what was previously done by hand is now done by machine such as Printed Circuit Board (PCB) cleaning. Employees in this industry operate potentially dangerous machines and, if not trained properly, can be exposed to toxic substances, which can cause skin irritations. Other activities in the ICT industry that

²⁴ Regulations and laws include: Labor Law, Hygienic Standards for the Design of Industrial Enterprises GBZ1-2002, Regulations on Safe Sanitation in Factories, Design Regulations for Fire Extinguisher Installation GBJ140-90, Regulations on the Building Design for Fire Prevention GBJ16-87, Norms for the Noise Control Design of Industrial Enterprises, Regulations on the Building Design of Dormitories JGJ36-2005, Safety Production Law, Code of Occupational Disease Prevention, Law on Safety Management in Shenzhen Special Economic Zone and Regulations on Migrant Workers in Shenzhen Special Economic Zone.

can cause occupational harm without proper training and personal protective equipment (PPE) include noise from stamping machines, paint exposure from powder coat spraying and tool injection and molding of metals and plastics.

Implementation of the laws and regulations varies from company to company, but the phenomenon of “emphasizing production while ignoring safety” is common, especially in smaller factories. Not all factories spend the necessary resources on worker training, safety protection, emergency education or regular safety inspections.

In 1990, a work injury insurance system was established in Shenzhen to cover all workers in case of an occupational injury or disease. While the system is a good way to ensure that workers get access to treatment, 4,661 enterprises were not paying into the social security system in 2005. As a result, some 1.088 million employees, most of whom were migrant workers, were not protected.

Six District Labor and Social Security Bureaus are responsible for supervising labor laws in Shenzhen, including health and safety measures. The number of labor supervisors is based on the number of permanent residents, not the total number of workers. This imbalance creates a resource constraint – and the labor inspectors do not have the capacity to inspect all enterprises. The Labor Bureau has hired part-time staff to combat the problem, but part-time staff do not have all necessary qualifications nor they can fill the capacity vacuum.

The Shenzhen Labor Bureau has developed an innovative color system that systematizes inspections and efficiently uses its limited resources. Enterprises are divided into three groups: green, blue and red. If an enterprise is categorized as green, the enterprise is complying with labor laws and it will not be inspected again within a year. If an enterprise is categorized as blue, it will be spot-checked once per year. If an enterprise is given the red label, it will be inspected every month because of bad performance. *The color system is an effective way to optimize the limited resources and should be replicated by other departments.*

Recommendations:

- ***Calculate the number of labor inspectors based on the number of workers:*** The number of labor inspectors is currently determined based on the number of permanent residents (1.6 million), not the number of migrant workers (6 million). The mission team recommends that the Shenzhen government increases the number of full-time inspectors based on the actual number of workers in order to ensure effective implementation and supervision of labor laws.

- ***Implement an information management system to facilitate labor inspections:*** The ILO has developed an information management system (IMS), which is a software system that measures compliance with labor standards. Labor inspectors can use the system by typing information into their palm pilots when making inspections. The information is later uploaded into the information management system, which then automatically produces reports comparing a particular company's processes with labor standards, such as the Chinese Labor Law. The mission team recommends that the Shenzhen Bureau of Labor Inspections invites the ILO to demonstrate the IMS software tool, as this can be an effective mechanism to increase effectiveness and transparency in labor inspections.
- ***Train the private sector:*** There are many training courses available in Chinese on occupational health and safety. The government can consider subsidizing training on the implementation of health and safety laws and regulations. The training should emphasize the steep price that employers pay for occupational injuries and accidents.

3.1.1.4 Minimum wage and employment terms

Legal framework:

The “Regulations on Payment of Shenzhen Employees’ Wages” define minimum wage as the minimum remuneration for normal labor within normal working hours.

A survey conducted by the Shenzhen Labor Bureau in 2006 revealed that the employees’ average living expenditure was 1,568 RMB per month inside the special economic zone and 703 RMB outside the special economic zone. Based on this living standard, the minimum wage inside Shenzhen was 810 RMB per month and outside Shenzhen it was 700 RMB per month.²⁵ The minimum wage was last raised on July 1, 2006. It is now the highest minimum wage in the Guangdong province and only second to Shanghai in all of China.²⁶ The minimum wage is lower in cities outside Shenzhen.²⁷

²⁵ <http://61.144.227.1/xwfbh/xwfbg/200608030069.h>

²⁶ www.chinalaborwatch.org

²⁷ In Zhuhai, Foshan, Dongguan and Zhongshan, the minimum wage is 690 RMB. In Shantou, Huizhou and Jiangmen the minimum wage is 600 RMB. The monthly minimum wage in Shaoguan, Heyuan, Meizhou, Shanwei, Yangjiang, Zhanjiang, Maoming, Zhaoqing, Qingyuan, Chanzhou, Jieyang and Yunfu cities is 500 RMB. In other provinces the minimum wage is 450 RMB per month. <http://www.china-labour.org.hk>

The minimum wage applies to all enterprises regardless of whether they pay their employees a monthly wage, a piece rate or a dividend wage. It does not include overtime pay or any other subsidy for special operations, such as working in extreme temperatures.²⁸

The relatively high minimum wage is a mechanism to encourage enterprises to move up the value chain and become less dependent on a cheap labor force. It is also a way to attract workers to the region and ensure that the workers can afford the cost of living in the Shenzhen area.

The Labor Law states that the Labor Administrative Department shall order employers to pay workers remuneration and cover economic losses in situations where the employer:

- deducts wages;
- delays paying wages to employees without reason;
- refuses to pay employees remuneration for extended working hours;
- pays laborers wages below the local standard or minimum wages; and
- fails to provide employees with economic compensation in accordance with the provisions of this Law after revocation of labor contracts.

The Labor Law also stipulates that employees have the right to choose to work; the employer cannot ask for a deposit or sign-up fee, nor can the employer force employees to invest in the enterprise.

Another important Labor Law regulation is that employees are entitled to a labor contract “in written form that contains clauses regarding the following:

- term of a labor contract;
- content of work;
- labor protection and working conditions;
- labor remuneration;
- labor discipline;
- conditions for the termination of a labor contract; and
- responsibility for the violation of a labor contract.”²⁹

²⁸Labor Law, Regulations on Minimum Wage, Notice of the Ministry of Labor on the Implementation of the System of Minimum Wage Protection, Regulations on Migrant Workers in Shenzhen Special Economic Zone, Regulations on Minimum Wages in Shenzhen Special Economic Zone, Regulations on Payment of Shenzhen Employees’ Wages, Regulations on Protection of Wages on Insolvency.

²⁹ Labor Law, Article 19.

A labor contract is key to establishing transparency in the working relationship and it provides workers with a clear overview of their rights, responsibilities and legal recourse.

The new Labor Contract Law will further strengthen workers' right to a labor contract, collective contracts and compensations. It also codifies administrative and criminal penalties for labor law violations.³⁰

Implementation in the ICT sector:

Based on discussions with local stakeholders, the mission team estimates that it is not difficult for ICT enterprises, especially larger ones, to pay minimum wage. However, *many employers pay less than the minimum wage, delay payment of wages, refuse to pay for extended working hours and fail to provide economic compensation after revocating a labor contract.* According to sector reports, other violations include paying below the minimum wage in the first three months of employment and in the low season, as well as deducting penalties and fines from the workers' salary.³¹

The key reason for the violations is that many workers are not aware of their rights or means of recourse and are not provided with a contract that clearly outlines their rights and responsibilities. Further, many enterprises do not have a mechanism through which employees can complain about violations.

The government can increase awareness through campaigns such as "Caring Action". For a month, the Labor Department of Shenzhen disseminated labor law and regulation information by distributing pamphlets to 300,000 migrant workers. The campaign was very successful; nearly 25 million RMB in unpaid wages were properly paid.³²

Another reason for the violations is that the cost of unlawful practice is rather low for some enterprises. While the Shenzhen government has more capacity than neighboring cities to inspect factories, it does not have the resources to ensure that all enterprises pay minimum wage.³³

Recommendations:

³⁰ Law of People's Republic of China on Employment Contracts, (Adopted at the 28th Session of the Standing Committee of the 10th National People's Congress on June 29, 2007. Effective from January 1, 2008.)

³¹ SACOM, *An Investigative Report on Labor Conditions of the ICT Industry*. November 2006.

³² Shenzhen Municipal Labor and Social Security Bureau Work Report from the first half of 2006.

³³ In the Regulation on Labor Security Supervision, the penalty for resistance to labor inspection is 20,000 RMB. For misreporting total salary or total numbers of employees, the fine is three times the employees' deserved payment. For delay of wage payment, employers must pay the compensation.

- ***Develop a simplified legal guide and distribute it to workers:*** Chinese laws offer a comprehensive system of protection for workers in the ICT industry. However, many of the workers are not aware of their rights and can therefore not articulate them in the workplace. The mission team recommends that the Shenzhen Labor Department builds on the success of “Caring Action” and disseminates information on the labor law in simplified pamphlets to ICT industry workers. This should include issues such as occupational health and safety, legal recourse, medical and injury and illness coverage etc.
- ***Publish the names of enterprises that pay less than minimum wage and violate labor laws:*** The mission team recommends that the government publicly names companies that default on wages or fail to comply with other aspects of Chinese labor law. The Shenzhen Government and the Guangdong Government have already published lists for a range of non-complying companies. The mission team encourages them to expand the lists and reach out to English-language papers in order to ensure that international consumers have access to the information.
- ***Increase fines for unlawful practices:*** The regulations on minimum wage carry comparably low penalties. Large companies can afford to pay a fine instead of following the law. The government can therefore consider increasing penalties to employers that do not issue or sign labor contracts, pay less than the minimum wage, avoid paying wages and/or require overtime without having obtained the necessary exceptions.

3.1.1.5 Juvenile workers

Legal framework:

In China, children under 16 years old are not allowed to work, with some exceptions in the areas of literature, art, physical culture and sport.³⁴

Juveniles are defined as young people at the age of 16 or 17. This group can only be employed under specific conditions where their right to education, as well as their occupational health and safety, is protected. The employer shall provide regular physical examinations of juvenile workers.³⁵

Implementation in the ICT sector:

The cost of violating the laws and regulations on child labor is rather high for employers. An employer using child labor is fined 5,000 RMB per child. The agency or the person who introduced the child to the employer is also fined 5,000 RMB per child.

³⁴ Labor Law, Article 15.

³⁵ Labor Law, Articles 15, 64 and 65.

If child labor is discovered, the government sends the child back to his/her hometown. Once back in his/her hometown, the local government issues a letter to the sending government. The employer that hired the child must cover the cost of this process. If the employer uses child labor again, the employer receives double the fine or has its license revoked.³⁶ The mission team did not hear any complaints of child labor, but some NGOs report stories of child labor, especially in the summer period, where children work in the factories to “pay of the school fees owed”.³⁷

Hiring juvenile workers is a bigger challenge in the ICT industry, and is related to the labor shortage in the region. Based on anecdotal evidence, some enterprises do not check identification or they are presented with falsified identification. The Labor Department is responsible for supervising the regulation on juvenile workers.

Recommendations:

- To ensure that companies check identification, the mission team recommends that labor inspectors review records of worker identification during labor inspections.
- Strengthen the age-verification system for workers coming from rural provinces. Establish clear alliances with law enforcement entities in these provinces for formal and thorough checks.
- Clearly state that it is the enterprise’s responsibility to ensure that identification has not been falsified, and that the enterprise will be held responsible if an inspector finds the record of a worker falsified identification.
- Ensure supervision of and clear guidance for companies regarding employing juvenile workers. The information should include a remediation plan if a juvenile worker is found working in the enterprise.

3.1.2 Relevant legislation on environmental protection

Legal framework:

An extensive legal framework covers pollution prevention and environmental protection. The most important legislation includes³⁸:

³⁶ Labor Law, Article 94.

³⁷ SACOM, *An Investigative Report on Labor Conditions of the ICT Industry*. November 2006

³⁸ Relevant laws and regulations include: Environmental Protection Law, Cleaner Production Promotion Law, Cleaner Production Auditing Process of Enterprises, Interim Measures for Cleaner Production Auditing, Law on Prevention and Control of Water Pollution, Law on Prevention and Control of Pollution from Environmental Noise, Law on Prevention and Control of Pollution of Solid Waste, Water Law, Soil Management Law, Regulations on Environmental Protection in Shenzhen Special Economic Zone, Promoting Regulations on Recycling Economy in Shenzhen Special Economic Zone, The Administrative Measures for Pollution Control of Electronic Information Products, Requirements for concentration limits for certain hazardous substances in electronic

- ***Environmental protection:*** According to “Regulations on Environmental Protection in Shenzhen’s Special Economic Zone,” enterprises must report and register their pollutant discharging with the Environmental Protection Department. Enterprises exceeding the national or local discharging standards, or using toxic and hazardous materials, conduct cleaner-production audits.
- ***Recycling:*** According to “Promoting Regulations on Recycling Economy in Shenzhen Special Economic Zone,” enterprises shall promote cleaner production and reduce waste in the production process, recycle the waste and waste heat or transfer them to enterprises or individuals who have the ability to recycle and reutilize the waste, and properly handle the non-recyclable waste.
- ***Hazardous substances:*** According to the “Administrative Measures for Pollution Control of Electronic Information Products,” manufacturers shall control the poisonous and hazardous substances or elements in the process of making electronic information products. They shall also adopt materials, techniques and processes with high resource-utilization rates and other environment-friendly effects.
- ***Wastewater and solid waste:*** According to the “Cleaner Production Promotion Law,” enterprises shall monitor resource consumption and generation of waste from production. They shall also conduct cleaner-production audits with respect to production and service procedures.
- ***Air emissions:*** According to the “Environmental Protection Law,” enterprises shall adopt effective measures to prevent and control pollution caused by poisonous and hazardous substances.
- ***Product content restrictions:*** According to “Requirements for concentration limits” and the “Administrative Measures for Pollution Control of Electronics & Information Products,” manufacturers shall declare the name, elements, recycling period and recycling possibility of poisonous and hazardous substances in electronics and information products.

Implementation in the ICT sector:

The Shenzhen Bureau of Environment Protection is responsible for environmental management, including pollution control, emergency command and dispatch, complaints, handling and inspections. The Bureau has developed an online monitoring system for pollution control. This system effectively detects and prevents pollution scandals. The mission team believes that this management system is more extensive than what many other countries use to prevent pollution.

The main challenge to environmental protection is that some laws and regulations are outdated. The “Shenzhen Environmental Protection Statute” was enacted 10 years ago – its waste-water discharge standard does not reflect current challenges or the technological developments of waste-water and air emission purification.

A second challenge is that the penalties for pollution are not high enough to prevent it. The maximum penalty in the “Prevention and Control of Water Pollution law”, for example, is 100,000 RMB for discharging pollutant in violation. This fine is not steep enough to prevent large factories from polluting.

A third challenge is the unclear division of labor among local government departments. For example, the Environmental Protection Department and the Water Resource Department are both responsible for water pollution, and cases often fall between two department chairs.

Recommendations:

- ***Update environmental laws:*** Many laws and regulations have not been updated to reflect the economic changes in Shenzhen and the more strict environmental standards in exporting markets. The mission team recommends that the Shenzhen Government reviews the most relevant laws and regulations to ensure that:
 - fines are high enough to prevent unlawful practices.
 - standards for pollution and waste water reflect technological development and the size of the companies in the Shenzhen area.
 - various government departments collaborate effectively to avoid grey areas of responsibility and authority.
- ***Publish the names of enterprises that continuously violate environmental laws:*** The mission team recommends that the government publicly names companies that continue to violate environmental laws. The government is encouraged to post names on Chinese websites and publish the names in newspapers as well as English-language papers and websites to ensure that international consumers have access to the information.

3.2 The All-China Federation of Trade Unions

A trade union bridges the gap between employers and the employees and, as a result, prevent labor disputes and increase productivity levels. The All-China Federation of Trade Unions (ACFTU) is the only trade union federation in China and all trade unions on an enterprise level are therefore affiliates of ACFTU.

The ACFTU is historically linked to the planned economy and the management measures and structural system that were developed for state-owned enterprises. As a result, the union was traditionally more focused on the welfare and entertainment of workers, rather than negotiating with management to protect the workers rights and benefits.

Enterprise trade unions can be established as affiliates of the national ACFTU in enterprises with more than 25 employees. Membership of ACFTU is open to all workers whose wages constitute their principal means of livelihood, irrespective of their nationality, race, sex, occupation, religious belief or educational background. Migrant workers can therefore also join a trade union.

While enterprise trade unions are not mandatory, they are gaining ground with the development of a market economy in China due to the increased focus on labor violations. Government and workers realize that trade unions can help prevent labor violations and avoid small problems escalating into a strike. International customers are split. Some customers encourage the establishment of trade unions because they believe that labor violations will be prevented, while others lobby the Chinese government to restrict unions from foreign-invested companies because they believe that unions will decrease labor force flexibility and increase prices.³⁹

One of the main challenges in relation to ACFTU is that election, promotion and salary of the trade union leaders are often subject to the employers' discretion – not that of the employees. As a result, they are in some enterprises perceived to represent the employer and government rather than the workers.

However, there are examples of enterprise trade unions in which employees elect the chairperson with guidance from the ACFTU. One example is the union in the KTS Reebok shoe factory. It has the following characteristics:

- One vice-chair is a worker and one is from management.
- The union creates effective system for communication between workers and management – and it is used as a management tool.
- The union's work is transparent to the company, and management must be accountable for how it responds to issues that the union raises.
- The union has credibility and trust from ACFTU, workers, management and customers.
- The union works as an effective worker engagement mechanism.

³⁹ New York Times, *China Drafts Law to Empower Unions and End Labor Abuse*, October 13, 2006.

Another example is the Shenzhen Swenco Electronics Co.,LTD. that employs approximately 300 employees. A chairperson was elected by the workers with guidance from Shenzhen ACFTU. The chairperson acts as a bridge between the owners and the workers and has successfully promoted a positive relationship between the two groups. The open election shows that there is much room to maneuver under the umbrella of the ACFTU and that the rules and regulations are not as strict as many international observers perceive them to be.

Another common misunderstanding is that the Trade Union Law does not allow for collective contracts. The Trade Union law does allow employees to negotiate and sign group contracts via a trade union or workforce representative. The negotiable rights in collective agreements include labor remuneration, working hours, rest and vacation, labor safety, labor hygiene, insurance, welfare and other matters.⁴⁰

For example, the trade union in Shenzhen Saiger Electronic Market helped workers sign a collective wage agreement to protect their rights in the retail industry. This is a groundbreaking precedent and the largest regional, industry-compatible collective wage agreement of Shenzhen. It covers more than 2,500 employers and 7,500 employees. The collective wage agreement will be incorporated into the management system of individual markets and shops.

The right to collective contracts is further strengthened in the New Labor Contract Law, Chapter 5.

Recommendations:

- ***Disseminate best practices on trade unions:*** Trade unions play an important role in preventing labor violations and improving communication between employers and employees. There are several examples openly elected worker representatives and the team recommends that the ACFTU gathers these examples and initiates a dialogue with employers, employees, the government and international customers regarding how to most effectively improve workplace cooperation in a market economy.
- ***Provide senior management training in the trade union:*** The team recommends that the ACFTU in Shenzhen reaches out to the ILO and explores its training programs on workplace cooperation and union representation.
- ***Revise the Trade Union Law:*** The team recommends that the government, in collaboration with employers, employees and trade unions, revises the Trade Union Law in order to increase the independence of trade unions from employers.

⁴⁰ <http://www.china-labour.org.hk/public/contents/article?revision%5fid=17399&item%5fid=17395>

3.3 Judicial law enforcement

The Labor Dispute Mediation Committee resolves employer-employee disputes, if such a Committee exists at the enterprise level. If the parties do not reach an agreement through the Committee, they can take their case to the Labor Arbitration System.

According to the Labor Law, the Labor Dispute Arbitration Committee “shall be composed of representatives of the labor administrative department, the trade union at the corresponding level and the employing unit. The chairman of the committee shall be a representative of the labor administrative department.”⁴¹

If either party is not satisfied with the arbitration decision, he/she can bring the case to the People’s Court. The court will make final decision after First or Second Instances.

The arbitration system handles more than 10,000 labor dispute cases each year. The cases usually relate to four issues: labor contracts, compensation, working conditions and social insurance. If the case concerns delay of payment, the case is given priority and proceeds directly to the People’s Court.

Arbitration is ideally a quick and effective way to solve labor disputes. However, in 50% of the cases, one of the parties is not satisfied with the arbitration decision and files a lawsuit with the People’s Court.

The People’s Court proceedings are long and cumbersome. The proceedings can take up to three years if the case has to go through First and Second Instance and the workers, especially migrant workers, usually cannot afford the long proceedings time. *In practice, it is almost impossible for migrant workers to safeguard their rights through the legal system.*

Another challenge relates to the costs of bringing a case to court. There is no financial aid and many workers that only earn minimum wage cannot afford lawyers’ fees, court fees and loss of working hours. Some law firms provide free legal aid, but the system is not sustainable in the long-run without government or private sector support.

⁴¹ Labor Law, Article 81.

Recommendations:

- **Assess the arbitration system:** The purpose of an arbitration system is to prevent minor work-related cases from entering the court system and to ensure that people with labor expertise make the arbitration decisions. However, arbitration simply prolongs court proceedings when half of the arbitrations are taken to court anyway. The mission team recommends that the Shenzhen Government evaluates the arbitration system and explores ways to make the system more effective, including minimize the number of unresolved cases brought to the People's Court.

As part of the assessment, the government can consider strengthening the role of the employees in the Labor Dispute Arbitration Committee. Employees are currently represented through trade union representative, not through a direct elected representative.

- **Provide legal aid for migrant workers:** Most labor cases involve vulnerable migrant workers that do not have time to wait for the judicial system to make a decision nor do they have the financial means to file a lawsuit. The mission team recommends that the government adds a function to the existing Legal Aid Center that provides financial aid to workers with few means so they can cover lawyer fees, court fees, loss of income, etc. Private sector contributions to the Legal Aid Center should be welcome, provided they are given in a transparent manner free of conditions.

3.4 Public sector recommendations

Achieving sustainable labor and environmental practices in global supply chains requires an enabling environment that is supported by government.

Governments are more likely to improve social and environmental standards if they develop coherent strategies that address the critical elements of the enabling framework and build on:

- transparent and efficient legal and market-based drivers,
- robust capacities and
- useful tools and skills.

The Shenzhen government is one of the first local governments in China to strategically consider how corporate social responsibility can enhance the competitiveness of its export industries and help attract and retain large multinational companies. The Shenzhen Government's initial efforts, including issuing 'Suggestions for Promoting CSR,' can be seen as best practice in China and throughout Asia.

Following are recommendations regarding how the Shenzhen Government can enhance the implementation of its initiatives and support sustainable labor and environmental practices in global supply chains.

The recommended CSR framework for the Shenzhen Government consists of the government playing four types of roles:

1. **Mandating** – issuing and updating laws, regulations and penalties pertaining to social and environmental aspects of the private sector.
2. **Facilitating** – providing incentives, advice, non-binding guidance, training, codes and deterrents such as market stimulation and tax incentives.
3. **Partnering** – combining public and private sector resources to leverage complementary resources, realize economies of scale and cross-fertilize best practices.
4. **Endorsing** – showing political support for CSR-performing companies and facilitating civil society organization in the form of publicized praise or awards. Other examples include showcasing or endorsing best-practice examples and engaging in general awareness-raising.

The mission team has used this CSR framework to provide specific recommendations on how the government can use CSR to strengthen compliance, improve law enforcement and promote innovation and public-private partnerships in Shenzhen's ICT sector.

1. Mandating

- **Update relevant labor and environmental laws:**
 - Update the system of flexible working hours and the environmental laws.
 - Further the implementation of 'Shenzhen Municipal People's Government to Further Strengthen the Rights of Migrant Workers' initiative.
 - Revise the principle of territoriality in the pension insurance plan in order to better accommodate migrant workers' needs.
- **Increase the number of labor inspectors:** The number of labor inspectors is currently based on the number of permanent residents (1.6 million) rather than the number of migrant workers (6 million). Inspectors therefore do not have resources to inspect all relevant enterprises. The team recommends that the government bases the number of inspectors on the actual number of workers.

- ***Assess the dispute resolution mechanism and provide legal aid.*** The arbitration system is not effectively reducing the number of labor dispute cases entering the court system. The team recommends that the Shenzhen Government evaluate the arbitration system and explore options to strengthen the role of the trade union and the employees within the arbitration process. Further, the government can consider providing more funds to the Legal Aid Center to distribute financial aid to workers with few means to cover fees for lawyers, court fees and loss of income. Private sector contributions to the Legal Aid Center should be welcome, provided they are given in a transparent manner, free of conditions.

2. Facilitating

- ***Conduct consultations with private sector on ‘Suggestions for Promoting CSR’:*** The Shenzhen Government has already taken an important step by issuing a policy paper on CSR. To ensure broad stakeholder support for the policy it is recommended that the government use this pilot project to consult with the private sector and civil society on the implementation of the policy paper. As part of the consultation, the government is recommended to explore options for capability building and training of both the private sector and civil servants. It is also recommended that the policy paper be posted on the internet and invite feedback.
- ***Establish a Shenzhen municipal leading group for CSR:*** The mission team recommends that a leading municipal group on CSR be established to coordinate implementation of the CSR framework. The group can be led by the Mayor, with representatives from the Labor, Environmental and Trade Bureaus. Among other tasks, the group could be responsible for:
 - liaising with national government to ensure that Chinese labor and environmental laws are consistent with internationally agreed upon principles;
 - ensuring that labor provisions apply equally across all categories of workers and workplaces and that any exemptions are unambiguous and limited in scope and duration;
 - liaising with industry representatives and other stakeholders to ensure that the CSR framework is understood and implementable. Specifically, the group can develop a *users’* guide on relevant legal requirements, a guide to help *managers* implement various provisions and a *workers’* guide apprising workers of their rights under the law; and
 - promoting transparency and full disclosure in order to ensure that market forces and CSR drivers can function.

The Government could consider integrating the leading group for migrant workers into the CSR group, since the special challenges for migrant workers is a core component of CSR.

- ***Establish positive and ‘negative’ incentives to encourage CSR:*** The Shenzhen government is already using positive and ‘negative’ incentives in their overall integrated strategy to promote better workplace practices and is recommended to expand on this practice:
 - ***Offer positive incentives to companies that employ sound labor and environmental standards.*** Positive incentives may include reduced local fees and charges for compliance or innovation, lower insurance premiums, access to soft-lending services, participation in trade fairs, public endorsement and media exposure.
 - ***Levy negative incentives/sanctions on transgressors.*** Using industry-wide penalties, media exposure and public shaming can lead to improved self-regulation. There is a fine line between these negative incentives and basic enforcement, but the main goal is to promote certain behavior by means other than inspections and monitoring.
- ***Help conduct CSR training:*** As described in the private sector chapter of this report, many ICT suppliers lack the basic management skills to ensure sound labor and environmental practices. The government could encourage capacity building with these suppliers, in part by ensuring that resources are available to teach suppliers how to achieve world-class standards. Private sector training in factories could complement the notion of alternative inspections, i.e., companies investing in certain training programs may be exempt from government inspections for a set period of time.

Secondarily, the mission team recommends that the government explores *internal capability-building needs and opportunities* in order to undertake the range of actions discussed in this report. Governments are increasingly re-orienting their labor and environment inspectorates away from pure top-down enforcement and toward an educational function. This functional change requires a different set of skills in a variety of CSR issues and training methodologies. *The team recommends that civil servants receive CSR training at the Shenzhen College of Communist Party and Shenzhen Institute of Administration in order to effectively implement the CSR framework.*

3. Partnering

- ***Work with the ICT private sector initiative.*** As part of this pilot project, BSR will facilitate a group of suppliers to focus on key issues such as management systems, cost benefit analysis, NGO engagement and worker grievance systems. The mission team recommends that the government meets with this group of suppliers and present their CSR framework. The objective of the

meeting is to explore options for public private-partnerships in areas such as occupational health and safety training and best practices on worker grievance systems.

- ***Invite a Better Work scoping mission to Shenzhen.*** Compliance and enforcement of regulations are essential elements of a well-functioning legal system, economy and society. However, basic problems of capacity, limited budgets and lack of transparency often undermine effective public inspections. These problems detract from the business community's ability to compete in the global marketplace.

Governments are increasingly turning to innovative public-private collaborative approaches in order to prevent labor violations and enhance capacity in the private sector. The Better Work Program, a partnership between the International Finance Corporation and the International Labour Organization, is a leading-edge capacity-building model in general manufacturing. The Program's objective is to improve labor conditions and enterprise competitiveness in global supply chains, building on broad stakeholder engagement from both the public and private sector. The Better Work Program sets up capacity-building institutions that:

- assess labor conditions and productivity in local enterprises;
- help develop an action plan to improve labor conditions and enterprise competitiveness; and
- reach out to relevant training providers.

The Program can help further the work that the government already started and it can establish best practice in Shenzhen. The mission team therefore recommends that the government invites a Better Work scoping mission to Shenzhen to focus on labor standards in the ICT industry. The scoping mission could be invited at the end of this pilot project as a way to ensure its sustainability of the pilot and build on existing efforts.

- ***Invite ILO to demonstrate its information management system (IMS):*** The ILO has developed an information management system, which is a software system that measures compliance with labor standards such as the Chinese Labor Law. The Shenzhen Bureau of Labor Inspections could use the system to increase the effectiveness of the inspections. The mission team therefore recommends that government invites the ILO to demonstrate the IMS capabilities as part of the Better Work scoping mission.

4. Endorsing

- ***Develop a CSR Award:*** The government can consider establishing a CSR Award for best-performing enterprises. The enterprise that receives the CSR Award can also be exempted from public-sector inspections for a number of years and can be granted other preferential treatment. A CSR Award can also be an important qualification to select May 1 certificates and entrepreneurs' model workers.

Example: The Russian government holds an annual contest to determine the most socially responsible Russian companies. Companies in various sectors compete in five categories: personnel development, health protection and safe working conditions, socio-economic effectiveness of the collective contract, environmental protection and resource conservation, and implementation of social programs and local community development. Multiple financial awards are granted based on the companies' levels of compliance and innovation.

- ***Disseminate information on labor law and best practices:*** Chinese laws offer a comprehensive system of protection for ICT industry workers. However, many workers are not aware of their rights. The mission team therefore recommends that the government develops and widely distributes a simplified legal guide. The legal guide can also include examples of how to engage with trade unions and which types of trade union models are approved under the Constitution of Chinese Trade Unions and most effective in export oriented industries.

4. Conclusions and capability building strategy

A fundamental lesson from the past decade of factory auditing is the importance of institutionalizing the effort into the supply chain, specifically by focusing on systems at the factory level. Companies have recognized that compliance is not an absolute state, but rather that factories operate in a dynamic environment with constantly changing variables. To this end, creating company management systems that are embedded into operations is increasingly seen as fundamental to ensuring that workplace conditions are maintained. Such efforts seek to help factories develop and maintain internal operational systems that institutionalize good performance. Such systems-based methodologies are as follows:

- Recognize that responsibility for good labor practices and environmental management begins with company commitment from both factory owners and on-site management.
- Define roles and responsibilities for stakeholders (e.g., factory owners and management, supervisors, workers, governmental organizations, trade unions, supply chain organizations, customers and NGOs).
- Identify and document applicable laws and internal policies, assess related internal practices, communicate with and train employees on those laws and policies, and measure and internally report performance
- Define specific goals for each focus area, based on legislation, customer expectations and internal commitment, to periodically measure and report factory performance against compliance goals – daily, weekly, monthly and annually.
- Validate factory performance by using a combination of regular internal assessments and external assessments (performed by outside monitoring resources) to verify the effectiveness of self-correcting factory systems.
- Identify root causes of (persistent) problem areas
- Establish measures to ensure accountability at the supplier level and at the customer level.
- Provide an opportunity for innovative and creative solutions for systemic issues (i.e., performance incentives, worker participation in designing systems, total compensation packages rather than hours and overtime).

Companies recognize that the challenges in the global supply chain are not ones that can be remedied by the private sector alone. The most successful scenarios are those in which government, suppliers, NGOs, customers, multilateral organizations and others have collaborated and committed to their respective responsibilities in order to improve labor and environmental conditions and build a foundation for sustainable growth. The capability-building strategy for the ICT sector in Shenzhen is therefore dependent on each of these stakeholders acknowledging responsibilities, making commitments, implementing changes and collaborating to maximize overall success.

4.1 Summary of recommendations

Based the diagnostic assessment findings from the public and private sector interviews, research as well as the review of current approaches, the mission team proposes the following capability building strategy. This strategy aims to address the main obstacles to CSR performance improvement for the ICT sector in Shenzhen.

Government

- **Mandating**
 - Update relevant laws in the labor and environmental areas
 - Increase the number of labor inspectors
 - Assess the dispute resolution mechanism
- **Facilitating**
 - Consult with the private sector and trade union on ‘Suggestions for Promoting CSR’
 - Establish a Shenzhen municipal leading group for CSR
 - Establish positive and negative incentives to encourage CSR
 - Help conduct training on CSR
- **Partnering**
 - Work with the ICT private sector initiative
 - Invite a Better Work scoping mission to Shenzhen
 - Invite ILO to demonstrate the capabilities of its information management system
- **Endorsing**
 - Develop a CSR Award
 - Disseminate information on the labor law and best practices

Suppliers

- Develop cost-benefit analysis
- Implement management systems and measure performance
- Improve worker communication and feedback channels
- Take ownership of CSR implementation within factories
- Implement CSR across the supply chain
- Participate in supplier training/guidance

Customers

- Develop strategic partnerships with suppliers
- Develop supplier incentives for CSR investments
- Align CSR expectations internally
- Implement standard industry code
- Conduct audits for improvement, not compliance

NGOs

- Provide worker training/education
- Partner with suppliers and customers for accountability

Association

- Offer CSR/EICC/GeSI awareness training
- Survey association members

4.2 Proposed capability-building pilot

Based on the above recommendations as well as input from the workshop in Shenzhen, BSR will facilitate the following pilot of the strategy, which will be followed by an evaluation of the pilot's success and key lessons learned.

4.2.1 Public/private sector workshop

The mission team hosted a workshop in Shenzhen in the beginning of June 2007 to introduce the capability building strategy, ask for feedback and encourage open dialogue among key stakeholders. A key objective of the conference was to engage stakeholders from the government, the private sector and civil society. The objective was fully met by participation of:

- 18 Shenzhen and Beijing government representatives and ACFTU
- 21 representatives from EICC and GeSI major brands
- 2 representatives from the Shenzhen Electronic Industry Association
- 32 supplier representatives
- 11 representatives from local NGOs or academic institutions
- 8 representatives from multilateral institutions and BSR

The conference encouraged genuine dialogue on the report and pilot project through plenary discussions and separate meetings with customers, suppliers and NGOs.

There was general consensus that monitoring is necessary, but not sufficient to improve social and environmental standards on a local level. It was recommended by most stakeholders that monitoring should be combined with capability building to achieve long term sustainable improvements on the ground. Specifically the *international customers* encouraged the suppliers to integrate CSR in their management systems and the *suppliers* emphasized the need for clear incentives from their international buyers in relation to social and environmental requirements. The *government* also supported the increased focus on capability building and mentioned that the local government in Shenzhen is currently establishing a coordinating group on CSR. It is recommended this CSR group is consulted during the pilot project.

The workshop provided an opportunity for all participants to see demonstrations of support from the various stakeholder communities and discuss the current challenges to implementation. Many participants also provided written feedback to the report, which has been included in the final version. Another important objective of the workshop was to reach consensus on the capability building pilot mentioned below.

4.2.2 Capability building pilot

The pilot is only a subset of the overall capability building strategy. It focuses on progress within the supply chain and provides an opportunity for relevant stakeholders to be involved in implementing a limited number of recommendations. Specifics of the pilot will continue to evolve in collaboration with local stakeholders. The description below represents the initial scope.

During the workshop it was agreed to develop a pilot project consisting of a small group of stakeholders including suppliers, buyers, academics, NGOs and government officials, as appropriate. BSR, EICC and GeSI will facilitate the overall process and learning, but it will be up to participants to implement specific recommendations and test different strategies. The participants in the workshop agreed to focus the pilot on two main areas:

- **Management systems.** A subset of the stakeholders will ‘test’ certain aspects of CSR management systems. The pilot will develop a framework for

implementation of a management system and will evaluate the costs/benefits of such implementation.

- ***Worker engagement.*** A second set of stakeholders will test a few different approaches to worker communication. This may include worker hotlines, worker councils and surveys of employees. A cost/benefit analysis will be conducted as part of the evaluation of each approach.

Specific metrics will be developed for each focus area. Participants in the pilot will be asked to track a set of key metrics so that progress can be measured throughout the project. Feedback will be collected throughout the process and a final assessment of the pilot's success and challenges will be documented after the pilot's completion.

Appendices

1. Brief overview of international standards
2. EICC compared with legal framework in China / Shenzhen
3. International best practices on capability building
4. Summary of cost-benefit data

Appendix 1: Brief overview of relevant international standards

- The **OECD Guidelines** for Multinational Enterprises are recommendations by governments to multinational enterprises that operate in 33 adhering countries. The Guidelines provide voluntary principles and standards for responsible business conduct that enterprises should follow in order to contribute to sustainable economic, social and environmental development.
- The **eight core ILO conventions** address basic labor rights such as anti-discrimination, freedom of association, elimination of the worst forms of child labor, etc. China has ratified many core conventions, but not the Freedom of Association and Protection of the Right to Organize (C87) or the Application of the Principles of the Right to Organize and to Bargain Collectively (C98).
- **ISO 9000**, a quality-management certification, and ISO 14000, an environmental management certification, aim to minimize companies' harmful impacts on the environment.
- **OHSAS 18000** sets forth clear management system standards as they relate to health and safety.
- **ISO 26000** is new, voluntary guidance slated to be published in 2008. ISO 26000 aims to integrate social responsibility into the business strategy of private enterprises, but it will not include requirements and will thus not be a certification standard. China took part in the working group on ISO 26000 via the Standardization Administration of China.
- **SA 8000** is a labor management certification system based on international standards. It was established by Social Accountability International (SAI) in 1997 to protect the basic rights and labor conditions of workers. 127 Chinese enterprises have obtained the certification.
- **The Global Compact** was introduced in 1999 by former UN Secretary-General Kofi Annan and includes 10 universal principles that are divided into four areas: human rights, labor, the environment and anti-corruption. The Global Compact is based on international conventions, but is a purely voluntary initiative. Over 70 Chinese companies have joined the Global Compact.
- **Millennium Development Goals (MDGs)** are a set of eight inter-connected goals that all UN-member states pledged to achieve by the year 2015. The goals range from halving extreme poverty, to halting the spread of HIV/AIDS, to providing universal primary education and ensuring environmental

sustainability. Former UN Secretary-General Kofi Annan initiated the MDGs and all member states adopted them in 2000.

- **United Nations Declaration of Human Rights** adopted by the United Nations in 1948 was proclaimed as a common standard of achievement for all peoples and all nations. It stresses teaching people to respect basic human rights and freedoms as well as promoting those principles.
- **CSC9000T** (China Social Compliance 9000 for the Textile and Apparel Industry), released by China National Textile and Apparel Council in 2005, is the first Social Responsibility Management System based on China's laws and international conventions. It includes 10 key labor elements for business enterprises to effectively manage their social responsibility. Its goal is to protect labor rights and achieve continuous improvement. Over 200 enterprises signed CSC9000T.
- The **Ethical Trading Initiative (ETI)** is an alliance of companies, trade union organizations and non-governmental organizations (NGOs) that are committed to working together to identify and promote good practice in labor code implementation, including monitoring and verifying compliance with code provisions. The ETI code is based on the Core Conventions and other relevant ILO standards.
- Some major ICT industry players recently developed and adopted an industry-wide standard called the **Electronics Industry Code of Conduct (EICC)**. The EICC covers performance expectations in the areas of labor, health and safety, environmental practices, ethics and management systems and is based on many of the standards highlighted above.

Appendix 2: EICC compared with legal framework in China/Shenzhen

- √ EICC and laws and regulations in China (Shenzhen) have the same content and description
- No law and regulation in China (Shenzhen) is available

EICC	Laws and Regulations in China (Shenzhen)
Labor	
1) Freely chosen employment <ul style="list-style-type: none"> • Workers shall not be required to hand over government-issued identification, passports or work permits as a condition of employment. 	<ul style="list-style-type: none"> • There is no such provision about handing over government-issued identification, passports or work permits as a condition of employment. • The employer cannot ask for deposits or mandatory investment from workers.
2) Child labor avoidance <ul style="list-style-type: none"> • “Child” refers to any person employed under the age of 15. • Workers under the age of 18 may be restricted from night work, with consideration given to educational needs. 	<ul style="list-style-type: none"> • “Minors” refer to any person under the age of 16. • The right of compulsory education is defined, but there is no such regulation on night work.
3) Working hours <ul style="list-style-type: none"> • A work-week should not exceed 60 hours per week, including overtime. 	<ul style="list-style-type: none"> • The worker shall work for no more than 48 hours per week, inclusive of overtime. • Special work has special provisions on working hours.
4) Wages and benefits <ul style="list-style-type: none"> • Deductions from wages as a disciplinary measure shall not be permitted. 	—
5) Humane Treatment <ul style="list-style-type: none"> • There is to be no harsh or inhumane treatment, including sexual harassment, sexual abuse, corporal punishment, mental or physical coercion or verbal abuse of workers; there should not be the threat of any such treatment. 	—
6) Non-discrimination <ul style="list-style-type: none"> • Companies shall not engage in discrimination based on sexual orientation, 	<ul style="list-style-type: none"> • Non-discrimination on sexual orientation, political factions,

<p>political affiliation, union membership or marital status in hiring and employment practices.</p> <ul style="list-style-type: none"> Workers or potential workers should not be subjected to medical tests that could be used in a discriminatory way. 	<p>member societies or marital status is not clearly stipulated.</p> <ul style="list-style-type: none"> There is no provision about medical tests used in a discriminatory way.
7) Freedom of association	√
Occupational Health and Safety	
1) Occupational safety <ul style="list-style-type: none"> Workers shall not be disciplined for raising safety concerns. 	—
2) Emergency preparedness	√
3) Occupational injury and illness <ul style="list-style-type: none"> Encourage worker reporting; classify and record injury and illness cases. 	—
4) Industrial hygiene	√
5) Physically demanding work <ul style="list-style-type: none"> Worker exposure to physically demanding tasks is to be identified, evaluated and controlled. 	<ul style="list-style-type: none"> Special protection is only made to women staff, workers and the underage in the labor–intensity articles of the law. In those sections, there are clear provisions on the level of labor intensity.
6) Machine safeguarding <ul style="list-style-type: none"> Physical guards, interlocks and barriers are to be provided for machinery used by workers. 	—
7) Dormitory and canteen <ul style="list-style-type: none"> Workers are to be provided with clean toilet facilities, access to potable water and sanitary food preparation and storage facilities. Worker dormitories provided by the employer or a labor agent are to be clean, safe and provide emergency exits, adequate heat and ventilation and reasonable personal space. 	<ul style="list-style-type: none"> The relevant provision is not as stringent or comprehensive as EICC.
Environment	
1) Environmental permits and reporting	√
2) Pollution prevention and resource reduction	√
3) Hazardous substances	√
4) Waste water and solid waste	√
5) Air emissions	√
6) Product content restrictions	√

Management Systems	
1) Company commitment	—
2) Management accountability <ul style="list-style-type: none"> Clearly identified company representative[s] responsible for ensuring implementation and periodic status review of management systems. 	<ul style="list-style-type: none"> There is only provision that the company representative[s] responsible for the safety management system.
3) Legal and customer requirements	—
4) Risk assessment and management	—
5) Performance objectives with implementation plan and measures	—
6) Training	—
7) Communication	—
8) Worker feedback and participation	—
9) Audits and assessments	—
10) Corrective action process	—
11) Documentation and records <ul style="list-style-type: none"> Creation of documents and records to ensure regulatory compliance and conformity with company requirements, in addition to appropriate confidentiality to protect privacy. 	<ul style="list-style-type: none"> There is no provision on creation of documents and records to ensure regulatory compliance and conformity to company requirements.
Ethics	
1) Business integrity	√
2) No improper advantage	√
3) Disclosure of information	—
4) Intellectual property	√
5) Fair business, advertising and competition	√
6) Protection of identity	√
7) Community engagement	—

Appendix 3: International good practice on capability building

Companies have come to recognize that the challenges and conditions in the global supply chain can not be remedied by the individual actors alone. As such, they recognize that the most effective and systemic solutions to these issues will involve multiple actors that collaborate with each other. In a limited number of scenarios, government, manufactures, unions, customers, multilateral organizations and others have collaborated to improve labor standards and build a foundation for sustainable growth. The following provides various successful practices and an array of capability-building approaches that can be replicated or leveraged in other sectors and other nations.

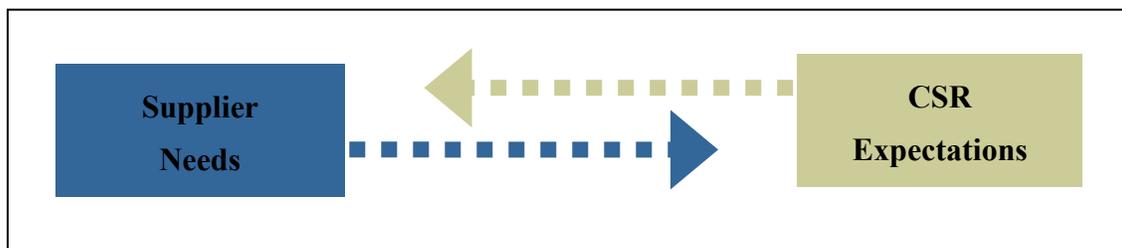
3.1 Good practices on designing effective supplier training

Both suppliers and customers believe that training is an attractive CSR solution because it offers a potentially scalable way to transfer knowledge and skills throughout the entire supply base. This concept makes sense in principle; however, in practice, the immediate impact of training on certain topics may be limited.

Rather than providing a single example of conducting effective CSR training, the following section is based on the participation and provision of several training courses in several sectors over the past few years, as well as feedback on their impact.

Training must be able to connect a buyer's CSR expectations with advice, skills and tools that make sense for a factory. Good training reflects both an in-depth understanding of factory needs and a thorough understanding of CSR.

Figure 1: Good training functions as a bridge between customers and suppliers



From a supplier perspective, effective training does not just share new knowledge and ideas; the “litmus test” for good training is whether or not it also instills the confidence, tools, resources and skills to help a supplier *take action* after training.

Four essential factors should be considered when designing and executing effective training: clarifying training objectives, selecting the right training partner, designing the course and finding appropriate trainees.

a) Clarifying training objectives

There are several different types of training. The first step is to clarify what type of training is most appropriate and whether the training goal is to raise awareness, transfer knowledge or change behavior. Each goal is progressively more challenging and requires more effort. The different training goals are outlined in Figure 2.

Figure 2: Training goals determine workshop style



The training goal determines the structure, curriculum, target audience as well as the training provider, as described in Figure 3. Further, effective training often combines objectives and incorporates a variety of learning types in order to reinforce the objectives over time.

Figure 3: Learning objectives

Objective	Structure	Curriculum	Audience	Provider / Instructor
Awareness raising	Single session; perhaps repeated every year	Overview and introduction to issue	Head of function	Influential speaker – i.e., head of purchasing
Knowledge transfer	E-learning or in-person seminar – several hours to several days	Detailed information presented in a class room setting with take-away documents	Practitioners –those responsible for CSR programs and those that are implementing CSR programs	Content expert – third party
Behavioral and attitudinal change	Workshop, best-practice sharing, peer learning	Structured interactions relying on the experience of participants	Influencers	Facilitator, connector

b) Selecting the right training partner in China

Any good trainer or training organization should have the following attributes:

- 1) Extensive in-factory, industry-specific, **day-to-day management experience** on non-CSR topics to ‘translate’ CSR in a way that makes sense to non-CSR audiences
- 2) Excellent **soft skills** and the ability to utilize a mix of training techniques
- 3) Strong **understanding of the broader field of CSR**, particularly, knowledge of a buyer’s approach to compliance in order to enable the supplier to meet the customers’ requirements
- 4) Commitment to managing CSR for the **benefit of workers and employers**
- 5) **Local language**

In general, there are three types of training organizations in the China market: professional-training companies, a handful of NGOs and academic organizations and consulting/auditing companies.

Professional-Training Companies:
+ Great training experience; much more skilled at making sure that material and content sticks with trainees
- May not have enough CSR background and exposure.
NGOs/Academic Organizations:
+ Mission-minded. Could be skilled at training facilitation
- Some may not have content and industry expertise to speak to a factory manager audience as sophisticated as those in the ICT sector
Consulting/Auditing Firms:
+ Strong knowledge of CSR audit approach or CSR certification systems
- May be unable to effectively translate audit into a training context with good cases, strong facilitated group discussions, corrective actions, timelines, best practice, etc.

Per the chart above, in the current China market, there are several organizations and people that have some of the attributes of a great CSR trainer; however, it can be challenging to find an organization that possesses all of the desired characteristics. There is currently not an organization in southern China that can deliver ‘off-the-shelf’ CSR training focused on ICT suppliers. Customers and suppliers keen on training should be aware that currently, working with a training partner to deliver the type of desired CSR training takes an investment in time and resources and may need to involve some curriculum development or creation of ICT case studies.

c) CSR course design

Well-designed CSR courses are those that are practical. Currently, many CSR training materials are very theoretical and do not have enough relevance to practice and applicable examples. Theoretical CSR training is useful if the purpose is to raise awareness, but for impact-oriented training, materials need to demonstrate that CSR can be effectively implemented in the ICT sector.

Case studies and analysis. Real, complex case studies that illustrate CSR ideas are a key feature to making sure that curriculum is well designed. Participants should have an opportunity to analyze cases, and then hear and provide feedback from the trainer. Actual legal cases about labor rights provide a good basis for discussion. When reviewing how a company handled a labor-related situation, participants can discuss what they would have done to more effectively address the issue. Then, the trainer can describe how the company addressed the issue and how the legal case was resolved. Development of case studies focused on the ICT sector will greatly improve the quality of such training. Basic root-cause training has proved very beneficial in other sectors, resulting in both CSR and productivity improvements. However, as opposed to retail, footwear and apparel sectors, many ICT managers already have a strong understanding of root-cause analysis and thus training will not be as effective unless it is combined with specific cases and focused on applying such skills to CSR challenges.

Opportunity to share best practice. Because CSR is still new to the ICT sector, the trainer may not necessarily be the best source of information on all fronts. Participants bring a wealth of information on how CSR challenges should be dealt with in their own facilities and training needs to allow for that information to surface. This can be done through formal and informal best-practice sharing. Parts of the training should be a structured “salon” where participants (coming prepared to do so) share with others their experience implementing CSR challenges. This exercise helps to establish a local CSR support network that can be influential in the long term success and sustainability of CSR efforts.

Resources, tools and templates. Good training provides a general direction as to why something needs to be done. It also provides several resources, tools and templates that might help a factory manage this process.

Engaging lecture. Good training design incorporates a lively and engaging lecture. Trainees in southern China are interested in participative training techniques; however, they also expect the trainer to provide information to them in a lecture format.

Consultative/on-site aspect to training. Training alone may not be able to solve the specific problems at a supplier’s facility. Many problems are specific to each supplier; additionally, much of what is learned in training is lost if it is not

immediately put into practice. A consultative/on-site aspect to training is therefore beneficial to making sure that training has impact.

d) Appropriate trainees

Training should be structured so that the appropriate attendees are present. Training is needed at senior levels, mid-management levels and at worker levels. However, training for general managers should not be the same as that for technical specialists.

Although the idea of designing a course on CSR for an “appropriate” audience seems obvious, it can be challenging. As there is often not one particular department responsible for all aspects of CSR, creating a general CSR course attracts different people at different levels of participating companies. Rather than holding a broad-based CSR course, to maximize impact, skills-based courses should be designed for participants with a specific background. Course descriptions should be explicit as to the type of trainee most suited for the course.

3.1.1 Training on management systems implementation: Fit5 factory improvement program

The TÜV Rheinland Group (Shenzhen) and CSR Asia (Hong Kong) with the support of InWent Capacity Building International have developed a multi-supplier training program for the apparel sector in China that links productivity and quality with CSR. Called FIT5 (Factory Improvement Training: an integrated 5-module approach), the program is subtitled “Increasing efficiency in the Chinese supply chain for CSR gains.”⁴² The integrated modules are:

1. Communication;
2. Human resource management;
3. Lean manufacturing;
4. Occupational health and safety; and
5. Social accountability.

The initial program starts with a group of six factories for a six-month training and on-site consulting curriculum designed to integrate efficiency and good workplace practices. Training sessions for each module begin with group sessions (bringing together management from all factories), followed by factory visits and on-site consulting by specialists in each area. The sessions are designed to deal with the specific needs of individual management teams. FIT5 has been initially designed for the apparel sector in southern China, but will be rolled out in other sectors and countries in Asia as applicable. The objective of the program is to deliver five modules in a continuous and integrated learning program that brings about behavioral change.

⁴² <http://www.fit5.net/boce/Project.html>

3.1.2 Training on overtime and productivity: Impact Limited and local partners

Impact Limited is a London-based ethical trading consultancy. The Impactt Overtime Project tested a model for reducing overtime at supplier facilities by improving efficiency, human resource management and communication between management, supervisors and workers. It was funded by the purchasers, with some additional funding from the Ford Foundation and CAFOD. Some factories also paid for further productivity consultancy. Local partners also participated in the evaluation of conditions and the provision of advice and services to improve human resources management and business processes at supplier facilities.

Each purchasing company chose one of their supplier factories in China to work with on the project. The factories were located in Guangdong Province, Hangzhou and Xiamen and produced garments, underwear, beauty products, furniture and accessory products, all of which involved low-tech, labor-intensive processes. The factories varied in size from 200 to 2,500 workers and the share of the supplier's revenue from the purchasing company varied widely from 2% to 90%.

The project began with an in-depth evaluation of labor practices based on a detailed inspection of the site, interviews with management, review of records and worker interviews carried out by independent researchers from the Institute of Sociology and Population Research, Guangdong Academy of Social Sciences and the Institute of Contemporary Observations. These visits resulted in a better understanding of the issues faced by the factories as well as the root causes of those issues. At the end of the project, a final evaluation was conducted using the same methodology to measure changes made over the course of the project.

There were several rounds of interventions by local organizations to improve conditions at the facilities:

1. Training in productivity from the Hong Kong Productivity Council (HKPC) that involved a visit to assess the factories' current production methods, recommendations for improvement and then a group training session with other factory managers.
2. A training session in human resources management, conducted by Linda Xian and by Yalian Li from the Shenzhen Society of Human Resource Management, which explored opportunities to introduce positive human resource management techniques into factories and to use incentives to support productivity improvements.
3. Participatory communication workshops, led by the Guangdong Participatory Development Appraisal (PDA) Network, which brought together managers, workers and supervisors to understand each group's perspective on its own factory's issues and to negotiate shared solutions.

Key achievements from an exemplary facility for the period, November 2002-2004 are as follows.⁴³

- 30% increase in productivity
- Downward trend in average working hours
- Upward trend in wages (percentage of workers earning the minimum wage for normal time increased from 40-50% to 95%)
- Greater sense of teamwork and higher levels of motivation (cited by workers, managers and supervisors)

3.1.3 Training on worker empowerment: Institute for Contemporary Observation⁴⁴

The Institute of Contemporary Observation (ICO), founded on March 18, 2001, is a civil-society organization concerned with labor, law and corporate social responsibility in China. Its areas of research and activities include labor, law, public policy, protection of human rights, global supply chain management, environmental protection, occupational health and safety, public health, gender issues, civil society and community development. The organization seeks to benefit migrant workers in factories along the southeastern coast of China, as well as other disadvantaged and marginalized communities.

ICO provides several different kinds of training programs to educate workers about their rights and improve effective worker communication with management. Such programs target both workers and management and most are comprehensive programs that last from six months to three years. Impacts of some of their pilot projects include more proactive workforce, improved retention, reduced overtime and more stable orders.

In addition to such training, in March 2004, along with the University of California, Berkeley, ICO established a community college for migrant workers that provides free public education courses in legal awareness, occupational health and safety, HIV prevention, basic health, and other subjects.

⁴³ <http://www.impactlimited.com/site/OvertimeReport.pdf>

⁴⁴ <http://ico-china.org/guwm1/English/Eksy.htm>

3.1.4 Training for knowledge transfer: Hewlett Packard and CTI - Focused Improvement Supplier Initiative⁴⁵

HP has created a program, in partnership with Business for Social Responsibility's China Training Institute, to provide supplier factory management staff with the knowledge and experience to continuously improve and integrate social and environmental (SER) practices into their factory management systems. The Focused Improvement Supplier Initiative (FISI) is a year-long training program designed to increase efficiency, minimize potential business risks and promote best-in-class SER practices.

FISI provides clear and measurable benefits for supplier factories, including increased productivity and quality and reduced worker turnover, injuries and illnesses. Over the year suppliers will minimize factory risks, share best practices with other suppliers, obtain access to SER content experts in China, improve the skill sets for key factory managers, and demonstrate progress toward conformance to the Electronic Industry Code of Conduct.

3.2 Good practices on collaboration in the private sector

3.2.1 Project Kaleidoscope⁴⁶

McDonald's Corporation (McDonald's), The Walt Disney Company (Disney) and a group of faith-based, socially responsible and institutional investors whose work focuses on labor rights, collaborated on a multi-year project to determine how factory-based compliance with corporate codes of conduct can be improved and sustained over time through a systematic approach.

Project Kaleidoscope launched as part of an ongoing effort by McDonald's and Disney to improve the effectiveness of their labor standards compliance programs. The companies and investors developed a new compliance approach and piloted the effort at 10 factories in China that produce toys, footwear and apparel. This approach developed factory-based systems that identified the root-causes of recurring compliance issues. The broader project objective was to identify effective practices that can be applied across different industries, geographic regions and socio-economic and regulatory systems.

The central premises of Project Kaleidoscope include:

- Sustained compliance is possible
- The factories themselves must become part of the system responsible for compliance

⁴⁵ <http://www.hp.com/hpinfo/newsroom/press/2006/060601b.html>

⁴⁶ http://corporate.disney.go.com/corporate/pdfs/collaborative_monitoring_interim_report.pdf

- A new, inclusive approach to compliance will enable timely corrective action

A comprehensive report on the results of the project will be published early 2007.

3.2.2 Auditing: ethical trading initiative recommendations⁴⁷

Audit programs based on compliance and negative consequences for non-compliance have led some suppliers to resort to fraudulent tactics. In some instances, these programs have created unintended consequences that negatively impact workers (e.g., by leading to layoffs and factory closings when orders are withdrawn). Specifically, companies have seen fraudulent factory records and workers have been coached how to answer auditors questions. Deception makes real understanding and identification of core issues very difficult.

Professionals with supply chain experience acknowledge that sustained improvement will require long-term, systemic changes in attitude, behavior and incentives. As a result, customers have begun to adopt a continuous improvement philosophy. Customers have also tried to communicate that the honestly sharing records and performance data will not result in retribution or adversely affect their business relationship. In addition, they have communicated that honesty and transparency are necessary for customers and suppliers to develop a long-term approach to meeting social and environmental goals.

A number of companies that are members of the Ethical Trading Initiative (ETI) have discussed challenges to auditing and ways to overcome them. The main recommendations are for:

- Customers to employ in-house auditing teams – including local staff based in key sourcing countries;
- Customers to review purchasing practices (e.g., short lead times) that conflict with good labor standards and encourage audit fraud;
- Suppliers to share audit reports and corrective action plans with other retailers and brands;
- ETI and other multi-stakeholder initiatives to engage more proactively with the commercial auditing companies to try and bring about systematic improvements in third-party auditing;
- Customers, suppliers and auditors to work together to develop common standards and protocols for auditing practices and an effective system to enforce them.

⁴⁷ <http://www.reports-and-materials.org/ETI-Getting-smarter-at-auditing-Jan-2007.doc>

3.2.3 SMEs⁴⁸

Small and medium-sized companies are not faced with the same public pressure and scrutiny to engage in CSR activities as larger companies and, as a result, awareness is much less. However, there are several advantages for small and medium-sized companies to engage in CSR. The main ones include:

- Attracting international customers (e.g., members of EICC or GeSI);
- Attracting and retraining staff; and
- Saving money in relation to energy reduction and recycling.

SMEs typically have fewer resources to invest in CSR activities and prefer to use existing standards and tools. Relevant tools include the following.

Small Business Journal:

The journal is a website that helps SMEs get started. The tool was developed in the UK by British Chamber of Commerce. It includes an introduction to CSR in three relevant areas:

General CSR policy. The site helps companies make the business case for engagement and provides recommendations on how to develop a communication strategy.

CSR and internal practices. The website gives recommendations for good human resource management, drawing on the experience of other SME companies

CSR and external relations. The website can inspire SMEs to improve communication with external stakeholders and design an environmental policy for the company.

SME Key:

The SME Key is an online support tool that comprises arguments for the 'business case,' a downloadable guide to assessing a company's social responsibility and a database of SME responsible business practices. It is currently available in English, Spanish, Italian, Finnish and French. The SME Key was developed by CSR Europe in conjunction with national partners and with the support of the European Commission.⁴⁹

Other relevant tools are the Brazilian Ethos Social Responsibility Indicators that includes a self-assessment tool for micro and small companies in relation to social, environment and economic impact management.

⁴⁸ The overview of SME tools is based on "Catalogue over CSR-tools," Anne Roepstorff and Lene Bjoern Serpa, for Danish Commerce and Companies Agencies (DCCA), June 2005.

⁴⁹http://ec.europa.eu/enterprise/entrepreneurship/support_measures/responsible_entrepreneurship/support-tools.htm

3.3 Good practices on public sector support

3.3.1 Better Factories Cambodia⁵⁰

Better Factories Cambodia is a program of the International Labour Organization (ILO) to improve the CSR performance of the garment industry in Cambodia. The project grew out of a trade agreement under which the United States granted Cambodia better access to U.S. markets in return for demonstrated improvements in the working conditions of Cambodian manufacturing facilities. The ILO project was established in 2001 to help the sector make and maintain these improvements. The government played a key role in the program by linking program participation with granting export licenses.

The program includes several components:

- The ILO monitors working conditions in Cambodian garment factories according to national and international standards and makes the results of monitoring available to international customers.
- The program helps factories improve working conditions and productivity through training activities involving management and union representatives. The training program includes follow-up factory visits to ensure that attendees are able to transfer classroom learning to their places of work.
- The program supports developing the skills of local trainers and training institutions.

Better Factories Cambodia has developed an information management system (IMS) for monitoring and reporting on working conditions. The IMS is a totally computerized system for collecting, storing and analyzing data. It enables the generation of reports tailored to user needs, and provides enhanced security, easy access to information, and greater transparency.

A tripartite project committee including government oversees and governs the program. The project is guided by a Project Advisory Committee (PAC), which consists of three representatives, each from the Government of Cambodia, GMAC and the Cambodian trade union movement. The PAC meets at least quarterly. It provides guidance on such matters as work plans, implementation of activities, communication with the parties involved and coordination of project activities with relevant work undertaken by other entities. It also advises on the operation and evaluation of the monitoring and reporting system.

⁵⁰ <http://www.betterfactories.org>

The program has been scaled up to an international program called Better Work, which is managed in a partnership between the ILO and the International Finance Corporation (IFC). The program aims to improve labor standards and enterprise performance in global supply chains in developing countries and is currently being piloted in Jordan, Lesotho and Vietnam.

3.3.2 UK government as a CSR driver

The UK government is another example of strong public sector support for CSR. The government is not only focusing on CSR, but has deployed a range of resources to this end. In addition, the government has shown a greater willingness to use “soft” regulation to encourage CSR.⁵¹

The UK government supports and subsidizes CSR activities and organizations, for example, Business in the Community (BITC), the single largest business association for CSR with a membership of over 750 companies and Ethical Trade Initiative (ETI), which seeks to improve the lives of workers in global supply chains. The UK government also supports many other CSR projects through the Department of Trade and Industry and other government departments.

UK Prime Minister Tony Blair has appointed ministers within the Department of Trade and Industry (DTI) with special responsibility for CSR. This ministerial post has provided a focal point for CSR within government with regard to the encouragement of research and development of CSR issues. Further illustrative of this commitment to CSR, the DTI publishes an Annual CSR Report and it hosts a Society and Business website that sets out different ways in which the government can support CSR.

The UK government also takes initiatives to adjust the regulatory environment for CSR. In 1996, the Occupational Pensions Schemes Regulations required pension funds to disclose how they take account of social, environmental and ethical factors in their investment decisions from 2000 onward. The UK government has also introduced fiscal changes to elicit more CSR. For example, a ‘Climate Levy’ encourages greater energy efficiency in industry and a Landfill Tax encourages better disposal or re-use of waste. Additionally, the 2002 Community Investment Tax Credit is a means of attracting private capital into disadvantaged areas.

With the support of the UK government, UK CSR has become more institutionalized. There is the emergence and growth of CSR business associations and umbrella organizations. A range of other organizations that provide CSR consultancy services have also emerged and UK corporations are much more explicit about their CSR. There is board-level responsibility for CSR and more CSR posts in corporations.

⁵¹ Jeremy Moon (2004) “Government as a Driver of CSR,” Research Paper Series of International Center for CSR, Nottingham University Business School.

Appendix 4: Summary of cost and benefit data

Summary of Cost and Benefit Data				
Tangible External Benefits	Retention of orders	Increase in orders	Improvement in price	
Tangible Internal Benefits	Improved quality/ Reduction in errors	Reduced human resource costs (less turnover, enhanced retention, reduced training and hiring expenses, reduced medical/insurance costs)	Reduced CSR audits due to improved relationships with customers	
Intangible Benefits	Improved relationship with shareholders	Improved relationship with government regulators	Improved collaboration and communication with buyer	
Compliance Costs	Exceptional (non-capital) cost/year – e.g., staff training per year	Capital costs (total) – implementation, e.g., new equipment, new staff hires	Recurrent costs of implementation/year, e.g., higher minimum wages/yr; maintenance of new equipment/yr	Recurrent costs of compliance monitoring and documenting/year
Non-Compliance Costs	Arbitration expenses	Cost of turnover	Cost of increased injuries	
	Loss of sales	Legal fees	Government fines	Loss of sales