

the**warehouse** //

**ETHICAL SOURCING REPORT 2016**

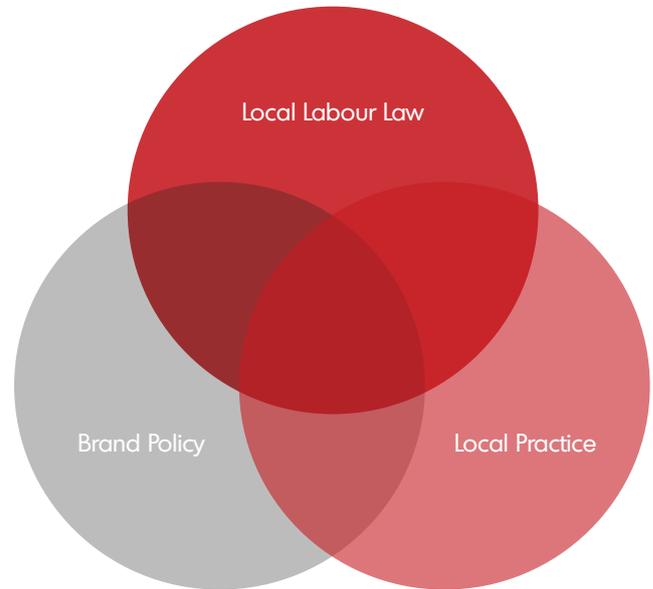
## Report background

This report represents a resumption of our public reporting on this topic. This was previously included in our Annual Community and Environment reports, which are now part of The Warehouse Group's annual report. Hence our decision to periodically report specifically on our Ethical Sourcing programme for the benefit of customers and stakeholders. Our report consists of a description of our programme along with some contextual commentary. This is followed by an appendix with some statistics and key measures for the past two years. Further enquiries may be directed to [ethical.sourcing@thewarehouse.co.nz](mailto:ethical.sourcing@thewarehouse.co.nz)

The Warehouse has had an Ethical Sourcing programme since 2004. We recognised then, as now, our duty to customers, team members, and shareholders to protect the welfare of workers in our supply chain. While we began this journey with little direct knowledge of working conditions "behind the barcode" in source factories, today we have visibility of over 2880 factories within our factory register and have completed over 2,500 factory evaluations<sup>1</sup>. In a typical year we estimate we have around 1800 active factories supplying goods for our private label programmes alone<sup>2</sup>. We have closely collaborated with hundreds of factories to improve conditions for workers in circumstances where our monitoring had identified significant gaps in performance. We have accumulated invaluable first-hand knowledge about our supply chain over the past decade. However the dynamic and highly competitive nature of the global sourcing environment and the emergence of new source countries such as Bangladesh, mean that our ethical sourcing efforts are as relevant today as they were in 2004.

## Global progress and common challenges

The Warehouse has not been alone in this endeavour. The past decade has seen an unprecedented global effort by numerous brands to leverage the power of their trading relationships towards better outcomes for workers. There is no question that as a result, millions of workers have seen dramatic improvements in their working conditions. However more recently progress has been incremental and important systemic challenges remain to be addressed. Some of the reasons for this are illustrated in the diagram below.



As the diagram shows, there are both commonalities and significant differences between local Labour Law, Local Practice, and Brand policies. These alignments vary from country to country and between brands. In China for example there is an explicit local labour law restriction on overtime hours but local practice for much of the export sector is much higher.<sup>3</sup> Similar variances exist in regard to the provision of social insurance and rest days. This is a big challenge for consumer brands who want to align their policies to international labour conventions and local labour law in the countries they source from. Local practices such as long working hours and limited days of rest have persisted in the face of both legal restrictions and intensive monitoring efforts from international brands. Other important elements of worker welfare such as health and safety, and remuneration have proved much more responsive to interventions from regulators and brands. There are several drivers which inhibit factories' willingness and ability to restrict working hours to legal limits and codified ideals. In part it is because these practices are culturally (versus legally) sanctioned – strict enforcement of labour law by local regulators is often weak. Another is that workers, especially migrant workers, expect the income associated with higher overtime hours and in a competitive labour market factories choose to offer this overtime to retain their workforce. Finally intense competition within the export sector drives factories to maximise their orders and leverage the greatest returns from their capital and labour assets.



<sup>1</sup> A total of audits and desktop factory evaluations undertaken since 2011

<sup>2</sup> Figures exclude local New Zealand manufacturers and the source factories for externally branded goods

<sup>3</sup> According to our own extensive audit data and the consolidated data across 1000s of audits shared with us by our service providers.

## Unintended consequences

Despite the best intentions, a number of unintended consequences have emerged in the ethical sourcing environment. One of the most disappointing and challenging is non transparency – specifically the intentional falsification or misrepresentation of working hour, payroll, and other important records reviewed by auditors in the course of their due diligence work in factories. While there is no moral or legal justification for these practices they can be understood in the light of the divide between brand policies or international codes, the realities of local practice, and the passive sanction of local regulators. Unfortunately this greatly undermines the reliability of audit based labour standards certification schemes which brands, civil society groups, and consumers could otherwise hope to have faith in.

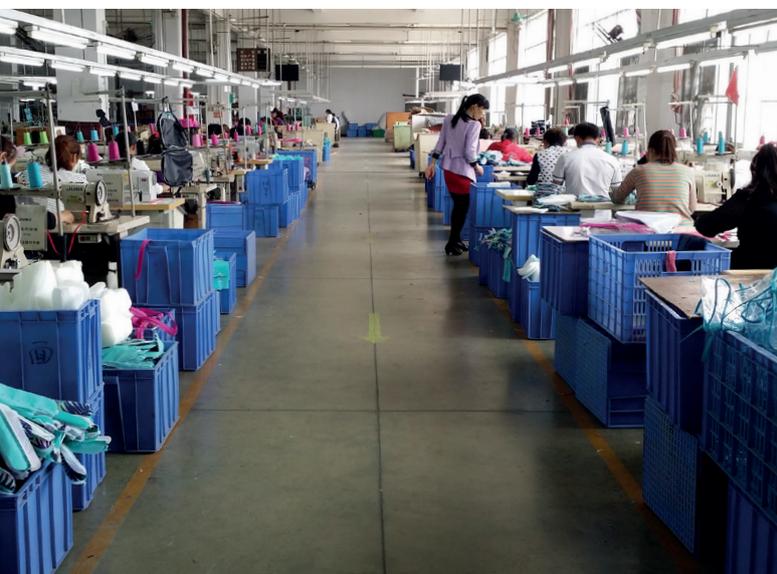
## United Nations supply chain guidance

The United Nations' Guiding Principles on Business and Human Rights describes the approach responsible business should take to protect human rights in their value chains. A core Principle for businesses is that they should maintain

- (A) A policy commitment to meet their responsibility to respect human rights;
- (B) A human rights due diligence process to identify, prevent, mitigate and account for how they address their impacts on human rights;
- (C) Processes to enable the remediation of any adverse human rights impacts they cause or to which they contribute."

## New Zealand requirements

In New Zealand there is no legal requirement to undertake these forms of offshore supply chain assurance. All of the countries from which we source our private label ranges from have their own labour laws with attendant obligations for factory owners and managers. At The Warehouse, we believe our stakeholders expect more of us in ensuring ethical practices within our supply chain. We have established our Ethical Sourcing programme to give our customers an assurance that the products we offer them come from reputable providers.



## Our approach

The Warehouse's Ethical Sourcing programme contains the three elements of policy, due diligence, and remediation or corrective action described in the United Nations Guiding Principles.

Our policies, and a description of our due diligence and remediation processes are published on The Warehouse Supplier website.<sup>4</sup> In practice our policies are enforced and implemented through supplier pre-qualification processes (for new factories), ongoing factory monitoring, and continuous improvements initiatives and training.

Through these activities we ensure that only factories which meet or exceed our standards are able to supply goods bearing one of The Warehouse's many private labels. We maintain visibility of standards through an ongoing monitoring and continuous improvement cycle. Monitoring is achieved either via our own commissioned factory audits or via a desktop review of audit reports commissioned by other brands. Continuous improvement is achieved through a schedule of corrective actions agreed by the factory as an output of the audit process. In addition we hold regular development workshops and training for factories who need help to improve their labour management practices.

## Challenges

*How does The Warehouse deal with some of the challenges and unintended consequences that have emerged within the ethical assurance environment?*

Our starting point is transparency – ambiguous or conflicted information about factory working conditions in factories is not acceptable and where factories persist with these practices we end the relationship. We do however acknowledge the reality of long working hours provided this overtime work is compensated appropriately. Recently in China at least we have observed a relaxation of upward pressure on working hours due to the manufacturing slowdown there. We insist on the provision of legal contracts for all workers, observed prohibitions on child labour, and bonded labour, health and safety provisions in accordance with our code and local regulations and the provision of at least the basic elements of workplace insurance where prescribed by law.

An important resource we call upon in driving improvement and affecting change when needed, are our senior merchandise sourcing personnel. Although we rely on our internal Ethical Sourcing specialists and associated service providers to provide us objective and reliable information about the status of factories; when an issue is uncovered, it's the close engagement of our sourcing personnel with factories that can motivate these factories to make attitudinal or system changes that may be required. Where we can't secure this commitment we move to alternative sources.

<sup>4</sup> <http://www.thewarehouse.co.nz/red/catalog/suppliers/twl-ethical-sourcing>

## Second tier suppliers and raw materials

To date our programme does not involve the assessment of second tier subsidiary manufacturing process such as dyeing or washing in the apparel sector. Like our primary manufacturing sites these too are governed by local laws and regulations. To date our specific raw material policies include those in relation to sustainable sources of timber paper and palm oil, and a prohibition on genetically modified organisms in food.

## Participation in multi-stakeholder initiatives

Some brands rely entirely on multi-stakeholder initiatives such as SEDEX<sup>5</sup> or the BSCI<sup>6</sup> to inform them about the ethical status of their factory base. We have chosen to rely primarily on our own direct assessment of factory conditions and our own audit protocols pertaining to transparency, working hour tolerances, and the like. In some cases however instead of conducting our own audits, we will accept audit reports associated with multi-stakeholder schemes or individual brand programmes – if we judge the information they contain to be reliable. This relieves audit fatigue for factories and rewards them for efforts they have already made. In the wake of the Rana Plaza factory disaster in Bangladesh there was a widespread call for brands to do more to promote worker safety in Bangladesh. Two schemes arose in response. The Warehouse has been observing these developments closely and consulting with individuals working in the field in Bangladesh. Most of our current source factories in Bangladesh are participants in these safety schemes. As a result of these reflections we have applied to join the Alliance for Worker Safety in Bangladesh<sup>7</sup>

## Are we making a difference?

As mentioned above the cumulative effort of multiple brands enforcing these policies across their supply chains coupled with the work of local government has generated significant improvements in working and living conditions for millions of workers – as anyone who has been a regular visitor to these environments for the past two decades can attest. Despite increases in income, improvements in health and safety and widening access to workplace insurance, challenges such as long working hours remain. For developing countries newly entering the global supply chain the development cycle must begin again at a lower level - as evidenced in the recent intensive collaborative efforts in Bangladesh to improve the structural integrity and other safety attributes of their clothing factories.

Specific progress in factories we are working with, range from minor improvements to health and safety or aspects of human resource policies, to major transformations where factories abandon non transparent practices, record working hours accurately for the first time and align worker remuneration properly to legal hourly and overtime rates.

A significant share of our factory base is in a mature state from a labour standards perspective and requires no intervention apart from ongoing monitoring.

We are proud to see our efforts to meet customer needs here in New Zealand also contributing to the income and welfare of citizens in developing countries. There is more to do and The Warehouse is committed to working with its trading and service partners to effect positive change in every environment in which we operate.



Attendees at a recent supplier workshop in Guangzhou.

<sup>5</sup> SEDEX <http://www.sedexglobal.com>

<sup>6</sup> <http://www.bsci-intl.org>

<sup>7</sup> <http://www.bangladeshworkersafety.org/>

## Appendices

### Key performance measures

The below table illustrates the scale of our programme and some of its key measures and outputs over the past two financial years.

| Pre-qualification and Audit activity | FY14             |  | FY15 |  |
|--------------------------------------|------------------|--|------|--|
|                                      | (financial year) |  |      |  |
| Factory Prequalification             |                  |  |      |  |
| New Factories Pre-qualified          | 319              |  | 371  |  |
| New Factories Declined               | 97               |  | 146  |  |

| Audits                       |       |       |
|------------------------------|-------|-------|
| Initial Audits               | 88    | 88    |
| Follow up Audits             | 14    | 25    |
| Pre-qualification Inspection | 37    | 53    |
| Unannounced Audits           | 30    | 42    |
| Inspection / Audit Total     | 169   | 208   |
| Average Audit Score Total %  | 80.02 | 84.19 |

| Issues  |    |    |
|---|----|----|
| Active Factories Discontinued for Standards Failure | 13 | 12 |
| Non Transparency cited                              | 33 | 41 |

### Commentary

Factories are qualified either through a desktop review of existing labour audit reports or by conducting our own inspections. In the last financial year 35% of new factory candidates failed to achieve our qualification thresholds and therefore were not permitted to receive orders.

Our workplace standards audits assess a factories performance across five areas:

- Policies, Pay and Working hours, Health and Safety, Environment, Dormitory.
- The average audit score above is based on a total of contributing scores from each of the sectors.

In addition to this score we pay particular attention to the factories performance in relation to critical standards such as the presence of signed labour contracts, the prohibition and the absence of child labour, achievement of minimum wage rates, rest days, overtime hours and compensation, the provision of social insurance, and the absence of any form of bonded labour.

### Transparency

The provision of transparent and accurate working hours and payroll records is a baseline we strive to achieve in every audit we commission or report that we review. Without a foundation of transparency and accuracy audit findings are not reliable representations of workers' true situation in the factory.

According to our audit findings in 2015 factory managers were transparent from the outset (providing reliable disclosures and documentation) 46% of the time; remained committed to unreliable forms of disclosure 37% of the time; and in 17% of cases participating factory managers in the group replaced initial non transparent practices with reliable disclosures after deeper dialogue and transparency advocacy from our audit professionals.

Because of the frequency of non transparent practices, which unfortunately we find to be typical in the mass market, department store strata, of the supply chain, we treat the submission of existing labour credentials by new candidate suppliers with caution. In 2015 we declined to recognise 44% of the audit reports submitted to us by factories and instead insisted on carrying out our own inspection.

## Country of Origin Profile 2016

| Source Country (Top 25) | Total  |
|-------------------------|--------|
| CHINA                   | 66.02% |
| NEW ZEALAND MADE        | 9.96%  |
| AUSTRALIA               | 6.56%  |
| UNITED STATES           | 3.90%  |
| UNITED KINGDOM          | 1.51%  |
| THAILAND                | 1.41%  |
| DENMARK                 | 1.14%  |
| MALAYSIA                | 0.94%  |
| INDIA                   | 0.93%  |
| GERMANY                 | 0.84%  |
| VIETNAM                 | 0.78%  |
| BANGLADESH              | 0.59%  |
| ITALY                   | 0.57%  |
| FRANCE                  | 0.52%  |
| INDONESIA               | 0.43%  |
| PAKISTAN                | 0.43%  |
| NEW ZEALAND ASSEMBLED   | 0.31%  |
| BELGIUM                 | 0.31%  |
| CANADA                  | 0.29%  |
| KOREA                   | 0.26%  |
| TAIWAN                  | 0.25%  |

## Commentary

China is by far the predominant source of merchandise supplied to The Warehouse. Its integrated raw material supply chain, diverse range of manufacturing, sound infrastructure, and abundant labour force still place it as the world's pre-eminent manufacturer of consumer goods. While smaller developing nations such as Vietnam (furniture and apparel) and Bangladesh (apparel) are emerging as countries of interest to The Warehouse they are unlikely to significantly displace China's share in the near term. The Warehouse maintains its own sourcing office in Shanghai directly employing 100 people.

While most merchandise at The Warehouse is imported, New Zealand made products are the second-biggest single source. Local importers and agents also capture margins on all products that are not directly imported by The Warehouse.

Below: Team members from our Shanghai office along with our New Zealand based sourcing executives.



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