



# A Mutually Beneficial Arrangement: Aligning Procurement and EHS to Reduce Risk

In the early 1960s, a student at Stanford Business School named Phil Knight had a good idea. Knight noticed that Japanese imports were undercutting U.S. manufacturers of consumer appliances and electronics on price—but most athletic shoes were still manufactured domestically. By outsourcing athletic shoe production to Japan, Knight and his business partner were able to bring lower-cost athletic shoes to the U.S. market.

As a business strategy, it worked brilliantly: outsource production to countries where production and labor costs are lower—and when costs rise, move production to another country where costs are still low. Knight’s company, Nike, moved its production from Japan to South Korea and Taiwan, then later to Indonesia, China, and Vietnam. The company’s U.S. sales overtook first Adidas, in the early 1980s, and Reebok, in the early 1990s.

Unfortunately for Nike, part of the reason that costs were lower in these other countries was that workers were underpaid, underage, and forced to work under conditions that were illegal in the United States. It wasn’t long before human-rights groups noticed, and brought consumer and regulatory attention to the fact that Nike’s low prices were being subsidized by poor workers, some of them children, working in appalling conditions. In May, 1998, Knight acknowledged to the National Press Club that “the Nike product has become synonymous with slave wages, forced overtime, and arbitrary abuse.”<sup>1</sup> As a result, Knight told the National Press Club, Nike committed itself to creating a code of conduct for its suppliers to set minimum ages, wages and working condition requirements.

It was a turning point in global business practices. “For once, a major public company with a household-name brand took responsibility for its supply chain. No longer could companies get away with simply shrugging off the practices of [their] suppliers as ‘out of their control.’”<sup>2</sup> The risk to a company’s image and bottom line were just too high.

Since Nike first attempted to rehabilitate its public image by setting and enforcing minimum standards for its suppliers, the practice of ethical procurement has matured, intersecting and dovetailing with the sustainability movement and with international consensus standards. It pays scrupulous attention to both the “sweatshop” or “slave labor” conditions that led to the initial criticism of Nike’s business model, and the environmental impacts identified by the sustainability movement. In more colloquial terms, that was the day that EHS first got its chocolate in procurement’s peanut butter. As it turns out, those two disciplines can do a lot of good things together.

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<sup>1</sup>Locke, Richard, Fei Quin and Alberto Brause, 2006. “Does Monitoring Improve Labor Standards? Lessons from Nike.” Corporate Social Responsibility Initiative, Working Paper No. 24. Cambridge, MA: John F. Kennedy School of Government, Harvard University

<sup>2</sup>Epstein Reeves, James (2017). “The Parents Of CSR: Nike And Kathie Lee Gifford.” Retrieved 7 March 2017, from <https://www.forbes.com/sites/csr/2010/06/08/the-parents-of-csr-nike-and-kathie-lee-gifford/#5e0dab33f416>

## Procurement and Risk

Procurement is a risky business. Procurement managers are responsible for obtaining materials, goods, and services at the lowest reasonable cost—and they are responsible for ensuring that the supplier or vendor reliably provides high-quality goods, in both the present and the future. They must make sure that the organization does not knowingly or unknowingly engage in, support or turn a blind eye to criminal behavior, like bribery. They must negotiate contractual agreements that protect the company against possible disputes, and the procurement process against fraud and theft. If the procurement process goes wrong at any point—for example, if a supplier cannot provide enough raw materials to support production demands, and no alternative is readily available—the entire organization could be harmed.

Add to those responsibilities and risks the expectation that organizations will commit themselves to corporate social responsibility (CSR), embracing business practices that value and account for more than just short-term financial performance. Organizations that wish to thrive in a global economy need to look beyond their financial bottom line to their social and economic impacts.

One vital aspect of CSR is “ethical and sustainable procurement”—the principle that a corporation has a responsibility to hold its vendors and suppliers to acceptable standards for both worker and environmental protection. Contracting with lower-cost suppliers outside the United States does not absolve an organization of responsibility for the way that its suppliers in foreign countries treat their workers and the environment. As Nike and many other global corporations have discovered, consumers and shareholders know that a commitment to “ethical and sustainable” production methods that applies only to an organization’s domestic operations is a shallow commitment indeed.

But procurement managers are unlikely to have extensive expertise in EHS issues, so EHS professionals have an important role to play in identifying and mitigating the environmental, health, and safety-related risks affecting procurement. Effectively addressing EHS concerns in the supply chain can make a significant contribution to procurement. It’s also a win for EHS, because it powerfully reinforces the value of EHS in the achievement of organizational objectives, including risk reduction.

Here are three areas in which EHS expertise can be aligned with an organization’s procurement practices to create an arrangement that is beneficial for everyone.

### *1. EHS and Supply Chain Specifications*

Corporate social responsibility should not be an after-the-fact consideration. Rather, it should be incorporated into the procurement process before a supplier is ever approved. EHS professionals should be involved in the development of the codes of conduct and monitoring protocols that add the “ethical and sustainable” to “procurement” by setting minimum acceptable standards for suppliers.

In setting these specifications, EHS professionals must be aware of:

*Specific risks.* Each country or region has specific weaknesses that will help to identify the greatest risks to ethical and sustainable procurement. In some countries, for example, ineffective government may mean that fundamental safety regulations—things as basic as building codes—simply don't exist. This can lead to hazardous working conditions like those that lead to the collapse of a garment factory in Bangladesh in 2013 that killed more than 1,100 workers.<sup>3</sup> In West Africa, rampant trafficking operations supplying child labor to the cocoa industry have caused ongoing supply-chain headaches for major chocolate producers.<sup>4</sup>

*The supplier's local laws.* Most EHS professionals are very familiar with the safety and environmental laws at home. When a company is sourcing materials abroad, however, it is important to ensure that the supplier is in compliance with its own local laws and regulations. Be aware that in many countries, there may not be much in the way of EHS regulation, and what exists may be out of date or unenforced. In China, for example, weak environmental regulations made for cheaper production costs, but as electronics giant Apple Inc. discovered in 2011, when a rash of stories about pollution and hazardous chemical exposures in its Chinese suppliers' factories made the news.<sup>5</sup> So, understanding and requiring compliance with local laws is a place to begin, but not necessarily a place to end.

*Conflicting requirements for suppliers.* One problem that suppliers encounter is that each of their clients may have different—and conflicting—requirements for each client. When suppliers have to deal with multiple codes of conduct, monitoring protocols, and employee involvement mandates, they sometimes find compliance frustrating or impossible.<sup>6</sup> To the extent possible, EHS professionals should be aware of and work to accommodate suppliers who are subject to many different sets of requirements. Failing to do so risks disqualifying otherwise high-quality suppliers or qualifying suppliers who are less scrupulous, and more willing to lie about their actual practices and conditions.

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<sup>3</sup>Engel, Pamela (2017). "Bangladesh Factory Disasters Will Become 'More And More' Common." *Business Insider*. Retrieved 9 March 2017, from <http://www.businessinsider.com/bangladesh-factory-disasters-are-increasing-2013-4>

<sup>4</sup>Keefe, Brian (2016). "Inside Big Chocolate's Child Labor Problem." *Fortune*. Retrieved 9 March 2017, from <http://fortune.com/big-chocolate-child-labor/>

<sup>5</sup>Martina, Michael (2017). "Apple criticized for China supply chain pollution." (2017). Reuters. Retrieved 9 March 2017, from <http://www.reuters.com/article/us-apple-china-idUSTRE77U4M620110831>

<sup>6</sup>Locke, et al. "Does Monitoring Improve Labor Standards? Lessons from Nike."

## 2. EHS and Compliance Monitoring

Research has demonstrated that creating codes of conduct and contractual obligations for suppliers is not an effective way to improve working conditions and environmental compliance, even when paired with careful compliance monitoring.<sup>7</sup> To improve compliance throughout the supply chain, organizations need to be directly involved with their suppliers. Strategies include:

*Performing your own compliance audits.* Organizations that have relied on either the supplier's own internal audit process, or audits performed by third-party, have been burned. It is unsurprising that distant suppliers may feel no compunction about falsifying internal compliance reports, but many organizations considered third-party audits more reliable. Unfortunately, they may not always be the case. Third-party auditors, like any other contractor, can suffer from conflicts of interest when evaluating suppliers, and it's important to remain diligent when working with these auditors.

*Developing a working relationship.* One strategy that has shown promise as a way of significantly improving working conditions and environmental compliance is for organizations to develop close relationships with suppliers that enhance trust and enable them to offer ongoing technical assistance. Nike's experience supports this approach. In one supplier's factory where Nike's technical personnel were frequently on-site, helping to introduce and implement quality improvement and lean manufacturing systems, and working with management on problem solving, the factory had better working conditions, wages, and labor rights than a similar factory where there was no close, direct working relationship between the supplier and the organization.<sup>8</sup> Apple is now using a similar, hands-on strategy to reduce waste and expand green power initiatives in its Chinese suppliers' facilities.<sup>9</sup>

## 3. EHS and Supply Chain Disruption Planning

All of these preparations and EHS best practices for procurement are designed for implementation under ordinary circumstances. But organizations should also have contingency plans in place, for when the supply chain is suddenly disrupted by a natural or manmade disaster—or, by a disaster that's a little of both. When the Fukushima Daiichi Nuclear Reactor was swamped by a 14-foot tsunami in March, 2011, three of its reactors suffered partial meltdowns.

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<sup>7</sup>Ibid

<sup>8</sup>Locke, Richard and Monica Romis (2006). "Beyond Corporate Codes of Conduct: Work Organization and Labor Standards in Two Mexican Factories." Corporate Social Responsibility Initiative, Working Paper No. 26. Cambridge, MA: John F. Kennedy School of Government, Harvard University. Hks.harvard.edu. Retrieved 9 March 2017, from [https://www.hks.harvard.edu/m-rcbg/CSRI/publications/workingpaper\\_26\\_Locke\\_Romis.pdf](https://www.hks.harvard.edu/m-rcbg/CSRI/publications/workingpaper_26_Locke_Romis.pdf)

<sup>9</sup>-- (2016). "Apple announces environmental progress in China." Apple Newsroom. Retrieved 9 March 2017, from <http://www.apple.com/newsroom/2016/08/apple-announces-environmental-progress-in-china.html>

The earthquake, tsunami, and nuclear disaster combined to disrupt the supply chains of many organizations, especially in the automobile and electronics industries.<sup>10</sup> In the absence of a contingency plan that accounted for EHS concerns, some affected organizations had to decide whether to relax EHS-related supplier requirements in order to immediately activate available alternative suppliers; risk prolonged production delays in order to identify new suppliers who meet all requirements, including EHS requirements; or risk prolonged production delays by taking the time to bring an alternate supplier into compliance with all procurement requirements, including EHS requirements.

Business continuity and disaster recovery plans, including supply-chain disruption planning, then, are another area where EHS involvement can reduce the risks inherent in procurement. Of your alternative suppliers, are there any who meet the EHS procurement specifications? If not, consider whether:

- Alternative suppliers who do meet EHS procurement specifications could be identified
- The organization should encourage existing alternative suppliers to achieve EHS procurement specifications

### EHS, Procurement, and Risk Reduction

When a supplier is shown to be utilizing child labor; when a factory collapses or burns, killing hundreds of workers; or when the methods of production are environmentally unsustainable, an organization can suffer a damaging hit to its reputation—and through that, to its bottom line. It is essential, in a global economy, for organizations to offer more than lip service to the idea that workers in any part of the world should be treated fairly and protected by basic safety precautions, and that a basic level of environmental protection is valuable to everyone. Because this is not something that procurement managers are equipped to evaluate, facilitate, and monitor on their own, ethical and sustainable procurement demands that EHS professionals be actively involved in the process. It's a mutually beneficial arrangement that assures the integrity of procurement, demonstrates the business value of EHS, and reduces the risks to the organization that are inherent in modern global procurement.

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<sup>10</sup>Lohr, Steve (2011). "Quake in Japan Broke a Link in Global Supply Chain." *Nytimes.com*. Retrieved 9 March 2017, from [http://www.nytimes.com/2011/03/20/business/20supply.html?pagewanted=all&\\_r=0](http://www.nytimes.com/2011/03/20/business/20supply.html?pagewanted=all&_r=0)

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