

## VII. Union Organizing and Changing Employment Relations in Globalizing China

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### What Leads to Better Working Conditions in Global Supply Chains: A Case Study of Apparel Factories in China

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#### Introduction

The diffusion of manufacturing supply chains worldwide has provoked a fierce debate over how to effectively monitor and promote compliance with labor standards in supply chain factories (Frenkle and Scott 2002; Fung, O'Rourke, and Sabel 2001; O'Rourke 2003; Weil 1996). In this paper we aim to identify the factors that lead to better working conditions through a structured comparison of two factories in the same supply chain.

In an earlier quantitative study of the labor compliance audit records of all 830 suppliers of a leading multinational corporation (MNC), we found that after country-level variables—such as rule of law and level of economic development—and basic factory characteristics—such as factory age and ownership—are controlled, there are still considerable variations in labor compliance (Locke, Qin, and Brause 2007). The in-depth case study presented in this paper is designed to understand the underlying mechanisms

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driving these variations. Specifically, we focus on three linked questions: First, why do working conditions vary across factories located in the same region and producing for the same global brand? Second, what are the root causes of the prevalent labor problems in supply chains? And last, what accounts for the improvements in labor conditions among global suppliers? We argue that some of the most prevalent problems in compliance with labor standards are deeply rooted in the way that supply chains are coordinated. To achieve sustainable improvements in working conditions and labor standards, systematic interventions aimed at tackling these root causes are critical—in particular, improving the ability of suppliers to better schedule their work and stabilize and motivate their workforce through new forms of work organization.

### **The Research Design and Methods**

This study took place as part of a larger project in which paired factories were studied in China, India, Bangladesh, Honduras, the Dominican Republic, Turkey, and Mexico. The selection criteria is to hold constant most variables except for labor compliance performance. This study presents the findings of analysis of two Chinese apparel factories (A1 and A2 contracting with global buyer A). Similar patterns are also identified in another pair of factories, B1 and B2 contracting with global buyer B. Fieldwork took place from spring 2005 to summer 2006. Our research team spent on average thirty hours in each factory and undertook interviews with factory managers, workers, and local non governmental organizations (NGOs). Interviews were also conducted with the sourcing, quality control, and labor compliance staff of the two global buyers. In addition, shadow audits were carried out with some factories. In total 141 interviews were conducted.

### **Global Buyers and Codes of Conduct**

In response to the risks of criticism associated with poor working conditions when MNCs began to move to offshore production in the 1990s, many MNCs have developed their own codes of conduct (Jenkins 2001). In fact, given the limited capacity of many developing countries to fully enforce labor laws (Elliot and Freeman 2003), monitoring for compliance with codes of conduct is currently the principle way that labor problems in supply chains are addressed.

Company A is among the largest athletic shoe and apparel companies in the world. It controls about one third of the global athletic footwear market. In 2004 the company had about US\$12.2 billion in revenues, of which \$6.5 billion came from footwear and \$3.5 billion from apparel. In 2004, while the company employed only 24,291 direct employees, it sourced from more than

800 suppliers, employing over 600,000 workers in 51 countries. Over the course of the 1990s, A was criticized for sourcing its products in factories where low wages, poor working conditions, and human rights problems were rampant. As a response to public criticisms and external pressures, in 1992 the company formulated a code of conduct that required its suppliers to observe some basic labor and environmental and health standards. The code of conduct has evolved since it was first introduced. In recent years A has pushed its suppliers to observe standards through increased monitoring and inspection efforts. Among various monitoring schemes, the Compliance Rating Program (CR rating) is an important one; it uses a grading system (from A to D) to evaluate all suppliers. The grade, assigned by the local compliance manager, enters A's balance score card, which provides information to the company's sourcing and production managers assists them in their decision making.

To see whether the patterns we identified in this case study are consistent across supply chains, we also examined a second case of factories supplying another global buyer, B. B is among the world's oldest and largest marketers of dress shirts and a leader in sportswear, sweaters, casual clothing, and accessories. In 2005 the company sourced its products from more than 1,300 factories in 68 countries. In 1991 B became one of the first MNCs to develop a voluntary code of conduct.

The two companies' compliance programs typify the response of a large number of MNCs to the opportunities and risks associated with globalization and the outsourcing of production to low-wage countries. Other MNCs have held up their compliance programs as exemplary of best practices in compliance and real dedication to addressing human rights issues. However, our study reveals great variation in labor standards and working conditions among the contractors for both companies. An earlier study by Locke, Qin, and Brause (2007) systematically analyzes the labor compliance record of all of A's suppliers and shows considerable variation across factories, even after country-level variables and factory-level observables are controlled. As for B, of the 1,311 contractors, only 15 percent are fully compliant with the company's code of conduct. Another 30 percent are patently *not approved*, while the majority (55 percent) of are categorized as *in progress* or *requiring follow-up*, meaning that some *terminal*, *significant*, and/or *minor* flaws exist, as described by the company's auditing protocol.

### **One Supply Chain, Two World of Work**

A1 and A2 are similar in many ways, such as workforce size, ownership (foreign or local), and product mix. The plants are located in industrial parks where other garment factories are also operating, which is common for apparel factories in China, and they are part of some larger, vertically integrated groups.

A1 and A2 are both subject to the same code of conduct and both interface with the same regional office of A based in Shanghai, which is responsible for coordinating orders and compliance visits to the factories. Both factories operate in the same political and economic environment and are subject to similar labor regulations. However, their compliance ratings are very different. Plant A1's latest score was reported in September 2004; it was a "D" rating, which means that the factory had critical CR issues pending. The unsatisfactory grade reflects several serious violations of A's Code of Conduct. These include more than seven consecutive days of work. One of A's compliance monitors overseeing plant A1 summarized the September visit by stating that "management attitude has been more cooperative than in the past albeit changes have been too slow." In contrast, plant A2's CR rating was recorded as a "B" in August 2004, which means some issues are pending but improvements have been made. A's labor compliance auditors views plant A2 as being very cooperative and having improved significantly in labor rights and working conditions, including extending an insurance policy to 100 percent of its workers.

#### *Recruitment, Training, and Promotion*

Recruitment, training, and promotion practices differ significantly between A1 and A2. Workers have three-year employment contracts with A2, in contrast to a one-year contract in A1. While tenure does not enter the wage matrix in A1, it is an essential component of the wage structure at A2. In A1 the hierarchy is clear, with most of the key positions at the middle management level occupied by expatriates from Hong Kong. In A2 empowerment is viewed as the means to success. There used to be Korean production managers and supervisors when the factory was first established, but all have since been replaced with local residents. While both factories value training and invest heavily in it, in A1 it is viewed mainly as a means to promote productivity, while in A2 it is also regarded as an effective way to retain workers.

#### *Wages*

The biggest difference in wage structure between A1 and A2 is the individual versus group incentive. In A1 wages for production line workers are comprised of a base salary plus a piece rate to motivate workers to improve productivity. In A2 wages are comprised of a base wage and a group bonus. The work study team assigns team goals based on the type of production lines; if a team makes 100 percent of their goal, a bonus is to be shared among workers. The group bonus is seen as an effective means to boost cooperation instead of competition, which is especially beneficial to new and inexperienced workers, who can receive timely help from their co-workers in face of any problem.

### *Work Hours*

Excessive overtime and inadequate payment for overtime hours are the most serious labor problem for both factories. Our interviews with local NGOs and compliance auditors show that this is not unique to the factories in our case study; it is the most prevalent labor compliance problem among apparel factories in China. In principle, there are six work days per week, with eight hours a regular workday and three more hours of overtime per day during busy seasons. Workers are entitled to take off the public holidays. Overtime wages are 1.5 times the normal during weekdays, double during weekends, and three times on holidays. Overtime is also supposed to be voluntary. However, the principles on paper can hardly be met in practice.

The attitude toward overtime differs between A1 and A2. In A1 overtime, sometimes excessive overtime, is viewed as inevitable given the frequent changes in orders from buyers and the small profit margins that global buyers leave to the factory. A2 follows the strict guidelines of buyers. Overtime is voluntary, and it never goes beyond the thirty-six hours allowed by A. According to the factory's chief executive manager, their ability to deliver orders on time without excessive overtime is through working with A and other buyers to extend deadlines.

### *Work Organization and Management Systems*

While A1 is tightly controlled by the Hong Kong headquarters and has a pervasive hierarchical structure for decision making, A2 has systems in place that empower local management at all levels. The incentive structure in motivating production floor workers also differs significantly. Plant A1 responds to challenges and opportunities from buyers by introducing lean manufacturing processes within their facilities. Great emphasis is placed upon measuring and improving productivity, tracking how much time a garment spends at each workstation to the second. The goal is to increase productivity while reducing the number of workers and maintaining quality levels. A1 also implements a kickback system by which all workers are trained to detect quality failures at each workstation and send back any defective item. Through these practices they have created an incentive structure and a work environment that lead to continuous productivity improvement. The reason for introducing lean manufacturing is, according to the production manager, "to catch up to an ever competitive market and our clients' push for lower price, higher quality and stricter labor and environmental standards."

Plant A2's production system is based on work study teams where workers are motivated to collaborate within teams as opposed to working individually.

Compensation is based on team productivity goals. The plant encourages loyalty through empowerment of its workers and achieving the right work environment. The management team is highly localized, and workers feel empowered at all levels of the organizational structure. This empowerment translates into higher worker satisfaction and working conditions.

### *Supplier-Buyer Relationship*

In our quantitative analysis of the labor standard compliance of all of A's contractors, we find that buyer-supplier relationship is an important variable for explaining factories' performance in labor standard compliance. This causal relationship is corroborated in our case study here. Table 1 illustrates the quantitative and qualitative details of A's relationship with the two factories, including the number of visits per year across the different levels of the organization and the nature of the relationship. A2 received significantly more visits by A. The low visit frequency to plant A1 translates into a lack of trust between the buyer and the supplier. According to a senior manager at plant A1, material supplier reliability is a key aspect of their production. Most of their overtime problems come from material delays, and the factory usually can only source from a limited number of material suppliers designated by the global buyers. They sometimes need the leverage from buyers to push material suppliers to deliver on time. While some brands are supportive when they call for help, others do not like to be bothered. The factory manager described their relations with A as "Don't go to them with problems, just with the final products." At the same time, the production manager in A's Liaison Office in China complained that plant A1 did not do a good job in communicating with A: "When A1 encounters a problem they throw it back to us. They are the ones who are supposed to deal with the material suppliers and we also expect that they communicate their problems earlier before it's in our face."

This rough relationship translates into the reluctance on the supplier's side to comply with A's codes of conduct, as reflected in the following comment from a senior factory manager: "The buyers press for lower price constantly. We have no choice but to pass on the pressures to workers to increase productivity but we are constrained by work hour codes of buyers. We have to come up with production systems structured to increase productivity without raising wages." This comment, to some extent, explains the rationale underlying the incentive structures in the production line that creates a system where only the most productive workers survive. One shop floor manager calls it a "natural selection," where slow workers end up leaving because they cannot keep up with the pace on the production line.

In stark contrast, the relationship between A and plant A2 is significantly smoother. Plant A2 is viewed as a Strategic Partner by A. A has selected a

TABLE 1  
Relationship Between the Company A and Its Factories

	Plant A1	Plant A2
Sourcing Visits (per year)	1 visit to check production, sample, and order placement	6 or 7 visits
API Visits (per year)	2 visits to check quality	52 (quality checks weekly)
Compliance Visits (per year)	1 follow-up visit	12 (2 monitors visit monthly)
Relationship with A's Local Office	Respectful but cold	Trust based
Nature of Relationship with A Overall	Defined as "technical"	Strategic Partner

limited number of factories as Strategic Partners with the aim to stabilize supply. According to the production manager at A2, their solution to on-time delivery without excessive overtime is to work with A and its other buyers to extend deadlines. Due to their close-knit relationship with buyers, they have the privilege to extend delivery dates and sometimes reduce orders. Plant A2's chief executive manager feels that "Following A's and other brands' requirements is pivotal to guarantee flow of orders. Although costs of maintaining a compliance infrastructure are high, the intangible benefit is the closer relationship with brands."

## Conclusion

Through a structured comparison of contractor plants along various dimensions in working conditions and employment relations, we have identified significant differences in workplace outcomes between the factories operating in the same region, subject to the same corporate code of conduct, and producing the same type of products. We have sought to explain these variations and found that the differences in work organization and management systems were the major contributors to the variations in labor practices. Our analysis further shows that the choices of management systems and methods of work organization are shaped by the relationship between plant management and the global buyers. A1, with only arms-length relations with their buyers, responds to these challenges by adopting incentive structures and production systems that focus heavily on promoting efficiency and productivity; it still suffers very serious and persistent excessive overtime problems. In contrast, A2, which has managed to develop a more collaborative relationship with its buyers, has not only managed to revise delivery deadlines and order volumes but also receives constructive interventions from their buyers to establish various worker empowerment schemes to ensure long-term sustainability

and competitiveness. These results are corroborated by the study of a pair of factories in another supply chain—B1 and B2—located in the same city and producing very similar types of products but differing greatly in working conditions. Our findings are also consistent with an earlier study by Locke and Romis (2006), in which similar patterns are identified among a pair of Mexican factories. Our results suggest that factory-level management systems and buyer-supplier relations are important areas to focus on in order to improve working conditions in global supply chains.

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