

XIII. 2010 Thomas A. Kochan and Stephen R. Sleigh LERA Best Dissertation Award

Labor Standard Compliance and the Role of Buyers: The Case of the Cambodian Garment Sector

CHICAKO OKA
University of London

Introduction

Globalization of production, combined with persistent lack of capacity and willingness on the part of developing country governments to regulate their economies, has left regulatory gaps in many parts of the world. As working conditions in global supply chains have come under increased public scrutiny, many multinational enterprises, particularly those that market labor-intensive consumer products, have come to implement codes of conduct and to monitor their suppliers. This rise of private regulation in the labor domain has provoked a heated debate about its effectiveness and desirability, and the debate remains inconclusive mainly due to lack of systematic and rigorous analysis. Using unique data from Cambodia's garment sector and a mix of quantitative and qualitative methods, this thesis fills the gap and shows that the effectiveness of private regulation depends on the buyers as well as the nature of buyer-supplier relationships.

This dissertation was motivated by an innovative monitoring program in the Cambodian garment sector called Better Factories Cambodia (BFC), spearheaded by the International Labour Organization (ILO). This scheme combines public authority and buyer leverage to bring about continuous improvement in working conditions. While the mandate comes from the government, (i.e., the Cambodian government obliges all exporting garment factories to be monitored by ILO BFC), enforcement depends on buyers (i.e., buyers have access to ILO monitoring reports and demand their suppliers to rectify problems).

The unique factory-level data on labor standard compliance and firm characteristics collected by ILO BFC have enabled me to ask questions that had not been possible previously. While the existing studies are based on a small number of case studies or a single supply chain, this study covers all the exporting factories across multiple supply chains. The dataset covers 344 exporting garment factories from 2006 to 2008, from which I created a panel dataset of 1,230 observations. In addition, I conducted surveys of suppliers and buyers to gather information not covered by the panel data. In addition, I conducted 61 interviews during the summers of 2007 and 2008 with various stakeholders in the Cambodian garment sector, including factory managers, buyer representatives, union leaders, government officials, industry experts, labor activists, and donor representatives. Further, participant observation at ILO BFC in Phnom Penh gave me an excellent insight into the context and dynamics surrounding the garment sector in Cambodia.

The richness of the data allowed mixing different methods of inquiry, thereby increasing inferential leverage and enhancing the validity of hypothesis testing. Chapter 1 is purely qualitative based on interviews and participant observation in Cambodia's garment sector to understand the context. Chapter 2 is a mixed piece, combining panel data regressions and interview materials. Chapters 3 and 4 are quantitative chapters based on the panel and survey data.

In terms of a theoretical framework, this thesis does not operate in a single framework, but rather it tests competing hypotheses to identify the utility and limits of different theories. Chapter 2 operates in the

rational expected utility framework, which emphasizes enforcement and deterrence to encourage compliance. Chapter 3 introduces the behavioral theory of the firm and shows the limits of rational assumptions. Chapter 4 goes one step further and contrasts the deterrence theory of regulatory compliance with the transaction cost economics and relational exchange theory.

Main Findings

Chapter 1 lays the groundwork for the succeeding chapters by describing the context of the Cambodian garment sector and assessing the ILO monitoring program, BFC, one of the most promising models of labor regulation. BFC is evaluated across the following criteria: rigor, legitimacy and accountability, impacts, complementarity with state regulation, coverage, and sustainability. The findings based on field interviews suggest that monitoring standards and procedures are rigorous and that positive impacts are felt in monitored factories. Nonetheless, BFC runs in parallel to state institutions, and enforcement is dependent on buyers—leading to patchy outcomes and throwing the scheme’s sustainability into question.

Chapter 2 examines the role of reputation-conscious buyers in regulating working conditions in their supplier factories. Critics of private labor regulation argue that buyers are not inherently interested in defending worker rights and that only those brands that target ethical-conscious consumers may regulate their suppliers (Esbenshade 2004; Seidman 2008). To shed light on these questions, Chapter 2 assesses whether buyers with different degrees of reputation consciousness variably influence suppliers’ compliance with labor standards and identifies the patterns through which buyers regulate working conditions in supplier factories.

This thesis operationalizes the concept of reputation consciousness based on buyer membership of multi-stakeholder initiatives (MSI). Since reputation-conscious buyers tend to participate in MSI to show their commitment to better working conditions and safeguard their reputation, it is a reasonable proxy. Buyers are divided into three groups: buyers that participate in BFC *and* the Fair Labor Association (FLA) or the Ethical Trading Initiative (ETI) (hereafter MSI buyers); buyers that participate in BFC but *not* in the FLA or the ETI (hereafter BFC-only buyers); and buyers that participate in none of the MSI mentioned. The degree of reputation consciousness is considered high for MSI buyers, given the extra burden involved. Indeed, all the MSI buyers in the sample are branded buyers that have experienced negative publicity. BFC-only buyers are considered less reputation-conscious than the first group. These buyers are mostly large and well-known retailers. The third category of buyers (that participate in none of the MSI) are mostly smaller, generic retailers that consumers rarely hear of and thus are the least reputation conscious.

Panel regression results show both the type and number of buyers sourcing from the factory matter. In consistence with the rational theory of deterrence, factories producing for reputation-conscious MSI buyers (facing a higher probability of detection and a larger penalty) are associated with higher compliance levels than other factories, controlling for factory characteristics. Moreover, when a factory is producing for a larger number of *less* reputation-conscious BFC-only buyers, the compliance level is significantly higher. This suggests that when there is a critical mass of buyer pressure, even *less* reputation-conscious buyers can bring about improvement.

Field-based interviews also demonstrate that the gap in compliance performance stems from varying degrees of buyer regulation. Reputation-conscious buyers tend to rigorously regulate their suppliers through pre-order selection and post-order enforcement, both reactively and proactively. Buyers act reactively in cases where transnational advocacy networks are mobilized to pressure them and demand remedial action in supplier factories. Through repetitive interactions, however, some reputation-conscious buyers have learned to be more proactive in addressing compliance issues in their supplier factories. On the other hand, some factories have come to see better compliance as a way of attracting reputation-conscious buyers and actively try to improve working conditions. Nonetheless, better compliance is not rewarded by buyers, and some purchasing practices conflict with the goal of improving working conditions.

Chapter 3 extends the analysis of Chapter 2 and explores the determinants of labor standard compliance across different issue categories (i.e., contract, wage, hours, leave, welfare, occupational safety and health, fundamental rights). One of the main criticisms of private labor regulation is that buyers selectively regulate their suppliers, emphasizing visible issues such as child labor and technical standards such as health

and safety while neglecting fundamental rights such as freedom of association (Barrientos and Smith 2007; Seidman 2008).

Panel regression results show that factories producing for reputation-conscious buyers are consistently associated with better compliance levels across many different issue categories. Interestingly, not only *very* reputation-conscious buyers but also *less* reputation-conscious buyers are significantly and positively associated with better compliance performance regarding contract, wage, leave and hours, OSH and welfare, and freedom of association in supplier factories.

In terms of theories, the findings are more supportive of the behavioral theory based on bounded rationality than the deterrence theory assuming perfect rationality. Although negative publicity concerning supply chains tends to focus on child labor and sweatshop conditions, reputation-conscious buyers, vaguely aware and fearful of potential risk, have been paying increased attention to issues that go beyond those visible and easy-to-fix issues. If the behavioral theory indeed better explains buyers' regulatory and suppliers' compliance behavior, critics' concern that only the media-sensitive issues can be regulated may be too pessimistic. Nevertheless, the *least* reputation-conscious buyers seem to behave in line with the deterrence theory: knowing their relative immunity from negative publicity, they let their suppliers systematically underperform their peers across all issue categories.

Indeed, the findings point to the growing gaps between increasingly regulated supply chains controlled by reputation-conscious buyers on the one hand and still sparsely regulated supply chains of the *least* reputation-conscious buyers on the other. While reputation-conscious buyers are increasingly committed to regulating various labor conditions including freedom of association, some buyers remain muted and do not participate in any initiatives aimed at improving working conditions. In this sense, therefore, the results paint a more nuanced picture of buyer-driven regulation.

While the first three chapters showed that factories supplying for reputation-conscious buyers have better labor standard compliance than other factories, data limitations prevented them from delving into the black box of buyer influence, through which channels buyers influence their supplier compliance-performance. Although case studies exist (i.e., Frenkel and Scott 2002), this is the first study to systematically test different channels of buyer influence (i.e., deterrence, relationship, and learning) using original survey data collected in the Cambodian garment sector.

Chapter 4 shows that the main channel linking buyers and supplier compliance-performance is the nature of their relationships. Suppliers engaged in market-based transactions through agents systematically underperform suppliers who deal directly with buyers. In other words, market-based relationships are associated with poor compliance performance. While deterrence and learning variables generally show expected signs, they do not reach statistical significance.

The findings have important practical and theoretical implications. The results indicate that market-based relationships through agents may be part of the problem rather than a solution from the viewpoint of improving working conditions. Market-based relationships characterized by short-term horizons motivate neither buyers nor suppliers to invest their time and resources to understand the root causes of poor working conditions and to commit to continuous improvement. Rather, market-based relationships prompt suppliers to try to pass compliance audits with minimum efforts. Moreover, the non-significance of the deterrence variables suggests that a policing approach based on intensive monitoring and credible threats may not be the best way to bring about progress in supplier compliance. These factors, together, point to the limit of arm's-length, compliance-oriented relationships, which could breed mistrust and dishonesty.

Conversely, the findings signal the need to develop collaborative relationships marked by open dialogue, trust, and commitment, which helps foster an environment supportive of continuous improvement. Close and open relationships with buyers enable suppliers to discuss problems and find solutions rather than to hide them from buyers. To improve supplier working conditions, therefore, buyers need to place more importance on the quality of their relationships with suppliers—openness, trust, mutual commitment—and not just on the traditional concerns of price, quality, and delivery of goods. These points are echoed by other scholars (Locke and Romis 2006; Locke, Qin, and Brause 2007; Locke, Amengual, and Mangla 2009).

Such collaborative relationships may well underlie the significant and positive effect of reputation-conscious buyers on supplier compliance-performance. Given the high degree of asset specificity required, reputation-conscious buyers tend to avoid market-based relationships and instead form collaborative

relationships with their suppliers. In fact, the duration of the relationship has a positive effect on compliance performance only when it is with a reputation-conscious buyer. In contrast, more cost-conscious buyers retailing highly standardized products tend to prefer market-based relationships that do not require asset-specific investment. This suggests that attracting reputation-conscious buyers could bring important benefits not only in terms of upgrading products and processes but also in terms of forming collaborative relationships and improving working conditions.

Conclusion

This dissertation contributes to the debate on the effectiveness of private labor regulation. Chapters 2 and 3 provide strong evidence that *very* reputation-conscious buyers are increasingly regulating labor conditions in their supply chains across various issue areas, including fundamental rights. Even *less* reputation-conscious retailers such as Wal-Mart and Target are found to pay attention to a variety of labor conditions in their supplier factories. On the other hand, significant compliance gaps have been identified between suppliers of reputation-conscious buyers and suppliers of the *least* reputation-conscious buyers, with the former systematically outperforming the latter. The findings thus contribute to a better and more nuanced understanding of the potential and limits of buyer-driven regulation.

Further, the dissertation sheds light on the different channels through which buyers influence working conditions in their supplier facilities. Chapter 4 tests various hypotheses on deterrence, relationship, and learning and finds that it is the nature of buyer-supplier relationships (market-based versus established) rather than deterrence *per se* that significantly affects supplier compliance-performance. The findings provide support for the work of Richard Locke and his collaborators (2009), who argue that the commitment-oriented approach is more effective than the compliance-focused model for addressing the root causes of poor working conditions.

This dissertation makes significant theoretical contributions as well. I have taken an evolutionary and eclectic approach to theorizing in order to demonstrate the utility and limits of different theories. The rational expected utility framework in Chapter 2 is useful for explaining why reputation-conscious buyers would behave differently from other buyers and why that affects supplier compliance-performance. Nonetheless, Chapter 3 shows the limits of the rational deterrence theory in explaining the comprehensive response by reputation-conscious buyers, which was better explained by the behavioral theory. Chapter 4 provides support for the relationship hypotheses consistent with the transaction cost economics and relational exchange theory rather than the deterrence theory.

In so doing, the thesis provides a theoretical bridge for the disparate literature on labor conditions in global supply chains. On the one hand, there is critical literature by sociologists and development scholars assuming that firms are solely motivated by incentives and threats in line with the rational deterrence theory. On the other hand, there is management literature that views buyers as partners in problem-solving through collaboration and learning. Such divergent perspectives arise from the fact that the former camp studies all types of buyers, especially unscrupulous ones, while the latter camp focuses on branded buyers who are conscious of their reputation and thus more responsible. This thesis seeks to reconcile the two perspectives and show that while the *least* reputation-conscious buyers behave in line with the rational deterrence theory, reputation-conscious buyers act in a manner more consistent with the behavioral theory. Moreover, the thesis explains the divergent behavior in terms of the varying degrees of asset specificity required by different types of buyers.

This finding has important policy and managerial implications as it suggests that different strategies may be needed for different types of buyers. For buyers with higher stakes in their reputation, it makes sense to foster long-term and collaborative relationships with their suppliers to improve labor conditions in their supply chains. For these buyers, therefore, a commitment-oriented approach is a better solution than a compliance-focused approach, as argued by Locke, Amengual, and Mangla (2009). Nevertheless, it is unrealistic to expect the *least* reputation-conscious buyers to take a commitment-oriented approach to supply chain management. These buyers tend to favor market-based relationships given the lower degrees of asset specificity required. Further, they are unknown to consumers and thus less vulnerable to negative publicity. In

the absence of “moral” market forces, suppliers producing for these buyers need to be regulated by another regulatory mechanism, namely the state.

This leads us to the discussion on the next generation model of labor regulation. While state regulation in many developing countries is far from effective, non-state regulatory schemes, including ILO BFC, are limited by their coverage. To avoid regulatory gaps, public and private initiatives should be better coordinated to make use of their relative strengths. Since non-state initiatives focus on the sector that exports consumer goods, public enforcement should concentrate on other sectors and subcontractors. In the long run, however, public and private regulatory efforts need to converge and government needs to take center stage.

References

- Barrientos, Stephanie, and Sally Smith. 2007. “Do Workers Benefit from Ethical Trade? Assessing Codes of Labour Practice in Global Production Systems.” *Third World Quarterly*, Vol. 28, no. 4, pp. 713–729.
- Esbenshade, Jill. 2004. *Monitoring Sweatshops: Workers, Consumers and the Global Apparel Industry*. Philadelphia: Temple University.
- Frenkel, Stephan J., and Duncan Scott. 2002. “Compliance, Collaboration, and Codes of Labor Practice: The ADIDAS Connection.” *California Management Review*, Vol. 45, no. 1, pp. 29–49.
- Locke, Richard M., and Monica Romis. 2006. *Beyond Corporate Codes of Conduct: Work Organization and Labor Standards in Two Mexican Garment Factories*. Corporate Social Responsibility Initiative Working Paper No. 26. Cambridge, MA: John F. Kennedy School of Government, Harvard University.
- Locke, Richard M., Fei Qin, and Alberto Brause. 2007. “Does Monitoring Improve Labor Standards? Lessons from Nike.” *Industrial and Labor Relations Review*, Vol. 61, no. 1, pp. 3–31.
- Locke, Richard, Matthew Amengual, and Akshay Mangla. 2009. “Virtue Out of Necessity? Compliance, Commitment, and the Improvement of Labor Conditions in Global Supply Chains.” *Politics and Society*, Vol. 37, no. 3. pp. 319–351.
- Seidman, Guy. 2008. “Transnational Labour Campaigns: Can the Logic of the Market Be Turned against Itself?” *Development and Change*, Vol. 39, no. 6, pp. 991–1003.