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Recommended Citation

Gallaugh, John, "The Fair Factories Clearinghouse: Sourcing Ethics Improved Through Information Systems" (2010). *AMCIS 2010 Proceedings*. 98.

<http://aisel.aisnet.org/amcis2010/98>

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The Fair Factories Clearinghouse: Sourcing Ethics Improved Through Information Systems

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ABSTRACT

Firms that outsource production to supply partners are at risk if those suppliers engage in unethical behavior. Such issues have been particularly acute in the apparel industry. If suppliers engage in unethical practices, firms may suffer brand and reputation damage, lost sales, cancelled contracts, legal penalties, lower employee morale, and more. An innovative program, originated at Reebok and expanded to become an interorganizational non-profit, the Fair Factories Clearinghouse, leverages technology to improve industry standards, lower costs, and reduce risks. The Fair Factories Clearinghouse offers an information systems-based solution that allows members to record, capture, and share audit information. This case study discusses the genesis of the FFC, the functionality and benefits of the system, and highlights an area where globally-focused technology can be used for deep and lasting social impact.

Keywords (Required)

Interorganizational Systems, Network Effects, Ethics, Non-Profits, Apparel Industry, Supply Chain, Corporate Social Responsibility

INTRODUCTION

“I didn’t want to come here, but we’re very poor and I had to come” – Sun Thyda, Age 12

The above quote from a Cambodian factory worker, a girl not yet a teenager, was captured on film in the BBC documentary “Gap and Nike: No Sweat?” (Kenyon, 2000). Thyda and six other girls interviewed reported working conditions that included shift cycles of up to 16 hours, seven-days a week. The factory Thyda labored at was a contract manufacturer, which produced products for the American apparel giant Nike, and the firm’s products were prominently featured throughout the film. In the eyes of many, the brand was the film’s villain.

This was not the first incident for Nike. Throughout the 1990s the firm had been repeatedly marred by accusations that many of its contract manufacturers produced Nike products in sweatshop conditions. And the damage that can ensue from unethical manufacturing practices can have lasting implications for organizations. Protesters crafted logos featuring the word “Slavery”, with the letter ‘v’ replaced by a Nike swoosh. Others ridiculed the firm with the tag line “Just Don’t Do It”. Nike was initially reluctant to deal with protestor confrontation. For example, in 1999, student activists demanded that Nike release a list of factories it was employing, but the company claimed such data was proprietary, eventually relenting in 2004 when pressure simply became too great. To this day, the Nike brand carries tarnish from the events of the 1990s, a period that also saw market share fall and the value of the firm plummet by 50 percent (Carty and Tamara, 2001). And Nike is not alone, Wal-mart, Gap, and other leading manufacturers have repeatedly been the focus of exposés highlighting ghastly incidents and horrendous labor conditions in supplier factories. In addition to the negative impact on exploited workers or harmful environmental effects, these incidents damage brands, can lead to lower sales, cancelled contracts, lower worker morale, fines, and other financial damage (e.g. Garrett et al., 1998; Spar and La Mure, 2003).

Damage and outrage was so widespread that the apparel industry was forced into taking an active role in setting standards. Several firms formed the Fair Labor Association to promote the auditing, monitoring, and enforcement of working condition standards. By 2002, over 21 NGOs, 170 colleges, 982 university licensee companies, and several firms had signed on to the FLA’s Code of Conduct (Spar and La Mure, 2003). While well-intentioned standards and codes of conduct are an important step in the right direction, success lies in enforcement across industries. If information on unethical behavior is not exposed and shared, industry-wide, then unethical contract manufacturers can often simply move on to the next unsuspecting contractor. Vulnerabilities continue, problem not solved. Issues are further heightened when social media and lightning-fast community organization can galvanize outrage and scar reputations on the permanent record that is the Internet (Kane et al., 2009).

But while technology amplifies damning messages, technology can also help firms take an active role in screening out unethical contract manufacturers. While it has been shown that interorganizational information systems can help firms share data to improve industry-wide practices (Kumar et al, 1998; Welty and Becerra-Fernandez, 2001; Zhu et al., 2006), there has been scant research on the impact of technology to improve industry-wide ethics and corporate social responsibility (CSR). This case study highlights how an internally developed system at one apparel manufacturer formed the nucleus of an inter-industry data collection and sharing system, meant to improve contract-manufacturing practices worldwide. The paper underscores issues and challenges in developing such a system. And it importantly highlights the positive role information technology can play in improving corporate social responsibility.

PROBLEM

As globalization spreads and supply chains continue to stretch into more and more countries, there is increasing concern among human rights activists, politicians, and corporations that workers in factories around the world are being exploited. Scott Greathead, chief executive of human rights consulting firm World Monitors Inc and Partner in the law firm Wiggin & Dana, notes a shift in the 1990s from activists targeting governments to activists targeting multinational corporations (Scheffey, 2006).

Reports of exploitation have pushed firms to reassess controls in their supply chain. The apparel industry was one of the first to make this shift because it was one of the earliest and most frequent users of outsourcing. Competition in the industry places a heavy emphasis on brand (Economist Intelligence Unit, 2005). As Nike discovered, once a brand has been tarnished, it could take years to rebuild its reputation.

The primary way companies keep tabs on their suppliers is through social audits. Audits have increased as industry associations have begun to promote compliance and as firms realize that to skip accepted compliance practices risks unethical partner behavior, consumer criticism, and further damage (Pereira, 2005).

However, while important, audits alone are not the answer (Kolka and van Tulderb, 2002). Most notably, audit information had rarely been shared among suppliers, making it difficult to uncover and eliminate an unethical operator. Audit standards are also criticized as being poorly defined and difficult to enforce. In a 2008 report on sustainability by the Business Intelligence Unit of *The Economist*, executives admitted that the supply chain is often “the weakest link” in maintaining effective corporate social responsibility (CSR), however 1/5 of the 1200 executives surveyed said they “performed poorly” in setting stronger supplier standards on both environmental and human rights issues. The same proportion had only instituted supplier controls in last five years (Economist Business Intelligence Unit, 2008).

Compliance doesn’t come cheap and executives have also voiced their concern over audit expense. CEOs attending a November 2002 conference in New York complained of having to ‘carry the burden’ of factory monitoring while some of their rivals did nothing. Audit costs often range from \$1,200 to \$1,500 and major manufacturers with diverse product lines might use 500 to as many as 3,000 factories per year (Pereira, 2005). This has left many firms who sought to outsource as a way to lower costs, now forced to spend more in overhead to ensure suppliers are behaving acceptably.

REEBOK & THE ORIGINS OF THE FFC

With hundreds of contract suppliers operating across product lines, the problem was particularly acute for Reebok. It is noted that firm had avoided many of the mistakes of Nike. In fact, Reebok had long made corporate social responsibility a major firm initiative – the firm even has a Vice President for Human Rights. However, Reebok also realized its vulnerabilities. With hundreds of contract manufacturers serving different divisions of the firm (e.g. footwear, apparel, sporting equipment) that had not previously communicated to one another, it was possible for one division to cancel a contract with an unethical supplier, only to have that supplier shop its services to another Reebok division, with this new division unaware the firm had already deemed the supplier unacceptable. Reebok’s audits were saved as Word documents on individual computers, with no formal method of searching, sharing, and comparing the firm’s gathered intelligence on suppliers. Under this system, progress was hard to monitor and red flags were hard to spot.

Reebok CIO Peter Burrows knew that technology could help improve the process while lowering costs. The solution was to create a structured but flexible web-based database program for collecting and sharing audit information. Reebok invested \$1 million dollars to develop its own internal software, the Human Rights Tracking System (HRTS), to track conditions at factories where its apparel was being produced (Kirsner, 2005; Power, 2005). The Human Rights Tracking System fulfills several functions (Economist Intelligence Unit, 2005):

- It gives the company’s own purchasers, who must consult the database before sourcing an order, instant, real-time data on whether a factory’s practices are acceptable, thus saving time, costs and site visits.

- It helps the company assist intermediary sources to manage their supply chains.
- It has increased consistency across human rights audit reports.
- It allows some automated data collection, although social audits remain largely manual.
- It permits easy comparison of factories over time and highlights any large geographic areas of non-compliance where auditors should focus.
- It is flexible enough to monitor compliance with environmental rules and U.S. regulations that deal with security at foreign factories producing goods for American markets.

After three years of internal use, the HRTS was so successful other companies began to take notice and asked Reebok about buying the software. This prompted Reebok's Burrows, and VP of Human Rights Doug Cahn, to sense an opportunity. The issue Reebok faced with divisions that hadn't shared data was amplified throughout the industry. Companies in the apparel industry share many of the same factories, but if buyers don't share information on bad apples, other buyers can't take action to quash bad behavior. No single buyer could effectively control factory conditions by acting unilaterally. But sharing audit information allows companies to use joint leverage over factories to improve conditions. This also offers the added financial incentive of less money lost in redundant audits or re-screening firms that should have been eliminated before a site visit. By opening Reebok's software up to other buyers, Reebok could create a network effect that improved the value of technology (Shapiro and Varian, 1999). A shared system would enable more buyers with data on more suppliers to create a system that adds more value – both raising the bar of ethical practice while potentially allowing firms to lower costs through more coordinated audit practices.

Realizing the potential, Burrows and Cahn, decided to share their technology with the rest of the industry. Gaining participants is critical to jumpstarting any system where network effects exists (Gallaugh and Wang, 2002; Eisenmann et al., 2006), and an effort coming solely from Reebok risked being seen as a "competitor's system". In order to seed the network with buyers and suppliers and provide additional buyer-neutral legitimacy to the effort, Reebok International Ltd., together with the National Retail Federation, Retail Council of Canada and the organization World Monitors jointly formed the Fair Factories Clearinghouse (FFC), a 501(c)(3) nonprofit organization in late 2004.

When the FFC was first launched, it made clear what it was not meant to do. It would not be a standard or ranking; FFC is neutral to codes (Economist Business Intelligence Unit, 2008). It merely allows companies to compare different codes and encourages them to work out solutions on their own. It is also not a blacklist for factories with human rights violations (Pereira, 2008). Its goal is to increase transparency and encourage best practices. The firm articulates its mission across four key principles:

- Technology enables cost-effective, well-informed ethical business transactions and continuous improvements in global workplaces
- Enhancing the capacity of business to conduct ethical sourcing
- Experienced partners share capability and enhance effectiveness
- Global clearinghouse contributes to factory improvements

In the words of the firm's website, the FFC was established to use technology to:

- Lower the cost of entry for those seeking to manage compliance programs
- Improve the availability, comprehensiveness, and standardization of compliance standards and audits through the use of a global management system to track workplace conditions
- Facilitate the exchange of non-competitive information concerning factory compliance, and enable collaboration in global efforts to assess and improve workplace conditions
- Reduce audit fatigue through the sharing of compliance data, without mandating any specific standard or rating factories
- Advance and promote education & knowledge about global workplace conditions

Reebok donated the HTRS software, which became the basis for the Audit Management System, to the FFC through a perpetual license. The FFC's website went live January 18, 2005 and received a \$350,000 grant from State Department's Bureau of Democracy, Human Rights, and Labor to provide seed capital and help launch the effort (Power, 2005). Today, the FFC software includes over 23,000 factories, 5,000 intermediaries, and 3,000 users in over 120 countries. Over 90% of the factories have compliance documents, in the form of either audits or self-assessments. These documents report everything from child and forced labor to health and safety standard at the factory to workers' wages and freedom association.

Today FFC has grown to include many well known brands such as Burberry, Nike, L.L. Bean, Starbucks, and in 2009, the retail giant Wal-mart. The FFC is not limited to big name brands either. Small and medium sized firms may not have resources to build their own million-dollar database system to manage audits, but the FFC gives them another option. For an annual subscription fee, these firms can gain the same access to audits and other information as the big firms. This is important – the cloud-based FFC solution effectively lowers the bar of CSR initiatives and allows new entrants to leverage and contribute to the wider body of industry supplier information. This allows CSR efforts focused on the supply chain to become part of new entrants, entrepreneurs, and mom and pop shops.

FFC members also include industry associations, nonprofits, and universities. And at this scale, the network effect appears to be realized. 2,800 of the factories in the FFC system are shared by more than one member and 2,100 documents about these factories are shared by FFC members. The FFC collects membership dues to cover its costs and continuously improve the software. Company and purchasers pay a percentage fee based on their annual revenues. Supply chain intermediaries are charged \$500, production suppliers \$100, service providers \$4,000 and trade associations \$10,000 annually.

MAJOR SYSTEM COMPONENTS

The FFC's technology consists of two primary systems: the Audit Management System and the Sharing Platform.

Audit Management System

The Audit Management System evolved from Reebok's original HRTS and was launched in 2006. Its goal is to be an efficient way to collect and analyze all compliance related information. The system is used to:

- Manage factory/farm/workplace data, including contacts
- Deploy self-assessment tools
- Create customized audit questionnaires
- Request, schedule, deploy and record audits
- Manage corrective action plans
- Manage product information and map supply chain with workplace performance
- Store audit/assessment documents
- Analyze workplace/supply chain information
- Provide access to partners to manage their audit and remedial activities
- Produce custom reports on almost any data element

Sharing Platform

The Sharing Platform was launched two years later in 2008. The sharing platform facilitates sharing data collected by any participant for accessibility and transparency among all participants. Some features include:

- Search factories/farms/workplaces to identify opportunities for collaboration
- Identify where suppliers overlap with other members
- Message other members to initiate collaboration
- Access shared compliance documents
- Share factory/farm/workplace lists and compliance documents with other members

All sharing done on the FFC's sharing platform is on a purely voluntary basis. Companies can choose to do it anonymously or not. It has even received interest from companies satisfied with own internal database.

Purchaser Members can purchase both the Audit Management System and Sharing Platform or just the Sharing Platform. Supply Chain Intermediaries and Production Supplier Members get both, except they do not have the ability to search or access document posted by in the sharing platform by Purchasers. Service Providers get the Audit Management System.

ADDRESSING ROLLOUT CHALLENGES

The FFC sought to solve several problems with the auditing process. With so many different buyers, factories face the problem of figuring out how to comply with hundreds and thousands of codes of conduct, all implemented in slightly different ways. FFC members can view reports to help them understand the advantages and drawbacks of each and will hopefully spark harmonization between them.

The unprecedented sharing and collaboration that the FFC provides was a problem that initially threatened the establishment of the system. Anytime members of an industry get together to share information on any level, it raises the concern of anti-trust regulators. Firms in the past have been fined for cartel behavior, collusion, price fixing, and other collaborative, anti-competitive behavior (Rudolf, 2006). Despite their good intentions, collaborative organizations such as the FFC could run into such legal hurdles. Lawyers warned that any major price changes in the industry would appear very suspicious to regulators even if it was not caused by the collaboration (Murray, 2006). Thus before launching its platform the FFC sought to clear its operations with the U.S. government. With pro bono help from Greathead and Wiggin & Dana partners Robert M. Langer and Suzanne E. Wachsstock, the FFC drafted a letter to the anti-trust division of the Department of Justice outlining the organization's intentions. The FFC was clear that members would only share information on social audits, not competitive data. In addition, individual factories will not have access to competitor wage and hour information except in aggregate form (Scheffey, 2006). The FFC obtained a favorable business review letter (BRL) from the Department of Justice in 2006 stating the government had no intent to challenge its activities. It does not mean the FFC is immune from government action, but right now it is unlikely. The Fair Factories Clearinghouse was a go.

FUTURE CHALLENGES

The FFC is not unique in its mission. Companies and organizations in other industries have taken a similar approach to enforce sustainable and responsible practices. These groups include the Fair Labor Association, Social Accountability 8000, Toy Industry Association and Worldwide Responsible Apparel Production.

While the FFC has done a lot since its inception, there are still many challenges in social audits. Ultimately, efforts like the FFC run into a garbage in-garbage out problem. The social audits are only effective if they are accurate and factories continue to find ways to cheat audits. Some tactics include keeping two sets of books and giving workers scripted responses for common audit questions. There are also reports of a new crop of consulting firms operating overseas, which specialize in helping factories evade audits (Roberts, 2006). "We've come to realize that, while monitoring is crucial to measuring the performance of our suppliers, it doesn't per se lead to sustainable improvements. We still have the same core problems." Hannah Jones, vice-president for corporate responsibility for Nike told BusinessWeek (Roberts, 2006).

The next step in improving outsourced working conditions is for companies to partner more closely with suppliers and improve business practices. Companies should find structural improvements that benefit the industry. Says World Markets' Scott Greathead, "We [the FFC] intend to someday serve as a sort of Zagat's guide to overseas manufacturing" (Ravich, 2009).

SUMMARY

The paper highlights how technology has been used to counteract ethical lapses in an industry. Information sharing through the Reebok-initiated and now widely adopted Fair Factories Clearinghouse has improved audit practices and recording procedures, allowed firms to share information, created beneficial network effects and lowered costs, all while raising the bar on industry-wide practice. The case shows how the effort overcame issues of varying standards, proprietary data, and regulatory challenges to craft a genuine example of 'tech for good'. Future studies will examine the lasting impact of this effort (both financial and social), and opportunities to leverage comparable efforts in other industries and contexts to improve CSR natives.

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