

Corporate Supply Chain Compliance



How can a modern purchasing function be certain that children have not been exploited, or workers forced to labour in dangerous or unsafe conditions in the factories and manufacturers in their supply chain?



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Section 1: Introduction: Corporate social responsibility (CSR) Corporate governance

Corporate social responsibility: An overview

We all purchase goods and services, whether in our working lives or our personal lives. We are all, therefore, by definition, consumers. In fact, the very ability to make that independent purchasing decision is considered by many to be a determinant of a truly free and democratic society.

But how many of us consider for a moment the source of these goods and services which we purchase? Where were they made or created? Who made them? Or even, were the people who made them happy? Were they being exploited? How old were they? The chances are that these questions were considered largely irrelevant only a very few years ago. Then, a purchasing decision, whether by an individual consumer or a professional procurement function, was based exclusively on price, brand and effective marketing – and, naturally, the measure of return for the purchasing organisation.

So, whether as a modern consumer, or as a purchasing organisation:

How do you know what you are buying?

All over the world, every day, people like us are making a million of those self-same purchasing decisions, buying products that we all hope and believe are manufactured in a humane working environment. Purchasing professionals, too, may express that same hope.

But how can a modern purchasing function be certain that children have not been exploited, or workers forced to labour in dangerous or unsafe conditions with discriminatory or abusive employment practices in the factories and manufacturers in their supply chain? How do we really, know that the bargain fashion trainers we pick up on a market stall have not been glued together by young workers being slowly blinded by the solvents they are using, or that the tailored jacket from the mail-order company has not been stitched by mothers in Eastern Europe regularly working 80 plus hours a week?

The only sure way to know is by the independent social responsibility audit of those same factories and working conditions where the items we buy are being made. This is to be carried out by a specialist independent auditor with recognised expertise and experience in the area, investigating the working practices in those factories, and working with local non-governmental organisations (NGOs - charitable bodies). At the worldwide level, the unbridled globalisation that resulted from the Uruguay round of General Agreement on Tariffs and Trade (GATT), has meant that corporations operate without borders. Labour has become a clear, flexible commodity. This is not new; anybody who has studied Marx will appreciate that this perspective lies at the heart of class struggle. Indeed, all of the present socio-economic factors at play in the world, can be found in the classic economic texts of the 18th, 19th and early 20th centuries.

Why then is this such a hot topic now?

The corporate level is one dominated by factors such as shareholder return, profits in plain English. But shareholder value can be affected by a surprising number of factors. The corporation controls many of these. In fact, this is what the science of management is all about.

However, the complexity in any large human endeavour will inevitably cause unwelcome, unexpected effects to emerge. Corporations are finding that global management differs from multi-national management. Decisions made in corporate headquarters were often far removed from their subsequent impact upon societies on the other side of the world or, for that matter, in the next street.

This is no longer the case.

These impacts upon societies are now recognised as impacts upon people. They can alter the pattern of a person's life; they probably alter yours and the hopes and expectations of your family. People are complex, they defy most attempts to model them, and they are almost impossible to predict. People communicate and we are living in the communications age. This is the same key that has unlocked both the corporate mind and that of the consumer. The mass media is communication and it informs consumers. It does this by marketing; news, printed, broadcast and, increasingly so, on the internet. This is achieved by tapping the prevailing mood of the society it is addressing, at least in most democracies. It should never be forgotten that the media is as much a creature of the global free market, and its information is only useful if it can be sold.

When we now go to buy an item of clothing, the media has made us aware that somewhere in the world there could well be a child, whose life is being destroyed by our need to own that item of clothing. Some will not care, others will wish they had not been told, but some of us will wonder and replace the item of clothing in question. We will look for a similar item, with a different brand. A brand that we know has a public image, rejecting this socially exploitative manufacturing scenario.

The same can apply to almost anything that we, the consumer, purchase: coffee, petrol, cosmetics, fruit, home improvement materials etc. The problem is the many sources of information, comes from the manufacturers themselves, who may expound their social record, but seldom have independent, credible verification. Other manufacturers are struggling under a barrage of media and activist group attention.

One of the key commercial consequences of the globalisation of world business that has taken place in the last decade since the fall of the Berlin Wall and the collapse of communism has been the massive extension of global sourcing by companies in the developed world, buying their products from cheaper overseas producers. Retailers in Europe and the US will routinely buy finished goods from suppliers in Eastern Europe as well as those of the Far and Middle East, China and India. And this is true not just in traditional areas such as textile and textile goods, but also for household goods including cast metal items, jewellery and decorative products.

Moreover, it is quite commonplace for produce on supermarket shelves in the UK to have been growing in another continent within the 24 hours preceding the consumer purchase. The world-wide sourcing operation has identified the supply, harvested the produce for chilling where appropriate, and arranged transportation around the world for the family purchase to be made.

The rapid and, until now, relatively unstructured expansion of global procurement is burdened with hazards and hidden threats to brand value. Western companies are finding themselves as never before exposed on what are now recognised as CSR issues. These include child and family labour; extended hours of work; lower safety standards and enforcement; routinely

discriminatory practices; a harsher management style; lack of any kind of workforce consultation.

These practices are not new. They have all been identified through verification in the UK, often being found in the heart of London itself. However the increase in the extent of the exposure of traditional High Street names to the accusation of unethical practices is new because of the use of suppliers in the developing world. These standards of employment vary considerably from those of the developed world.

A significant example is the use of dormitories to house a workforce. Virtually all factories in the Far East have workforces resident on site, whereas in the West this practice is highly unusual except for certain occupations, eg, forestry work in Scandinavia. Here is another area of likely non-compliance and public exposure.

The integrity of brand value is at risk.

Companies today are acknowledging the value their brand names represent. They recognise that, in the global marketplace, the biggest single threat to brand strength (and hence brand value) is an attack on a brand's ethical integrity. Since 1998, companies have had to reveal the value of their acquired brands on corporate balance sheets. The globally recognised brands, which make them synonymous with quality and aspirational values, represent corporate asset. For example Mercedes withstood the problems encountered with the "elk-test" on the new A-class car. The strength and resilience of the brand saw it through the difficulty. Arguably, the value of such brand strength is almost incalculable.

There should be no doubt now that this pressure, when brought to bear effectively, will hit the shareholder - who equally undoubtedly, will not like it. The larger ones will vote with their wallets and sell shares, others will use their considerable muscle to try and initiate change in an organisation. Company performance in any area needs to be managed and controlled. However, there is a problem, in the absence of any baseline against which performance can be measured and expressed. So how can change be measured? How can it be graduated?

This is the strength of independent audit and verification, to a recognisable requirement which a purchaser, whether the consumer in the street or the senior buyer for a retail chain, understands. In essence, a measure against which a company's performance can be expressed, be that above or below the standard required.

Section 2: Ethical management and the assurance framework

As part of an overall corporate programme of CSR implementation and good governance, decisions must be made by purchasing and executive management to meet the requirements of the framework of declarations, guides, conventions, normative statements, and semi-regulatory codes associated with corporate social responsibility and corporate governance.

The list given below is comprehensive, but not exhaustive:

The Universal Declaration of Human Rights (1948)

The Universal Declaration of Human Rights calls on 'every individual and every organ of society' to play their part in securing the observance of human rights. Even though nation states have the primary responsibility to promote and protect human rights, companies, as

organs of society, are also responsible for promoting and securing those human rights set forth in the Universal Declaration.

UN Draft Norms of Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights (2003)

The UN draft norms were written to be consistent with international, regional and multilateral agreements, conventions, principles and declarations. They relate these standards to specific human rights responsibilities of business.

International Covenant on Civil and Political Rights (1966)

Deals with: right to life, freedom from slavery and forced labour, non-discrimination, freedom of expression and assembly, and other associated factors.

International Convention on the Elimination of All Forms of Racial Discrimination (1966)

Convention on the Elimination of All Forms of Discrimination Against Women (1979)

Convention Against Torture and Other Cruel, Degrading Treatment or Punishment (1984)

Convention on the Rights of the Child (1989)

International Covenant on Economic, Social and Cultural Rights (1966)

Deals with the right to work, fair wages, safe and healthy conditions, join labour unions, health, education, and other matters.

European Convention for the Protection of Human Rights and Fundamental Freedoms (1950)

African Charter on Human and People's Rights (1981)

European Social Charter (1961)

American Convention on Human Rights (1969)

Arab Charter on Human Rights (1994)

Additional Protocol to the American Convention on Human Rights Convention on Human Rights in the Area of Economic, Social and Cultural Rights (1988)

UN Basic Principles on the Use of Force and Firearms by Law Enforcement Officials (1990)

UN Code of Conduct for Law Enforcement Officials (1979)

Convention of Combating Bribery of Foreign Public Officials in International Business Transactions of the OECD (2001)

Rio Declaration on the Environment and Development (1992)

World Summit on Sustainable Development Plan of Development (2002)

International Code of Marketing of Breast-milk Substitutes (1981)

ILO Convention No.87 Concerning the Freedom of Association and Protection of the Right to Organise ILO Declaration on Fundamental Principles and the Rights at Work (1998)

ILO Convention No. 169 on Indigenous and Tribal Peoples (1989)

UN Global Compact (2000)

OECD Guidelines on Multinational Enterprises (2000)

ILO Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy (1977)

Chapter 3: Corporate governance and procurement

Good corporate governance – in essence, the integrity with which a company is managed – is a central component of a robust CSR management programme.

The roles, the actors, the relationships

Modern commercial society in the 21st century enjoys a standard of prosperity unprecedented in human history. But sustained peace and prosperity in society is itself a product of good governance – a stable and stabilising control over human affairs effected judiciously, fairly, equitably, and in the best interest of all members of a society. This has been recognised since the days of Nicolo Machiavelli and before.

As with societies, so with companies. Only through the application of good corporate governance – the effective and equitable management of their own affairs – can companies be truly successful in achieving their corporate objectives.

Relationships

To be truly effective, the corporate governance of companies requires a clear understanding of the respective roles of the board and of senior management and their relationships with others in the corporate structure, and with the company's many stakeholders. It is worth exploring some of those relationships. Some specific examples are instructive:

- The relationships of the board and senior management with Shareholders should be characterised by candour and openness
- Their relationships with employees should be characterised by fairness;
- Their relationships with the communities in which they operate should be characterised by good citizenship; and
- Their relationships with government should be characterised by a commitment to compliance.

Executive Management, led by the Managing Director/ Chief Executive Officer, is responsible for running the day-to-day operations of the company and keeping the board fully informed about those operations. Effective corporate governance requires a proactive, focused state of mind on the part of directors, the CEO and senior management, who all must be committed to business success through maintenance of the highest standards of responsibility and business ethics.

Good governance is far more than a tick- box list of minimum board and management policies and duties. Even the most thoughtful and well-drafted policies and procedures are destined to fail if directors and management are not committed to enforcing them in practice.

General Management's responsibilities include strategic planning, risk management, and financial reporting.

The Board of Directors has the important role of the periodic oversight of management performance on behalf of shareholders. Its primary duties are to select and hold responsible a qualified and ethical MD/CEO who, with senior management, runs the company on a daily basis, and to review management's performance and adherence to corporate standards.

Shareholders notionally necessarily have little voice in the day-today management of companies operations. Instead, they have the right to elect representatives – directors - to take care of their interests, and to receive the information they need to make investment and voting decisions.

The corporate governance system

A good corporate governance structure is a working system for principled and values-driven goal-setting, effective decision making and appropriate monitoring of compliance and performance. Through a flexible and dynamic structure, the CEO, the management team and the board of directors can interact effectively and respond quickly to changing circumstances, within a framework of solid corporate values, to provide enduring value to the shareholders who invest in the enterprise.

The specific roles of executive management and the board of directors

An effective system of corporate governance provides the framework within which the board and management address their respective responsibilities.

The board of directors

A company is managed under the direction of the board. The board delegates to the CEO, and through him or her to other executive management, the authority and responsibility for managing the everyday affairs of the corporation. Directors monitor management on behalf of the company's shareholders. The selection, compensation and evaluation of a well qualified and ethical CEO to effectively lead the company is the single most important function of the board. The board also appoints or, more often, approves other members of the senior management team.

Directors, whether full-time or Non-Executive, bring to their role a range of experience, knowledge and judgment.

Effective directors maintain a permanent attitude of constructive scepticism; they routinely ask incisive, probing questions and require accurate, honest answers; they should act always with integrity; and demonstrate a commitment to the company, its business plans and long-term shareholder value.

They should not be afraid to challenge the most basic principles on which the company is being run, on their behalf, by the executive management.

In performing its overseeing and review function, the board is entitled to rely on the advice, reports and opinions of management, legal advisers, auditors and expert advisors. The board

should assess the qualifications of those it relies on and hold managers and advisors accountable. The board should ask questions and obtain answers about the processes used by managers and advisors to reach their decisions and recommendations and about the substance of the advice and reports received by the board.

Given their overseeing role, shareholders and other stakeholders can reasonably expect that directors will exercise vigorous and diligent oversight over a company's affairs. However, directors should not be expected to micromanage company business by performing or duplicating the tasks of the CEO and the senior management team. Only in exceptional circumstances, and with a specific objective, should they probe the minutiae of daily management actions.

The board's overseeing function can also carry with it a number of specific responsibilities in addition to that of initially selecting the MD/CEO. These include responsibility for:

Planning executive management succession

The board should reasonably plan for CEO and senior management succession and, when appropriate, replace the CEO or other members of senior management.

Reviewing corporate strategy

The board has responsibility for overseeing and understanding the corporation's strategic plans from their inception through their development in a values-driven context and execution by management. Once the board reviews a strategic plan, the board should regularly monitor implementation of the plan to determine whether it is being implemented effectively and whether changes are needed.

Reviewing budgets

The board has responsibility for overseeing and understanding the corporation's annual operating plans and for reviewing the annual budgets presented by management. The board should monitor implementation of the annual plans to assess whether they are being implemented effectively and within the limits of approved budgets.

Financial statements and reporting

While financial reports are primarily the responsibility of executive management, the board and should take reasonable steps to be comfortable that the company's financial statements and other public accounting accurately present the corporate financial condition and results of company operations to shareholders and other stakeholders, and that they do so in an understandable manner.

In order to do this, the board should have a broad understanding of the company's financial statements, including:

- why the accounting principles critical to company business were chosen
- what key judgments and estimates were made by management, and
- how the choice of principles, and the making of such judgments and estimates, impacts the reported financial results of the company.

Section 4: Management actions: the audit process

Key to an effective corporate governance system is the audit and review process. External auditors and independence issues The board is responsible for scrutinising, authorising and

engaging outside auditors to audit the corporation's financial statements and, increasingly, its management systems and for the on-going communications with, and management of, these auditors. The board should periodically consider the independence and continued use of these auditors, their overall capability, and the quality and depth of their reporting.

Audit committees

To assist them in carrying out these responsibilities, the boards of larger companies should appoint audit committees to oversee the competence of the audit function. In SMEs, this function can be performed by the board itself.

The audit committee is responsible for supervising the corporation's relationship with its outside auditor, including recommending to the full board the firm to be engaged as the outside auditor, evaluating the auditor's performance, and considering whether it would be appropriate for the outside auditor periodically to rotate senior audit personnel or for the corporation periodically to change its outside auditor.

The selection of an outside auditor should involve an annual due diligence process in which the audit committee reviews the qualifications, work product, independence and reputation of the proposed outside auditor. The audit committee should base its decisions about selecting and possibly changing the outside auditor on its assessment of what is likely to lead to more effective audits. Based on its due diligence, the audit committee should make an annual recommendation to the full board about the selection of the outside auditor.

Independence

The audit committee should consider the independence of the outside auditor and should develop policies concerning the provision of non-audit services by the outside auditor. The provision of some types of audit-related and consulting services by the outside auditor may not be inconsistent with independence or the attestation function. In considering whether the outside auditor should provide certain types of non-audit services, the audit committee should consider the degree of review and oversight that may be appropriate for new and existing services. When making independence judgments, the audit committee should consider the nature and dollar amount of all services provided by the outside auditor.

Critical accounting judgments and estimates

The audit committee should review and discuss with management and the outside auditor the corporation's critical accounting policies and the quality of accounting judgments and estimates made by management.

Internal controls

The audit committee should understand and be familiar with the corporation's system of internal controls and on a periodic basis should review with both internal and outside auditors the adequacy of this system.

Compliance

Unless the full board or another committee does so, the audit committee should review the corporation's procedures addressing compliance with the law and important corporate policies, including the corporation's code of ethics or code of conduct.

Financial statements

The audit committee should review and discuss the corporation's annual financial statements with management and the outside auditor and, based on these discussions, recommend that the board approve the financial statements for publication and filing.

Most audit committees also find it advisable to implement processes for the committee or its designee to review the corporation's quarterly financial statements prior to release.

Internal audit function

The audit committee oversees the corporation's internal audit function, including review of reports submitted by the internal audit staff, and reviews the appointment and replacement of the senior internal auditing function.

Communications

The audit committee should be the channel of communication to the board for the outside auditor and internal auditors and may also meet with and receive reports from finance officers, compliance officers and the general counsel.

Hiring auditor personnel

Under audit committee supervision, companies can implement so-called revolving door policies covering the hiring of auditor personnel. For example, these policies may impose cooling off periods prohibiting employment by the corporation in senior financial management positions of members of the audit team for some period of time after their work as auditors for the corporation. The audit committee should consider whether to adopt such a policy. Any policy on the hiring of auditor personnel should be flexible enough to allow exceptions, but only when specifically approved by the audit committee.

Audit committee meetings

Audit committee meetings should be held frequently enough to allow the committee to appropriately monitor the annual and quarterly financial reports, and to allow the committee to appropriately monitor the annual and quarterly financial reports. For most large companies, this can mean four or more meetings per year. Meetings should be scheduled with enough time to permit and encourage active discussions with management and the internal and outside auditors.

The audit committee should meet with the internal and outside auditors, without management present, at every meeting and communicate with them between meetings as necessary. Some audit committees may decide that specific functions, such as quarterly review meetings with the outside auditor or management, can be delegated to the audit committee chairman or other members of the audit committee.

Corporate governance committee

Every large company should have a committee that specifically addresses corporate governance issues. SMEs may appoint two members of their board for this purpose with designated responsibility.

A corporate governance committee is central to the effective functioning of the board. An early function of a corporate governance committee's role was to recommend director nominees to the full board and company shareholders. Today, the corporate governance committee's role has expanded so that it typically provides a leadership role in shaping the corporate governance of a corporation.

A corporate governance committee should develop and recommend to the board a set of corporate governance principles applicable to the corporation. These principles should be communicated to the corporation's shareholders and should be readily available to prospective investors and other interested parties.

Compensation committee

Every large company should have a committee comprised solely of independent directors that addresses compensation issues as a key component of its social responsibility monitoring system. A compensation committee has two principal responsibilities: overseeing the corporation's overall compensation programme, and setting CEO and senior management compensation. A compensation committee should look at the overall compensation structure of the enterprise to determine that it establishes appropriate incentives for management and employees at all levels.

Overall compensation structure

In addition to reviewing and setting compensation for management, a compensation committee should look more broadly at the overall compensation structure of the enterprise to determine that it establishes appropriate incentives for management and employees at all levels. In doing so, the committee should understand that incentives are industry dependent and are different for different categories of people.

All incentives should further the corporation's long-term strategic plans and should be consistent with the culture of the corporation and values on which the company is based. A diverse mix of compensation for the board and management can foster the right incentives and prevent a short-term focus or a narrow emphasis on particular aspects of the company's business.

Management compensation

Management compensation practices will necessarily differ for different companies. Generally, however, an appropriate compensation package for management includes a carefully determined mix of long- and short-term incentives. Management compensation packages should be designed to create a commensurate level of risk and opportunity based on business and individual performance. The structure of management compensation should directly link the interests of management, both individually and as a team, to the long-term interests of stockholders.

A compensation committee should consider whether the benefits provided to senior management, including post-employment benefits, are proportional to the contributions made by management.

Section 5: Corporate governance and board operations

Serving on a company board requires significant time and attention on the part of directors. Directors must participate in board meetings, review relevant materials, serve on board committees, and prepare for meetings and for discussions with management. They must spend the time needed and meet as frequently as necessary to properly discharge their responsibilities.

The appropriate number of hours to be spent by a director on his or her duties and the frequency and length of board meetings depend largely on the complexity of the corporation and its operations. Longer meetings may permit directors to explore key issues in depth,

whereas shorter but more frequent meetings may help directors stay up-to-date on emerging corporate trends and business and regulatory developments. When arranging a meeting schedule for the board, each corporation should consider the nature and complexity of its operations and transactions, as well as its business and regulatory environment.

Good practice does not prescribe a specific limitation on the number of directorships an individual may hold. However, service on too many boards can interfere with an individual's ability to perform his or her responsibilities. Before accepting an additional board position, a director should consider whether the acceptance of a new directorship will compromise the ability to perform present responsibilities. It also is good practice for directors to notify each board on which they serve before accepting a seat on the board of another business, in order to avoid potential conflicts. Similarly, the corporation should establish a process to review senior management service on other boards prior to acceptance.

Directors may seek the opportunity to meet outside the presence of the CEO and any other management directors. Many board responsibilities may be delegated to committees to permit directors to address key areas in more depth. Regardless of whether the board grants plenary power to its committees with respect to particular issues or prefers to take recommendations from its committees, committees should keep the full board informed of their activities. Companies benefit greatly from the collective wisdom of the entire board acting as a deliberative body, and the interaction between committees and the full board should reflect this principle.

The board's agenda must be carefully planned, yet flexible enough to accommodate emergencies and unexpected developments. The chair of the board should be responsive to individual directors' requests to add items to the agenda, and open to suggestions for improving the agenda. Importantly, the agenda and meeting schedule must permit adequate time for discussion and a healthy give-and-take between board members and management.

Management presentations should be scheduled to allow for question-and-answer sessions and open discussion of key policies and practices. Board members should have full access to senior management. Generally, the CEO should be advised of significant contacts between board members and senior management.

The board must have accurate, complete information to do its job; the quality of information received by the board directly affects its ability to perform its oversight function effectively. Directors should be provided with, and review, information from a variety of sources, including management, board committees, outside experts, auditor presentations, and analyst and media reports. The board should be provided with information before board and committee meetings with sufficient time to review and reflect on key issues and to request supplementary information as necessary.

Many companies provide new directors with materials and briefings to permit them to become familiar with the corporation's business, industry and corporate governance practices and to deal appropriately with issues that arise.

From time to time, it may be appropriate for boards and board committees to seek advice from outside specialist advisors independent of management with respect to matters within their responsibility. For example, there may be technical aspects of the corporation's business – such as risk assessment and risk management – or conflict of interest situations for which the

board or a committee determines that additional expert advice would be useful. Similarly, a compensation committee may find it useful to engage separate compensation consultants.

Board and management evaluation

The board should have an effective mechanism for evaluating performance on a continuing basis. Meaningful board evaluation requires an assessment of the effectiveness of the full board, the operations of board committees and the contributions of individual directors.

The performance of the full board should be evaluated annually, as should the performance of its committees. The board should conduct periodic – generally annual – self-evaluations to determine whether it and its committees are following the procedures necessary to function effectively.

The board should have a process for evaluating whether the individuals sitting on the board bring the skills and expertise appropriate for the company and how they work as a group. Board positions should not be regarded as permanent. Directors should serve only so long as they add value to the board, and a director's ability to continue to contribute to the board should be considered each time the director is considered for re-nomination.

Planning for the departure of directors and the designation of new board members is essential. The board should establish procedures for the retirement or replacement of board members. Such procedures may, for example, include a mandatory retirement age, a term limit, and/or a requirement that directors who change their primary employment tender a board resignation, providing an opportunity for the corporate governance committee to consider the desirability of their continued service on the board.

Planning for management succession is also critical. The board or its corporate governance committee should identify, and periodically update, the qualities and characteristics necessary for an effective CEO. With these principles in mind, the board or committee should periodically monitor and review the development and progression of potential internal candidates against these standards. Advance planning for contingencies such as the departure, death or disability of the CEO or other top executives is also critical so that, in the event of an untimely vacancy, the corporation has in place an emergency succession plan to facilitate the transition to both interim and longer-term leadership.

The board should annually review the performance of the CEO and should participate with the CEO in the evaluation of members of senior management. All non-management members of the board should participate with the CEO in senior management evaluations. The results of the CEO's evaluation should be promptly communicated to the CEO by representatives of the non-management directors.

Section 6: The Board and stakeholder relationships

Companies have obligations to shareholders and to other constituencies, including employees, the communities in which they do business, and government, but these obligations are best viewed as part of the overriding duty to optimise long-term shareholder value. Good practice determines that shareholder value is enhanced when a corporation treats its employees well, serves its customers well, maintains good relationships with suppliers, and has a reputation for CSR and legal compliance.

Shareholders and investors

Companies have a responsibility to communicate effectively and candidly with shareholders. The objective of shareholder communications should be to assist shareholders understand the business, risk profile, financial condition, and operating performance and trends of the company.

Companies communicate with investors and other stakeholders not only in proxy statements, annual and other reports and formal stockholder meetings, but in many other ways. All of these communications should provide consistency, clarity and candour. Shareholder communications In planning communications with shareholders and investors, corporations should consider:

Candour

Directors and management should never mislead or misinform stockholders about the corporation's operations or financial condition.

Timely disclosure

In an age of instant communications, there is an increasing need for companies to disclose significant information closer to the time when it arises and becomes available. The trend toward prompt disclosure of significant developments, is beneficial but it should be recognised that a current disclosure regime must allow time to reasonably assure accuracy and should not be a basis for new liabilities.

The goal of shareholder communications

Whatever the substance of the communication, the company's ultimate goal should be to furnish information that is honest, intelligible, meaningful, timely and broadly disseminated, and that gives investors a realistic picture of the company's financial condition and results of operations through the eyes of management.

Companies should obtain shareholder approval of new share option plans in which directors or executive officers participate. Because shareholders have a particular interest in the amount and nature of equity compensation paid to directors and senior management, companies should obtain shareholder approval of new share option plans in which directors or executive officers participate.

Employees

It is in a company's best interest to treat employees fairly and equitably. Corporations should have in place policies and practices that provide employees with compensation, including benefits, that is appropriate given the nature of the company's business and employees' job responsibilities and geographic locations. When companies offer retirement, healthcare, insurance and other benefit plans, employees should be fully informed of the terms of those plans.

Companies should have in place mechanisms for employees to alert management and the board to allegations of misconduct without fear of retribution. Companies should communicate honestly with their employees about corporate operations and financial performance. Technology makes communicating with employees quicker, easier and less expensive. Companies should take advantage of technological advances to enhance dissemination of information to employees.

Communities

Companies have obligations to be good citizens of the local, national and international communities in which they do business. Failure to meet these obligations can result in damage to the company, both in immediate economic terms and in longer-term reputation.

A company should be a good citizen and contribute to the communities in which it operates by engaging in community programmes and by encouraging its directors, managers and employees to form relationships with those communities. A company should also be active in promoting awareness of health, safety and environmental issues, including any issues that relate to the specific types of business in which the company is engaged.

Government

Companies, like all citizens, must act within the law. For companies, the penalties for serious violations of law can be extremely severe, even life-threatening. Compliance is not only appropriate; it is essential. Management should take reasonable steps to develop, implement and maintain effective legal compliance programmes and the board should periodically review such efforts to gain reasonable assurance that they are effective.

Section 7: Corporate governance and managing the supply-chain

In the context of a global marketplace which offers as many challenges as opportunities, and a guidance framework, as outlined above, that is exhaustive, purchasing professionals need to ensure that they have robust review, audit and assurance frameworks in place to ensure compliance. In particular, they need to ensure the following requirements are met:

- Ethical sourcing
- Risk analysis – critical points
- Partnership arrangements with first-tier suppliers
- Supplier communications
- Code of practice
- Verification audits.

Corporate governance programmes and systems were once held to be a ‘nice to have’ feature of corporate life - a luxury one could afford if everything was proceeding nicely in all other ways.

This is not the case today.

Apart from being a source of competitive advantage in an increasingly ranked world, there are significant opportunities for companies which implement a cohesive assurance and audit framework. Opportunities which would be missed by ignoring it. Many of these emerge from suitably well planned purchasing and supply management.

Policies, strategy, governance

Purchasing professionals cannot develop a supply chain CSR management system in isolation, or in a vacuum. It must be formulated in collaboration with the leaders of the other key disciplines; it must be aligned with the CSR policy of the organisation as a whole.

For this to be possible, the policy must be robust and meaningful: it must stand up to scrutiny from a wide range of interested parties, such as NGOs and other external agencies, and must take account of their particular needs, viewpoints and contributions. In this way, another vital criterion for success can be met: ownership. Those who have had a hand in – or simply been

kept informed during – the formulation of policy will tend to feel a sense that they co-own it. A CSR procurement policy which is imposed in isolation from above will fail.

The CSR policy must deliver what the organisation as a whole is aiming for in CSR and governance terms, whether that is sector leadership or followership (and both, at any given stage, may be legitimate aims). It is also vital that CSR commitments are entirely practicable within overall existing policies.

A necessarily abbreviated list of areas to be scrutinised in company operations would include the following:

Marketing and advertising

- Printed materials
- Promotional items

Staff and professional services

- IT developments and software
- Training

Overheads and support

- Fleet acquisition
- Office supplies

Facilities

- Electricity
- Catering

Raw materials

- Plastics
- Chemicals

Food and clothes

- Catering
- Protective wear

IT, Electronic equipment and telecommunications

- Desktop computers
- Office equipment

When the assessment of risk and CSR requirements is made, specific industry sectors clearly have differing requirements. For example the pharmaceuticals and retail sectors tend to have high environmental impact. Apparel and mining, on the other hand, are more often exposed to risk in human rights and may conduct analysis on a product-by-product basis. Service and information technology sectors can apply CSR decisions by grouping; toy manufacture has high human rights requirements.

This phase of the management process can prove to be a complex and highly challenging one for purchasing professionals, often requiring specialist advice.

Risk ranking modelling

No two organisations will have precisely the same requirements and, by definition, a unique risk-ranking model will need to be developed by each. Some core issues, however, are

applicable. Just as the CSR procurement policy needs to fit into the overall policy of the organisation, it must also be integrated with the existing sourcing governance and policy structure.

A CSR procurement policy that is outside the main sourcing governance structure and methodology will, inevitably, create unwanted tensions and contradictions. Once this has been achieved, the CSR supply chain programme has the foundations it needs in order for the next stage to be initiated.

Product and service analysis

The analysis of products and services invariably raises a wide range of CSR issues that were not immediately apparent. Working through the list of procured items, more and more matters tend to emerge but, with a solid policy foundation already developed, this should not present too many insoluble problems.

Purchasing professionals need first to establish their position on whether they propose to:

- 1) Analyse every product and service purchased from a life cycle assessment (LCA) confirming environmental credentials and, say, to apply human rights criteria for the social standards. The most scientifically reliable method, is the analysis of the environmental impacts of a product from its design to its disposal, taking into account all the steps in between including: raw material extraction, manufacturing, packaging, transport, storage and utilisation. LCAs can seem an inflexible and expensive tool: because they go into so much detail.

Or:

- 2) Group products and services into broad spend areas and assess the general environmental and social impacts.

The company should determine the robustness of actions they wish to take during direct engagement with suppliers – either through the tender process or with existing suppliers. Management action should be linked to the risk ranking of the product or service. Examples of appropriate purchasing management actions would include:

1. High management action

- Specific environmental action required; description of action
- Risk ranking
- Very high requirement specified (consider alternatives)
- CSR representative methods/purchasing options
- Priority for active action engagement of suppliers
- Inclusion of questions set as requirement within the tender/bid stage.

2. Moderate management action

- Inclusion of question as a minimum requirement at the tender stage
- Guidelines, with audit activity.

3. Low general action

- Inclusion of a generic environmental performance questionnaire at the tender stage
- Guidelines only, no audit.

Environmental/social

Social and environmental impacts are often interlinked. Purchasing professionals need to ask what are the specific environmental criteria that apply in our case? What are the social criteria? Environmental criteria typically include:

- Global warming impacts atmospheric ozone depletion
- Sustainable resources
- Resource consumption
- Local air quality
- Solid waste
- Land/water contamination
- Hazardous materials
- Legal compliance
- Reputational risk.

In virtually all cases, appropriate management actions must include:

Identification: Applying the Risk Ranking Modelling (RRM) to the chosen way of defining products and services

Analysis: Assessing defined products and services according to the environmental and social impact across the full life cycle or life stages.

The sourcing process

In order to create a sourcing process that is successful, rigorous questions need to be put to suppliers and potential suppliers. These will be used to rank suppliers of products and services according to their CSR credentials. It is important at this stage in order to take full advantage of, and to avoid conflicting with, all the work done up to this point. Additionally it is important that all the question sets are consistent with overall CSR strategy and aligned with the objectives sought by the procurement division. They must also be formulated in a way to which suppliers and potential suppliers can respond promptly and usefully. This requires that they are readily understood by a wide variety of respondents among suppliers' personnel, most of whom will be non-specialists.

It must also be borne in mind that the question sets will trigger an interpretation function when they are returned. For this reason, their formulation must take account of the need for procurement professionals to 'compare apples with apples' when analysing the responses, so as to provide clear and fair supplier ratings. Numerous other key characteristics apply to the development of an organisation's question sets in this context. This is the most critical part of the supply chain CSR management process. It is here that the biggest risks lie.

Purchasing professionals need to develop a methodology which meets all the criteria in the following checklist. It must be able to:

- Be operated by non-specialists on environmental and social issues procurement staff
- Assist procurement personnel in comparing the environmental and social performance of potential suppliers
- Provide opportunities for suppliers to be able to differentiate themselves on the basis of their environmental and/or social performance and facilitate positive selection in relation to differentiated products and services
- Demonstrate commitment and foster a joint approach to continuous improvement in the supply chain
- Identify management information needs and ensure data availability from chosen suppliers

- Identify and facilitate action upon key reputational risks and opportunities.

Social and human rights criteria typically include:

- Country of origin
- Political regimes
- Minimum working ages
- Forced labour
- Bonded labour
- Prison labour
- Union access
- Wages.

Supplier questionnaires

These may be used to ensure rigour in supplier activity. Questions should be:

- Consistent with overall CSR objectives
- Intelligent: what do we want to achieve in key areas, such as:
 - Legal compliance
 - Environmental products
 - Recycling
 - Region of origin
 - Human rights issues
- Appropriate to the level of risk identified in the risk ranking process
- Simple for suppliers to complete
- Uncomplicated for procurement professionals to analyse and provide supplier ratings, providing, where possible for yes/no answers with additional information only where specifically needed - see sample questions below
- Enable sufficient information to be gathered in order to assure:
 - Minimisation of CSR-related risks
 - Maximisation of CSR-related opportunities.

Typical questions to be posed in supplier questionnaires would be as follows:

Environmental compliance

What efforts does your company take to manage its environmental impacts?

- a) Certified Environmental Management System (EMS)
- b) Working towards EMS certification
- c) Operating an uncertified company-wide EMS, with no current plans for certification
- d) Currently developing and implementing a company-wide EMS
- e) No EMS planned but environmental policy in place
- f) None at present.

Social/human rights

Please state how compliance with your employment rights and policy is monitored and enforced.

- a) Site visit or audit by a recognised third party authority? Please attach details of audit body and terms of the agreement
- b) Site visit or audit by an in-house team?

Please attach details

- c) Other means? Please give details
- d) No verification.

Once completed, questionnaires should be returned by suppliers, and then internal management and use of the information takes over. For the majority of procurement personnel the body of data provided will be a valuable resource, enabling them to enhance the effectiveness of their purchasing in a wide range of ways, which are advantageous to the company.

Effective collaboration between purchasers and suppliers in the management of CSR issues produces many additional benefits. For example, a balance can be struck, between specialist supplier knowledge, where it exists, of CSR matters and specification on the part of purchasers.

In the public sector, a somewhat different set of priorities sometimes applies. For example, in 2003, the UK Government issued its Framework for Sustainable Consumption and Production. This includes a section relating to government procurement, "...we will be rolling out changes to guidance, setting clear environmental standards in areas of our own purchasing and issuing more comprehensive information about product specifications over the coming year."

In this context, purchasing professionals may be faced with the conflict between potential premiums for specifying environmental standards and delivering best value. By developing intelligent supplier questionnaires, a balance can be achieved which can often deliver both environmental and social benefits in a financially acceptable way.

Risk and opportunity

Central to the operation of any CSR procurement is the risk and opportunity profile. Whether directly or indirectly related to purchasing and supply, these are increasingly important matters for all the strategic leaders of any organisation. To mitigate CSR risks, from reputation to litigation, the risks can be considerable. For example, in just one week in 2003, the following issues were reported:

- the Bank of England faced a possible £1 billion in damages over its role in a banking fraud;
- a report showing that media coverage of CSR issues had increased by no less than 400 per cent in the last three years;
- the chairman of one of the UK's largest companies was asked to stand down on ethical grounds;
- a former Fortune 500 Chief Financial Officer pleaded guilty to charges of deception that carried a prison sentence
- several of the world's largest management consultancies shed top management and closed down their tax shelter divisions after severe criticism over ethical standards;
- an audit report suggested that one of the world's largest retailers may have been contravening child labour laws.

In most or all of these CSR-linked cases, procurement ultimately had a key role. Opportunities clearly exist to identify adding value, and there are few better places than this to make substantial direct economic benefits, in addition, that is, to the indirect ones created in areas such as brand equity, media profile and staff motivation. For instance, there are almost always significant savings to be made in energy use, materials and fuel consumption. Once embarked upon a CSR supply chain programme many organisations have found innovative ways of ensuring compliance.

Internal delivery

Internal delivery is a critical element in the success of CSR purchasing and supply management. As elsewhere, the key is to make it very clear to purchasing personnel that this is not only a discipline but also an opportunity to achieve multiple benefits, including cost reductions.

Collaborating with suppliers, for example, to create collaborative logistics systems, or recycling initiatives, leading to savings which can benefit the purchaser and make the supplier more competitive.

Many financial services organisation have – in conjunction with its supplier – identified the environmental benefits of online banking in reducing the need for paper statements, which have always been sent to customers. This initiative has the added advantage, once implemented, of saving several million pounds per annum in postal costs, since so many paper statements will no longer need to be sent to account holders.

The way to optimise both risk mitigation and added value opportunities is to ensure that as many participants as possible are involved on an on-going basis in the process. If staff and suppliers are continually kept up to date with developments and invited to contribute, not only are there issues of ownership to be successfully addressed, it can create many unforeseen breakthroughs.

Partnership development

Working in partnership with key suppliers can deliver very significant benefits for both parties. Many gains, often quite unforeseen, can be achieved by putting a number of suppliers together with procurement professionals in CSR learning and exploratory processes.

The risk ranking model should provide the means to determine where the best opportunities exist to move to products and services – and, therefore, suppliers – that provide significant CSR improvements. There are many options here and specific outcomes of the above phases will determine the course selected in each case.

One approach involves working with key suppliers specifically on CSR issues. This can be expensive and may involve specialist external facilitation but consistently produces the best results

Another way to engage is to design a process whereby CSR matters are built into an existing supplier development programme. This can provide results at lower initial costs and help to bring CSR matters into the mainstream; however, they can become lost within a large scope of general procurement issues.

The vital discipline at this stage is care in the integration into existing procurement methodologies and systems: it is inadvisable, for example, to develop paper-based risk ranking models and questionnaires if the existing supplier assessment process is enabled.

When initially scoping and designing the CSR supply chain programme, final information delivery methods should be an integral part of the process. For some organisations, simple paper-based assessment of completed question sets is sufficient: in-house staff may enter data received in response to questions and then prepare the reports required for the decision-making procedures. In some cases, in-house staff will enter digital data as part of an e-enabled system managed entirely by the procurement team. Other organisations will want potential suppliers to complete their question sets online and the results scored automatically for the purchasing professional. This will have development cost implications – especially where a fully e-enabled solution is sought. Often existing e-procurement tools do not include CSR related issues and these, therefore, have to be developed on a bespoke basis.

Whatever the chosen delivery method, it is important that training is provided on how to use the CSR purchasing and supply management tool.

Furthermore, a coherent systemised approach will optimise benefits in this area. Where advantages in, for instance, staff motivation and pride throughout the organisation are capable of being created by the CSR supply chain programme, internal communications are essential. A company's intranet, staff publications or events may be the most appropriate vehicles.

Key suppliers – CSR auditing

The single most important issue in CSR auditing is the identification of the precise areas where risk exists. Here, many organisations have historically addressed their first-tier suppliers and assumed that these organisations, in turn, will deal with risks further down the supply chain.

This has increasingly proven to be an ill-advised approach. Media exposés involving clothing retailers are a clear example: Nike or Gap may have very high standards, but a media exposé of a fourth-tier supplier may still prove to be the cause of a major negative impact on brand equity.

One answer is to use the risk ranking model to identify where real risk applies and to work on mitigation measures with suppliers at all relevant levels. This also provides a means by which to gauge the level at which the pro-active involvement of all suppliers might be assessed, the message being: we will require your organisation to be involved in risk assessment at all times.

The rotation of auditors on a one-, two-, or three-yearly basis, can add significantly to the effectiveness and credibility of this process. This, of course, adds significantly to the strategic need for purchasing professionals to be involved in the selection and management of auditors.

CSR reporting

It is becoming standard practice – in both the private and public sectors – to produce annual reports on environmental and/or social policies and achievements. Reporting on supply chain performance should be an integral component of this reporting process.

Procurement departments can add value to the quality and value of these reports by:

- Demonstrating a robust methodology to assess CSR issues across the supply chain: report data readers, particularly the increasingly important professional verification specialists, will require clear evidence that proven, replicable assessment techniques have been consistently applied in determining the credentials and performance of suppliers.
- Ensuring environmental and social data is available from suppliers: the provision by suppliers of reliable information requires that their contracts call for data relating, for instance, to energy consumption, packaging, transport, greenhouse gas emissions and human rights.
- Requiring case studies: not only do case studies – both positive and negative – provide examples of the 'real time' manifestation of CSR principles, they also bring alive the reporting process, providing readers with opportunities to interpolate and extrapolate to their own circumstances, making the reporting organisations discoveries more meaningful and more widely applicable.

What companies should do: implementation programme. The following are the key points to be borne in mind by purchasing professionals in creating their CSR and governance programme:

- Plan/behave/prevent/improve/inform
- Ethical sourcing

- Risk analysis – critical points
- Partnership arrangements with first-tier suppliers
- Supplier communications
- Code of practice
- Verification audits.

I. Awareness

- co-partnering with senior suppliers
- communications - supplier conferences.

II. Code of practice

- clear definition
- vision and mission
- aims and objectives
- stakeholders and dependencies
- information needs
- actions and responsibilities
- board performance indicators development.

III. Independent audit and verification

- The assurance framework
- Review and rectification.

Section 8: Conclusions and management recommendations.

CIPS: The role of the purchasing professional

In issuing guidelines on the role of purchasing professionals in implementing a CSR and governance programme, CIPS draws attention to the following key requirements in relationships with suppliers:

1. Declaring interest

Any interest should always be declared, and hospitality when accepted should never be excessive or frequent.

2. Payment to be an approved supplier

Purchasing and supply management professionals should not request payment from suppliers as a condition of being placed on an approved or preferred supplier list. Suppliers should be selected on the basis of meeting appropriate and fair criteria.

3. Payment towards joint projects

Purchasing and supply management professionals may invite suppliers to contribute towards the costs of joint projects or initiatives such as sector-wide supplier databases, marketing a new product range or investing in a new IT system, provided there are clear and tangible business benefits to the supplier.

This process should be undertaken carefully and fairly and must not discriminate against suppliers; small and medium-sized enterprises (SMEs) for example.

4. Barter

Barter is trade by exchange of goods or services for other goods or services. There is no exchange of money and, as barter is not usually a condition of contract between two parties,

coercion is not an issue. Where appropriate, barter is acceptable business practice, provided both parties have a current business need for the goods/services of the other party.

5. Reciprocal trading

Reciprocal trading or countertrade, which makes being a customer of an organisation a condition for being a supplier, is generally considered to be unacceptable business practice. Reciprocal trading to be only acceptable when:

- there is no coercion
- both parties are in agreement and
- there is mutual benefit and transparency.

6. Supplier relationships and competition

Most organisations purchase some commodities and services tactically, using short-term contracts, and others, for reasons of strategy, security or leverage, by means of longer-term arrangements. From time to time, longer-term agreements with suppliers should be subject to open and transparent competition:

- to provide new or alternative suppliers with an opportunity to win the business and
- to enable the buying organisation to access and obtain the best current market offering.

7. Supplier imposition

Supplier imposition may be defined as the situation in which a customer or end user stipulates that a particular supplier should be used. Purchasing and supply management professionals must ensure that the decision making process for appointing suppliers is visible and transparent.

8. Supplier mistake

A mistake is a non-deliberate error. Purchasing and supply management professionals should adopt a professional and understanding approach to the supplier when a mistake is brought to light unless of course it becomes apparent that the mistake was not a mistake at all but a deliberate attempt to gain unfair advantage. Purchasing and supply management professionals should search for anything that looks odd or unusual in a supplier's offer and seek clarification prior to contract award. Mistakes identified post contract award should be investigated impartially and ethically with a view to generating options for resolution.

9. Size, maturity and location

It is good practice to balance the risk of awarding contracts to new or small suppliers with the opportunity of encouraging new business to flourish. It is not good practice to exclude suppliers simply because they are small or new to the market. Capability and experience are examples of relevant supplier selection criteria. Purchasing and supply management professionals should, wherever possible, be aware of opportunities to support the local community and SMEs whilst maximising opportunities for global sourcing when this is appropriate.

10. Fraud and corruption

Purchasing and supply management professionals should seek to encourage the application of both the word and the intentions of the CIPS Personal Ethical Code.

Purchasing and supply management professionals must not tolerate corruption in any form. There is no excuse for corruption and it can never be blamed on naivety, lack of professional knowledge or poor management. Purchasing and supply management professionals aware of

any corrupt activity have a duty to the profession and to their employing organisations to alert their senior management.

Bribery is a criminal offence in the UK (and in most other countries).

11. Payment to agreed terms

Purchasing and supply management professionals should ensure that their suppliers understand and agree to the negotiated payment terms. Payment terms are the subject of legislation, notably the Late Payment of Commercial, Debts (Interest) Act 1998. Late payment undermines an organisation's credibility. Buying organisations should try to ensure that valid invoices are paid in accordance with the agreed terms and in the agreed manner.

12. Business gifts, hospitality and undue influence

Organisations should have a clear policy on accepting business gifts. Purchasing and supply management professionals should encourage colleagues to comply with any such policy. Normally the only acceptable gifts are items of small intrinsic value.

13. Decisions and advice

When it is not easy to decide between what is and is not acceptable, advice should be sought from the member's supervisor, another senior colleague or the Institute as appropriate.

14. Ethical codes

CIPS has published a model Ethical Code for purchasing professionals to follow, which can be found at www.cips.org. Guidelines on the implementation of such a Code are given below:

Checklist for implementing an ethical code

The following can serve as a useful short checklist for implementing an ethical code or policy:

- Carry out a self-assessment of the current situation, ie, the common perception held of the purchasing department's ethical behaviour, together with problem areas if any
- Undertake an in-depth audit of the purchasing documentation to identify any hidden problems
- Set up a system whereby changes to the organisation's ethical code, changes in the law, changes to corporate strategy, etc are automatically flagged up
- Constantly remind and educate employees, suppliers and customers of the existence of the ethical code and the importance of abiding by it using the most effective method available.

Given the foregoing, it is clear that supply chain professionals need to be keenly aware of the new challenges they face and the new obligations for their management of the supply chain in the global market place.

A robust corporate governance programme as part of CSR implementation in companies is key to meeting these new challenges.

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