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Indirect Sourcing, Direct Responsibility

– A guide to promote responsible sourcing practices through intermediaries (agents, distributors, wholesalers).

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INTRODUCTION

Developing responsible supply chains has become a fundamental part of any corporate sustainability strategy. Being a responsible company means integrating sustainable practices into all internal operations, as well as mainstreaming good practices across supply chains.

Over recent decades there have been substantial efforts made by companies in promoting decent

and fair labour practices and environmental improvements through engagement with producers in developing countries and high-risk regions. Although many challenges still remain, awareness and focus in this area has increased, with companies and suppliers investing resources into developing responsible supply chains further.



Photo: DIEH

BUT WHAT ABOUT SOURCING THROUGH INTERMEDIARIES?

Although the focus on responsible sourcing has increased, the handling of sourcing through intermediaries (agents, distributors, wholesalers, etc.) has remained a challenge for many companies - some of whom have significant supplier spend with intermediaries for a wide range of products.

Intermediaries provide a valuable service through their unique expertise, established supply chain networks and ability to deliver good quality products on time and at the right price. They allow buying companies and organisations to order flexibly without the need to develop supply chains for products that are not core to their own business, which is especially important for companies with an extensive variety of products, for example supermarkets.

DEFINITIONS

For many larger companies intermediaries are primarily used for spend on indirect procurement. Many definitions exist but in broad terms indirect procurement is the 'sourcing of all goods and services for a business that enable it's activity' and includes goods and services that, as such, do not make up a company's core product but are still essential for running the company's operations. For example, a clothing company's core product would be fabrics and finished/semi-finished garments, while its indirect procurement could be marketing services, promotional items, merchandise and travel.

For some companies, such as retailers and supermarkets, core products are also sourced through intermediaries. The same goes for organisations and public institutions that do not produce any goods, but often procure goods and services through intermediaries.

AIM OF THIS GUIDE

The Danish Ethical Trading Initiative (DIEH) and the Ethical Trading Initiative Norway (IEH) and their members are committed to promote responsible sourcing practices both in direct and indirect procurement. During various dialogues and consultations in 2012, indirect procurement through intermediaries was raised as a focus area as there is a need to reach a common understanding of the process for improvements, share best practices and improve collaboration between buying companies and intermediaries.

The processes are complex as buying companies do not have the same leverage and the same transparency for factories that they do not have direct contact with. The operational model for intermediaries is quite different from that of a direct producer or manufacturer, and therefore the 'factory-level' approach to ethical trading, typified by the setting of ethical standards and requirements (human and labour rights, anti-corruption and environmental standards), auditing, corrective action plans and follow-up, cannot easily be applied to identify and address ethical challenges for sourcing through intermediaries.

These complexities mean there is a need to apply a different approach to managing responsible sourcing through intermediaries. From a traditional Code of Conduct model, to an approach where capability building for intermediaries is a focus and includes two-way dialogue and the development of common approaches to responsible sourcing.

This guide aims to:

- Provide a starting point for working with responsible sourcing through intermediaries which can be shared internationally
- Create a shared understanding of the issues
- Foster opportunities to promote responsible sourcing practices with intermediaries throughout supply chains



CHALLENGES FOR COMPANIES AND ORGANISATIONS

Buying companies and procurement teams in organisations face the difficult task of promoting responsible practices when sourcing through agents, distributors, wholesalers or other intermediaries.

Traditionally, when sourcing directly through the producer, most companies work with responsible supply chain management by performing risk assessments and addressing strategic first tier suppliers.

For sourcing through intermediaries, assessing the risk of the producer is more complex, and should be done in dialogue with the intermediary:

- Buying companies do not have a contractual relationship with the producer(s) or service provider(s).
- Buying companies have limited or no leverage over the producer to effect change, as the business relationship is between the intermediary and the producer.
- Intermediaries may not have full transparency of their supply chain, either because of commercial considerations or lack of visibility.

Both buying companies and intermediaries should put focus on internal capability training of key persons.

GEOGRAPHY AND DIVERSITY

Suppliers in an intermediary's network can be varied and located in various parts of the world. These suppliers can be either large and sophisticated production facilities or smaller establishments i.e. a large manufacturing factory vs. an embroidery homemaker. Bigger suppliers have in turn their own sub-supplier network, which can be composed by smaller producers, home-producers, and raw material providers. Suppliers may be servicing a number of different clients and given the changing nature of orders of, for example, promotional items where there is often a short-term relationship with the buying company.

COLLABORATION

Larger companies may have significant leverage with intermediaries, especially where there is a high volume of yearly orders however this leverage to promote responsible procurement practices is often not utilised.

Intermediaries need to ensure that the potential risks in their supply chains are identified and mitigated, and that they act on their responsibility to respect ethical standards even though they themselves are not managing production. Improved collaboration and partnering with buying companies will ensure better efficiencies and impact in this area.

In turn buying companies need to mitigate risks in their supply chain and build the awareness and capability of their own marketing, commercial and sourcing departments, enabling them to make responsible sourcing decisions.

Figure 1 illustrates supply chain challenges when sourcing from intermediaries e.g. the increasing complexity and lack of transparency that is added to the sourcing process.

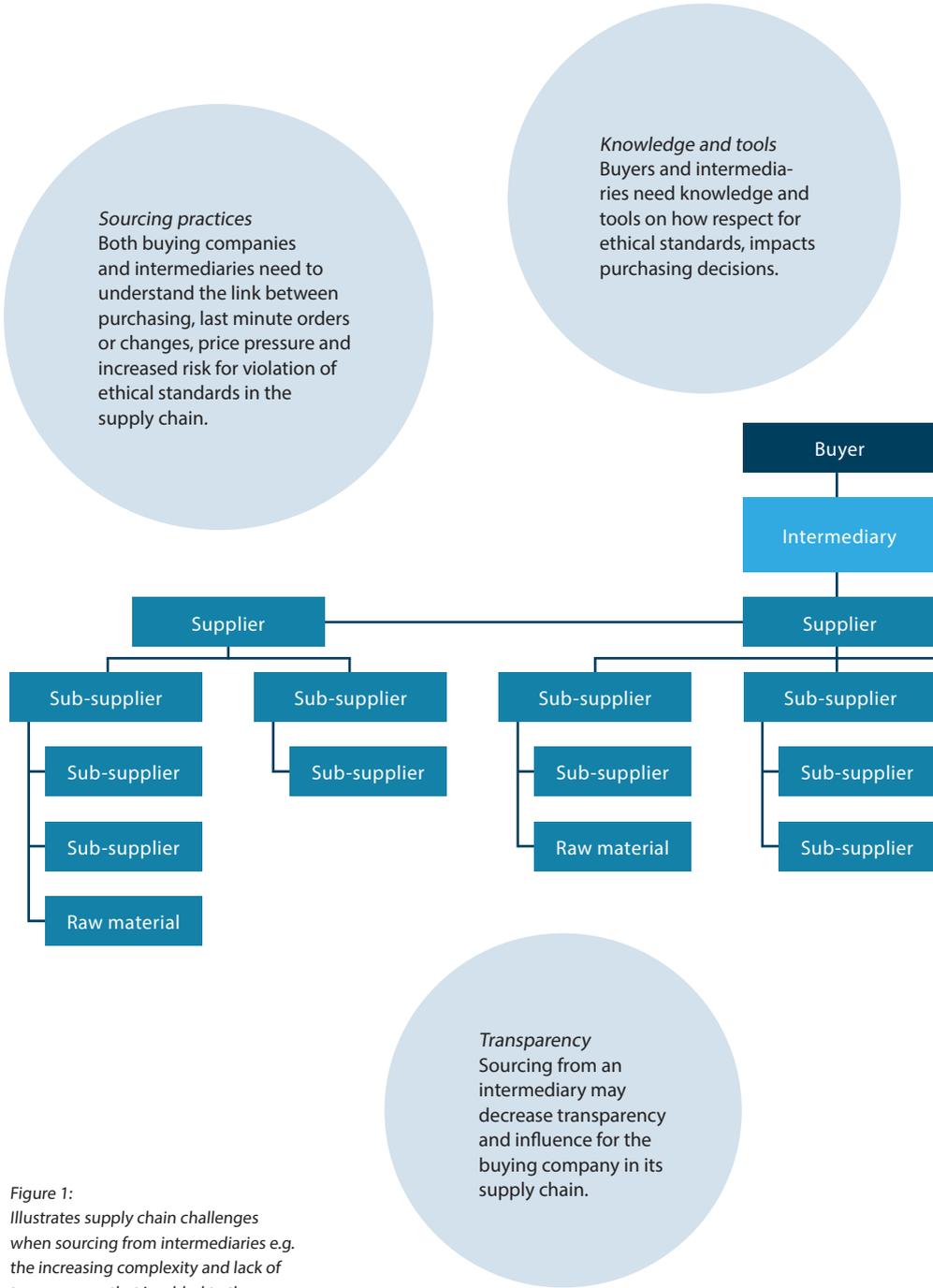


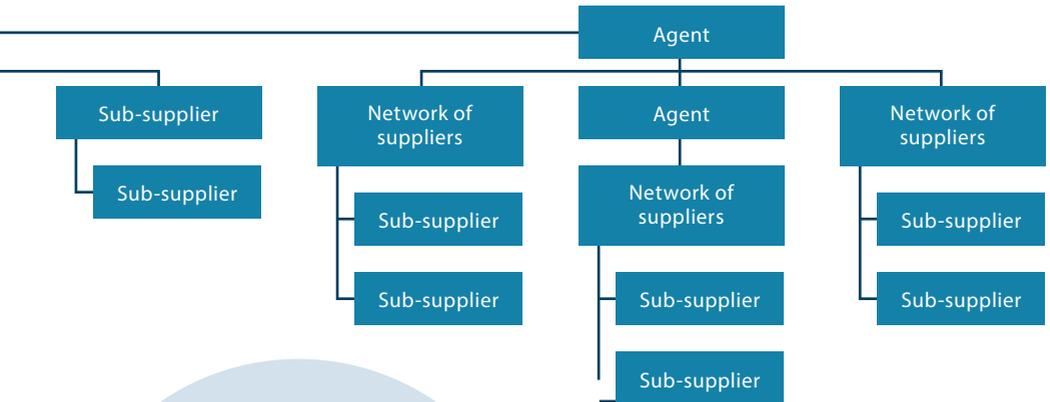
Figure 1: Illustrates supply chain challenges when sourcing from intermediaries e.g. the increasing complexity and lack of transparency that is added to the sourcing process.

Stable relations

“Fix don’t switch” is a common practice when ethical issues are identified. To switch to alternative suppliers instead of collaborating to improve standards with existing suppliers, does not improve ethical practices in supply chains.

Experience

Intermediaries may require more experience with responsible supply chain management in general. The pressure and demand for ethical concerns have not been as considerable as it has been the case for consumer-facing companies and their suppliers.



Control

Buying companies delegate control of their supply chain when using intermediaries. However this does not equal outsourcing responsibility – enforcement depends on ensuring that intermediaries have a direct link to their suppliers.

RESPONSIBILITY AND IMPACT

Both buying companies and intermediaries are expected to live up to their responsibility to respect human rights, labour rights and to reduce environmental impacts with regards to international standards, but what level of responsibility and impact does the buying company have when working with intermediaries and their suppliers?

EXPECTATIONS OF COMPANIES TO ACT RESPONSIBLY

It is increasingly acknowledged that companies have a duty to act responsibly in their operations and in their supply chains, to avoid any negative social or environmental impact and to actively promote responsible practices. Suppliers, as private companies in their own right, bear the same responsibility. However, to a certain extent buying companies are still linked to the actions of their suppliers, and corporate brands are certainly exposed to the risks of unethical production.

In this regard, it is important to understand how companies may cause, contribute or be linked to negative impacts through their own activities and business relations when sourcing through intermediaries.

Even if it makes good practical sense to prioritise strategic, first tier suppliers, greater risks may lie further up the supply chain. For instance when sourcing through an intermediary the risks are the same as sourcing directly from the producer, however the dynamics and relation between buyers, intermediaries and producers weakens the ability to identify and address potential risks.

The foundations of this guide are those expressed by the DIEH and IEH Guidelines on Ethical Trade and Implementation principles, and more broadly by:

- The ten principles of the United Nations Global Compact (UNGC) on human rights, labour, environment and anti-corruption
- The Universal Declaration of Human Rights (1948) and the core International Labour Organisation (ILO) conventions
- The United Nations Guiding Principles (UNGPs) on Business and Human Rights, particularly the corporate duty to respect human rights in business relations
- The OECD Guidelines for Multinational Enterprises (2011) for responsible business conduct and their non-judicial complaints mechanism through National Contact Points (NCP) in all member countries
- The United Nations Convention against Corruption (2000)
- Danish and Norwegian legal requirement on CSR reporting on environment and human rights

See links on page 19

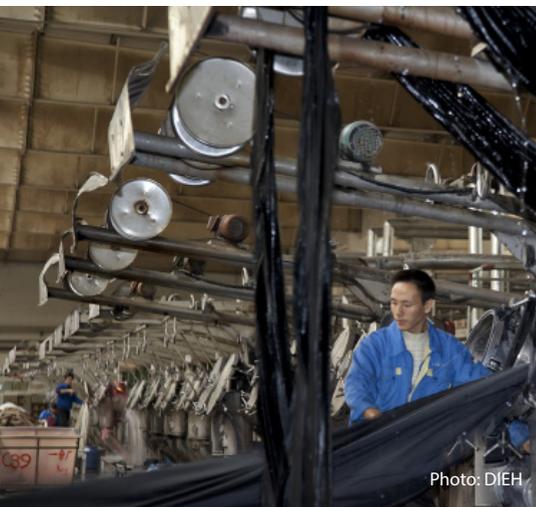


Photo: DIEH

SOURCING RESPONSIBLY IN PRACTICE

A joint approach between buying companies, intermediaries and producers is the way forward to manage ethical challenges – companies can choose to take this approach with all intermediaries or with selected strategic partners. These selected partners can be identified through a risk assessment that could include the type of services or goods provided, the geographical location, the amount of spend and the potential leverage of buying companies to affect change.

In order to avoid a bureaucratic exercise without real benefits, the buying company should complement the focus on their producers with focus on intermediaries where they have leverage. It is the responsibility of the intermediary to conduct a risk assessment and due diligence of the product or service and share this with the buying company. This risk assessment should also include ethical standards.

As companies depend on intermediaries for a number of products and services, and intermediaries rely on their supply chain, there is an opportunity to increase transparency, improve ethical standards and promote sustainable business partnerships.

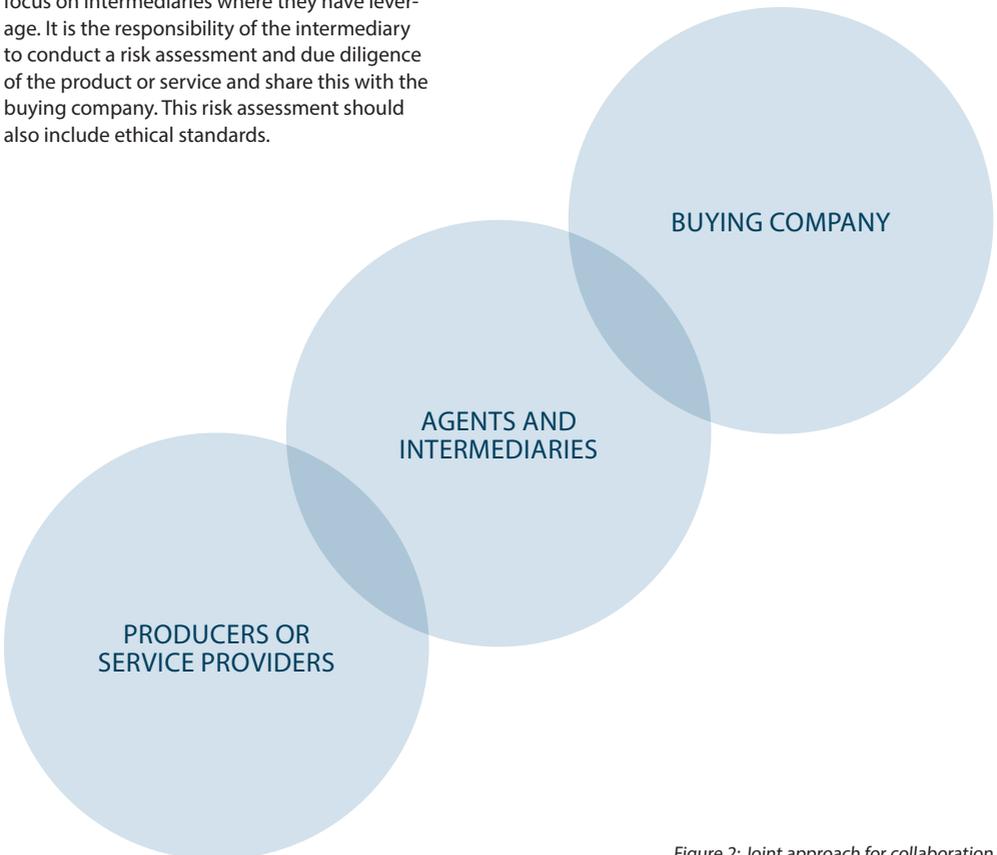


Figure 2: Joint approach for collaboration



Photo: DIEH

When working with responsible sourcing, a sourcing strategy should be in place to better organise the process:

1. The decision needs to be made at top level of an organisation that responsible sourcing practices will be extended to indirect procurement and service providers.
2. Policies and standards are implemented and clearly communicated throughout the organisation
3. Roles and responsibilities are clearly defined and an empowered team or individual take on the responsibility to manage the process of addressing responsible sourcing practices with intermediaries.

4. Buying companies aim to consolidate their indirect supply chains as much as possible to reduce the risk and increase leverage over intermediaries to affect change
5. Buying companies have strict minimum standards when on-boarding relevant intermediaries to prevent and mitigate future supply chain risks.

Once a sourcing strategy is in place, a buying company can consider the 4 steps in the management system model (figure 3) to address developing responsible supply chains with intermediaries.

In turn this model can also be used by intermediaries to address responsible supply chain management in their supply chain.

Figure 3: Responsible Sourcing Steps

| | SETTING EXPECTATIONS | IDENTIFICATION OF RISKS |
|-----------------------|--|---|
| BUYING COMPANY | <ol style="list-style-type: none"> 1. Share your Responsible Sourcing (RS) Expectations with potential intermediaries. 2. Request information from the intermediary about adherence to your RS Expectations. 3. Request information about producing suppliers (location, size) through your Request for Information (RFI). For example, the intermediary should be able to share information about where the product will be sourced and if multiple suppliers will be used. 4. Consider enabling the intermediary with mutual expectations of Responsible Sourcing. | <ol style="list-style-type: none"> 1. Develop criteria for selecting suppliers based on your RS Expectations and other business criteria. For example, the intermediary can show through documentation and other evidence their ability to fulfil your RS Expectations. 2. Define the verification approach for the sub-supplier. For example, when intermediaries source products from high-risk countries, intermediaries should show that their suppliers comply with ethical standards. This could be through recent audit reports and improvement plans, or other means as agreed with the intermediary. 3. Share with the intermediary the outcome of the review, based on the documentation shared. |
| SHARED RESPONSIBILITY | <p>If information about the supply chain (supplier, location) is not readily available, consider why not.</p> <ul style="list-style-type: none"> • Is this a risk? • Is there transparency in the supply chain? • Does the intermediary use another intermediary? • Give the intermediary incentives to build up credible processes and systems for complying with ethical requirements - for example through business stability and contracts | <p>If the intermediary does not have RS expectations, there may be a risk that they are not considering ethical standards.</p> <p>If the intermediary does not have verification about their supplier(s), there could be unknown risks further up the supply chain, such as suppliers operating with unsafe conditions.</p> |
| INTERMEDIARY | <ol style="list-style-type: none"> 1. Acknowledge the requirements of the customer's RS Expectations 2. Share information about your performance in relation to the expectations, e.g. your own RS Expectations if available, your policies in the areas of environment, human rights, and labour standards, your certifications. 3. Provide information about your production or service suppliers. | <ol style="list-style-type: none"> 1. Discuss with the buying company how your Code and policies are implemented in your operations; show the buying company that you for example train your employees or have a contractual requirement to your suppliers. 2. Share with the buying company verification and documentation about your suppliers: recent audit reports, membership to industry initiatives such as ETIs, SEDEX, BSCI, EPPA or similar, certifications. 3. Discuss with the buying company how to address any issues flagged at this stage that may be of concern to the buying company, e.g. plan to audit your suppliers. |

ENGAGING SUPPLIERS

1. Include your RS Expectations as a contractual clause with the intermediary.
2. Request the intermediary to communicate your RS Expectations with their relevant supplier(s).
3. Before sign off, develop a binding improvement plan if issues have been identified during qualification, but you still want to use this intermediary.
4. Recommend additional activities based on outcomes of risk assessments, for example joint audits of sub-suppliers with the intermediary.
5. Work with the intermediary to continuously advance ethical standards.

If there is disagreement about the contractual clause, consider the reasons for this. Compliance with ethical standards may be difficult to enforce and measure e.g. via an audit, without creating contractual accountability.

If issues were identified during qualification but you still want to proceed with the intermediary, it is of outmost importance that the contract includes an action plan for improvement of the intermediary's responsible sourcing management system, e.g. an audit or development of RS Expectations.

TRACKING AND REPORTING

1. Regularly include ethical standards in dialogue and tracking of intermediary's performance.
2. If location or sub-supplier has changed, the intermediary should provide verification (see step 2) and activities such as an audit may be necessary.

It is crucial that the improvement plan is followed up and closed within timeline.

If the sub-supplier is changed without notifying the buying company, this could have serious implications both from an ethical risk perspective and a sourcing perspective.

1. Accept buying company's RS Expectations as part of your contract with them; at this stage, consider including your own RS Expectations as well, as part of the contract for mutual commitment.
2. Accept the request to communicate the buying company's Code to your suppliers, and make a plan on how to reach out to your suppliers and their workers, e.g. if there are language needs to be addressed translate the Code, conduct training etc.
3. If issues were identified during qualification, develop an action plan with measurable, time-bound activities to improve your own or your supplier's practices.
4. Continuously invest in building capability on ethical standards and meeting customer requirements.

1. Track ethical practices in your supply chain and include these updates in your regular dialogue with the buying company.
2. Regularly identify risks in your supply chain and put in place activities for mitigation and prevention as necessary, e.g. audits, capability building, change in sourcing strategy.
3. If your suppliers change, ensure that these are verified through an audit or assessment process and provide this information as early as possible to the buying company.
4. If an improvement plan was in place as part of the contract, follow up on all actions and provide confirmation of closure within due timescale.

FINAL REMARKS

In the context of increasing focus on responsible sourcing, companies' as well as organisations' scope is broadened. The process and relations for sourcing through intermediaries need to be addressed and included in a responsible sourcing programme for a company to claim that it is sourcing responsibly.

This guide has given an overview of the challenges of addressing responsible sourcing through intermediaries and introduces suggested actions to be implemented in buying companies' responsible sourcing programmes. Further concrete recommendations and hands-on guidance are provided at training workshops for intermediaries and buyers offered by DIEH and IEH.

A recommendation is to link performance in ethical standards with commercial incentives. This requires a commitment from buying companies to ensure future business, enable long-term partnerships, and include ethical requirements in the specifications of the contract.

Buying companies can support the intermediary in building up a responsible supply chain approach in various ways. Intermediaries can adopt Responsible Sourcing Expectations (code of conduct, ethical requirements etc.) in line with buying companies' own standards and international best practice; for strategic partnerships, companies and intermediaries could investigate adopting mutual expectations of Responsible Sourcing.

Implementation of good practice can be seen in collaborations of European distributors and agents of promotional items, with joint efforts in promoting a common standard of fulfilling responsible sourcing expectations.

<http://www.eppa-org.eu/english/code-of-conduct/about-the-code.html>

This guide was developed with support from A.P. Møller-Mærsk A/S, Bestseller A/S, Danske Bank A/S and Novo Nordisk A/S.





Photo: Søren Zeuth "Young female textile worker from Dhaka, Bangladesh"

GLOSSARY

Agent:

An agent is one who acts for, or in the place of, another by authority; one entrusted with the business of another.

Distributor:

Typically the first tier for the buying company. A distributor is one who deals in the wholesale distribution of goods and products buying from a mix of wholesalers, agents and factories.

Wholesaler:

In the case of promotional items they keep stock in Europe, supplying standard product assortments to distributors. Often they offer the service of logo imprint.

Ethical standards/requirements:

Human and labour rights, anti-corruption and environmental standards.

Intermediary

(Agents, distributors and wholesalers):

Private companies or organisations that act as the 'go-between' between a company and a network of other organisations, in order to facilitate the provision of products, offerings, services. These intermediation services between a customer and suppliers are requested because the agent holds expertise, network or preferred access to the supplier(s) which are not core-knowledge of the customer. By delegating to the agent, the customer maintains efficiency while sourcing a product.

Responsible sourcing:

Also known with the terms sustainable sourcing or ethical trading, it is the process wherein companies implement ethical standards such as human rights and fair labour conditions, anticorruption, environmental responsibility, in their supply chain operations. This usually takes the shape of an organisational commitment with Responsible Sourcing Expectations, integration of the Expectations in sourcing practices and procurement processes, supplier engagement through contractual commitment to the Expectations and social auditing.

Responsible Sourcing Expectations:

The expectations that companies work to comply with in addressing responsible sourcing issues i.e. Code of Conduct, Ethical Requirements etc. These expectations should be presented to the intermediary in the first step of the responsible sourcing process and address human rights incl. labour rights according to ILO and FN conventions, environmental standards and anti-corruption.

Promotional items:

products, gifts and small merchandise often branded with a company's logo or representing the company's core business, used in marketing, communications and external stakeholder engagement. They are usually low value items (pens, calendars, t-shirts) but can also be higher value or luxury items, such as miniature reproductions of a company's main products or high-end fashion items.

RESOURCES

BUSINESS SOCIAL COMPLIANCE INITIATIVE (BSCI): PUBLIC RESOURCES

<http://www.bsci-intl.org/resources/public-resources>

DANISH CSR- COMPASS

<http://www.csrcompass.com/>

GLOBAL SOCIAL COMPLIANCE PROGRAMME (GSCP): REFERENCE TOOLS

<http://www.gscpnet.com/working-plan.html>

SEDEX: BEST PRACTICE GUIDANCE ON CONDUCTING ETHICAL TRADE AUDITS INCL. RISK ASSESSMENT

<http://www.sedexglobal.com/ethical-audits/smeta/>

UNITED NATIONS DEVELOPMENT PROGRAMME (UNDP): PRACTITIONERS GUIDE TO SUSTAINABLE PROCUREMENT

http://unglobalcompact.org/docs/issues_doc/supply_chain/UNDP_Procurement.pdf

DIEH WEBSITE

www.dieh.dk

IEH WEBSITE

www.etiskhandel.no

LINKS

THE TEN PRINCIPLES OF THE UNITED NATIONS GLOBAL COMPACT (UNGC)

www.unglobalcompact.org

THE UNIVERSAL DECLARATION OF HUMAN RIGHTS (1948)

<http://www.un.org/en/documents/udhr/>

CORE CONVENTIONS OF THE INTERNATIONAL LABOUR ORGANISATION (ILO)

<http://www.ilo.org>

THE UNITED NATIONS GUIDING PRINCIPLES (UNGPS) ON BUSINESS AND HUMAN RIGHTS, 2011

http://www.ohchr.org/Documents/Publications/GuidingPrinciplesBusinessHR_EN.pdf

THE CORPORATE RESPONSIBILITY TO RESPECT HUMAN RIGHTS: AN INTERPRETIVE GUIDE, 2012

<http://www.ohchr.org/Documents/Issues/Business/RtRInterpretativeGuide.pdf>

THE OECD GUIDELINES FOR MULTINATIONAL ENTERPRISES (2011) FOR RESPONSIBLE BUSINESS CONDUCT

<http://www.oecd.org/corporate/mne/>

THE UNITED NATIONS CONVENTION AGAINST CORRUPTION (2000)

<https://www.unodc.org/unodc/en/treaties/CAC/>

DANISH LEGAL REQUIREMENT ON CSR REPORTING ON ENVIRONMENT AND HUMAN RIGHTS

http://samfundsansvar.dk/file/358879/csr_rapport_2013_eng.pdf

NORWEGIAN LEGAL REQUIREMENT ON CSR REPORTING

<http://lovdata.no/dokument/LTI/lov/2013-04-19-15>

NORWEGIAN LEGAL REQUIREMENTS REGARDING ANTI-CORRUPTION

http://lovdata.no/dokument/NL/lov/1902-05-22-10/KAPITTEL_2-19#KAPITTEL_2-19