

# Business as Usual *is* Not an Option

Supply Chains and Sourcing after Rana Plaza

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About the Center for Business and Human Rights  
at New York University Stern School of Business

*“At NYU Stern, we develop people and ideas that transform the challenges of the 21st century into opportunities to create value for business and society. Our Center for Business and Human Rights is the embodiment of that mission. By creating a safe haven for open dialogue and convening relevant voices for discussion around practical solutions to some of the world’s most pressing problems, the Center, and by extension this report, demonstrate that profit and principle can co-exist.”*

*–Peter Henry, Dean  
NYU Stern School of Business*

Dean Henry launched the Center for Business and Human Rights in March 2013 with a strong belief in the power of business to create positive change in society. In that spirit, the Center’s mission is to challenge and empower businesses to make practical progress on human rights in their own operations. It is the first center to focus on human rights as an integral part of a business school.

We start from the premise that business can and does work for the good of society. We support the goal of business to create value while emphasizing high standards for human rights performance. Each year, we take on a major project around a set of human rights challenges in a sector that is of foremost concern for companies, consumers, regulators, and investors.

We use the convening platform of the NYU Stern School of Business to bring together groups of companies from different sectors and different parts of the world, along with outside stakeholders and experts. We devote significant attention and resources to ensuring that the Center provides a safe environment to discuss sensitive human rights and business issues that are critical to the long-term success of a sector and the societies in which it operates.

Finally, we take a problem-solving approach. The Center’s role is to empower companies and other stakeholders to address human rights challenges by bringing together thoughtful people willing to have frank and meaningful discussions, pointing out issues beneath the surface of the policy debate, and helping companies and others identify options for action. We seek to avoid the polarization that often characterizes debates on these issues, and instead explore sustainable solutions that meet the needs of business and society.

Peter Henry is the Dean of the Leonard N. Stern School of Business; Professor Bruce Buchanan is the Chair of the Business and Society Program; Michael Posner and Sarah Labowitz are co-founders and co-directors of the Center; Dr. Dorothee Baumann-Pauly is the Research Director. More information at <http://stern.nyu.edu/bhr>.

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## Preface

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Despite significant international attention over the last year on the urgent need for reform in the garment sector, relatively little has been written about how the garment business actually works in Bangladesh. Since last May, our efforts have focused on filling this research gap and developing a clearer understanding of the business practices that represent significant risks to factory safety and workers' rights.

This report is based on a yearlong effort by the Center for Business and Human Rights at NYU Stern School of Business. Sarah Labowitz, the co-director of the Center, conducted two fact-finding missions to Bangladesh in July 2013 and again in February 2014. Auret van Heerden, former President of the Fair Labor Association and one of the architects of the Better Work program in Cambodia, and Raymond Bonner, author and former foreign correspondent for the *New York Times* and the *New Yorker* also visited Bangladesh on the Center's behalf in the summer of 2013.

Over the last year, Labowitz, van Heerden, Bonner, and Dorothee Baumann-Pauly, the Center's research director, have conducted extensive research on the supply chain for garments, including a wide range of interviews and focus groups with buyers, suppliers, workers, and policymakers in Bangladesh, New York, Washington, Berlin, and Geneva.

In September 2013, the Center convened a major meeting in New York of more than 60 key players from across the garment sector, including global brands and retailers, local manufacturers, the government of Bangladesh, civil society and union leaders from Bangladesh, Western governments, international organizations, and other international experts.<sup>1</sup> The meeting was off the record, and this report is not a summary of that event. The Center is grateful for the candid contributions of the meeting's participants, which have informed our thinking about the complexity of protecting workers' rights in a global supply chain.

Since July 2013, the Center has interviewed more than 100 people about business practices in the supply chain, including owners of small and large factories, buyers, agents, workers, trade unionists, journalists, banking and finance professionals, and academics in Bangladesh and the United States. We include quotations from these interviews, but do not attribute most of them by name because of the risk of disrupting relationships across the supply chain.

The production of this report was greatly assisted by Auret van Heerden. He authored the section on Better Work Bangladesh and made significant contributions to the section on business and indirect sourcing. Ray Bonner wrote the section of the origins of the garment

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industry in Bangladesh and otherwise helped us understand the evolution of the garment sector in Bangladesh. Sara Hossain, Honorary Executive Director of the Bangladesh Legal Aid and Services Trust, and Syed Sultan Uddin Ahmed, Executive Director of the Bangladesh Institute of Labour Studies, contributed to the section on governance. Katharine Kendrick, a policy associate at the Center, conducted research on the complex issues of the number of factories in Bangladesh and compensation for victims of industrial accidents. We extend deep thanks to each of these very talented people for their invaluable contribution to the production of this report.

In addition to publicly available information, the report draws on information provided to us by the governments of the United States, the United Kingdom, Germany, Switzerland, and the Netherlands, as well as the World Bank about their donor programs and priorities.

The Center is especially grateful to Bishawjit Das, Executive Producer at Ekattor Media Limited, for opening many doors in Dhaka, Savar, and Gazipur. In addition to arranging meetings and translating both the language and the culture of Bangladesh, he took all of the photographs that are included in the report.

This report was written by Sarah Labowitz and Dorothee Baumann-Pauly and edited by Michael Posner. Colleen Osborne, the Center's special assistant during our first months of operation, and Jessica Marati, a Stern MBA student and a graduate fellow at the Center, executed the Center's two international convenings on Bangladesh. Lew Kaden, former Vice Chairman of Citigroup, served as moderator for the September 2013 convening in New York. Meredith MacKenzie and Matt Dorf of West End Strategy Team helped us tell our story. Chris Drew, consultant to the Center, was an invaluable guide and friend in setting the strategic direction of our work. Tara Wadhwa, an assistant director at the Center and our newest team member, supported the final stages of production. Many thanks to Aret van Heerden, Chris Drew, Katharine Kendrick, Meredith MacKenzie, and Justine Nolan, Visiting Scholar at Stern, for reading and improving the report throughout the drafting process.

The Center's work is made possible by generous support from Peter Henry, Dean of the Leonard N. Stern School of Business and Professor Bruce Buchanan, who chairs the Business and Society Program, of which we are proud to be a part.

*New York, New York  
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## Executive Summary

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This is a report about the garment industry in Bangladesh, its supply chain, and the workers at its heart. It is written in the context of intense international attention on working conditions in the global supply chain, and a shared desire for higher standards in the factories that produce the inexpensive clothing on which consumers in the United States and Europe have come to rely. It starts from the premise that the garment sector has greatly benefited the people and the economy of Bangladesh. But for low-cost garment production to continue to create value for business and society in Bangladesh and around the world, actors across the supply chain need to acknowledge and address the risks created by an indirect sourcing model.

There are significant challenges to achieving the objective of a sustainable garment sector in Bangladesh. To date, too little attention has been paid to connecting the dots to provide an overall assessment of where things stand and what really needs to be done to ensure safer factories and better working conditions. In this report, the Center for Business and Human Rights at NYU Stern provides that overview.

### Conclusions

1. Indirect sourcing is the routine practice of subcontracting, often through purchasing agents and in a manner that is not transparent to buyers or regulators. It has become an essential feature of the garment sector in Bangladesh as a means of increasing margins and boosting production capacity while keeping costs low. In the absence of an effective regulatory framework, the prevalence of indirect sourcing strategies has resulted in a supply chain driven by the pursuit of lowest nominal costs. This has increased risks for business and workers by undermining wages and working conditions, as well as investment in technology and training, and improvements in productivity and quality.
2. The two major remedial plans launched in the last year, the Bangladesh Accord on Fire and Building Safety and the Alliance for Bangladesh Worker Safety, fail to address the greatest risks of this system. The two initiatives have established parallel, and in some cases overlapping, systems of factory monitoring and worker training. But the universe of factories encompassed by their programs is less than 2,000, while the total base of factories and facilities producing for the export garment sector is likely between 5,000 and 6,000. The worst conditions are largely in the factories and facilities that fall outside the scope of these agreements.
3. The government of Bangladesh lacks the resources, administrative capacity, and often the will to protect workers in garment factories. The labor law remains weak and enforcement weaker still. Local industry enjoys outsized influence in the country's politics, which impedes the establishment and enforcement of rigorous regulation. The government has launched an ambitious National Action Plan aimed at addressing factory safety gaps, but few of its provisions have been successfully implemented and the government lacks resources to make it real.
4. The poor state of critical infrastructure, especially the weakness of the electrical supply throughout the country, exacerbates risks of factory fires and the likelihood of future tragedies. The international community has contributed significant funds to develop the garment sector in Bangladesh, but these programs are largely limited to training and for workers and management, inspections, and funds to support the International Labour Organization and International Finance Corporation's Better Work program. Especially in light of major corruption challenges, foreign governments and the World Bank are now shying away from investment in the infrastructure development that will be necessary to truly upgrade the sector.

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## The Way Forward

People across the sector recognize that Bangladesh's sustained economic and social development depends on the expansion and vitality of the garment sector, including through the continued investment of global buyers. We share the goal expressed by many people of ensuring that “made in Bangladesh” is a sign of pride for workers, business, and consumers. This is the right moment to assess the current status of efforts to improve the garment sector in Bangladesh and make necessary course corrections. We divide our recommendations into three broad categories, focused on business practices, governance, and infrastructure and foreign funding.

### Recommendations to the Business Community

Global brands and their first-tier manufacturing partners need to recalibrate their business relationships to prioritize transparency and longer-term commitments. This must begin with a thorough assessment of the overall universe of garment factories and facilities – big and small, registered and unregistered – that is producing products for export. The Accord and Alliance should join forces in this effort, working closely with the trade associations and the government. Once a comprehensive factory list has been compiled that identifies which factories or facilities produce for each brand, actors around the supply need to develop an ambitious but practical plan, consistent with business realities, to address the most urgent risks. Though this will be a long-term and difficult task, global brands should not cut and run from Bangladesh.

### Recommendations to the Government of Bangladesh

The government needs to reclaim ownership of the country's regulatory system. It cannot continue to outsource regulatory functions to the trade associations and others. International organizations like the ILO that are working with the government need to focus their resources and attention on building the government's capacity and expertise to monitor factory conditions and to develop credible, well-resourced remedial systems. The government should quickly complete the work of compensating victims of Rana Plaza and should institutionalize this effort to meet the needs of victims of future industrial accidents. Ultimately the government needs to take the lead in overseeing this system, though the private sector also needs to contribute.

### Recommendations to the International Donor Community

The task of repairing and rebuilding the most hazardous factories in Bangladesh will take years to complete and cost hundreds of millions of dollars. The effort to build a functional infrastructure will require still greater resources. It is unfathomable that the government of Bangladesh and the private sector can do this alone. The international community – foreign governments, the World Bank, and other multilateral institutions – need to step up as well. As we mark the one year anniversary of the Rana Plaza tragedy, this is a propitious time for the international community to convene a major donors conference on factory safety and critical infrastructure in Bangladesh. Absent an infusion of significant international support, we are destined to see recurring tragedies in Bangladesh which represent a growing threat to the long-term sustainability of its garment industry.

We believe that it is possible to see a different future, where the garment industry continues to grow and compete by producing large volumes of clothing in a timely manner at competitive prices and where workers enjoy safety in the workplace. As we mark the one year anniversary of Rana Plaza, this is the future of Bangladesh we all need to pursue.





Ten months after the collapse at Rana Plaza, bolts of fabric, pieces of finished garments, documents, building materials, and rebar from the factories that were located in the complex sit in enormous piles behind the building's original site. The original site is fenced off, but gaps in the corrugated metal reveal a swampy pit where the building once stood. Children sift through the rubble looking for things to sell. In late February 2014, pieces of human bone were still being unearthed from the ruins.



## Introduction: “Business as usual is not an option”

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One year ago, the collapse of a factory complex at Rana Plaza in the industrial outskirts of Dhaka, Bangladesh, killed almost 1,200 garment workers. It was the world’s worst industrial accident in 30 years, and came in the aftermath of the Tazreen factory fire in Dhaka only five months earlier that killed more than 120 workers. The images of grief-stricken families combing through the rubble is now seared in our consciousness. The size and scope of these disasters have captured public attention, focused on gaps in factory safety in Bangladesh. But a closer look reveals the uncomfortable truth that these tragedies are the almost inevitable result of a highly disaggregated sourcing model which has become the basis of global supply chains.

This report looks behind the headlines to reveal the way business operates at different levels of the supply chain in Bangladesh, the seventh most populous country in the world. We focus on global business relationships and especially what we call “indirect sourcing.” Indirect sourcing relies on the routine practice of subcontracting, often through purchasing agents and in a manner that is not transparent to buyers, to increase margins and boost production capacity while keeping costs low. As orders are subcontracted and in some cases re-subcontracted, production moves into facilities that are outside the scope of current regulation and often are “noncompliant” with minimum standards for safety and workers’ rights.

Indirect sourcing is an essential, though poorly understood, feature of the business models of global buyers and national-level suppliers in Bangladesh. Acknowledging these relationships is key to understanding the real scope of the factory safety challenges in Bangladesh. It also is essential for developing comprehensive policy responses that both will protect workers throughout the sector and ensure the sustained growth of Bangladesh’s export economy.

Indirect sourcing increases risk by reducing control and transparency in the supply chain. While this is the most prevalent sourcing model in Bangladesh, an alternative model is beginning to emerge. A small group of leading buyers and suppliers are starting to practice a more direct, transparent sourcing model in which the buyer works with partner suppliers on a long-term basis. We discuss the elements of this more direct and transparent sourcing strategy as an important alternative to indirect sourcing.

Second, the report examines public and private and governance of the garment sector. The government of Bangladesh should be the principal regulator of the garment sector. The country is deeply reliant on garments in its export economy and as a driver of employment and social development. The government also should be centrally involved in ensuring safety and high standards for working conditions, in addition to implementing public policies that encourage continued business growth in a way that benefits the whole society.

But today the government of Bangladesh lacks the political will, the technical capacity, and the resources necessary to protect the basic rights of its workers. Bangladesh ranks at or near the bottom across all measures of good governance, including civil justice, regulatory enforcement, and absence of corruption. In these areas, it is on the same level as Sierra Leone, Venezuela, Zimbabwe, Ethiopia, and Pakistan.

After years of halting progress, the government launched a National Action Plan to upgrade the garment sector in 2013. This plan is ambitious in scope, but unrealistic in terms of the government’s ability to implement it. The United States’ suspension of Bangladesh’s participation in a preferential trade program, coupled with the threat of suspension from the European Union’s program, has been a key motivator for the government’s commitments in this area.

We examine the status of public governance in the garment sector, including the legal framework for labor law and compensation for victims of industrial accidents, as well as the government's own National Action Plan.

We also explore the prospects for successful implementation of the International Labour Organization (ILO) and the International Finance Corporation (IFC)'s Better Work Bangladesh program. Governments, companies, civil society, and unions have all looked to this program as an important means of enhancing governance in the garment sector.

In the absence of strong government oversight, global companies have stepped in to provide some measure of private governance. Two major private initiatives were created in 2013 by global brands and retailers – the Bangladesh Accord on Fire and Building Safety ('Accord') and the Alliance for Bangladesh Worker Safety ('Alliance'). These represent an unprecedented collaboration among most of the biggest clothing companies in the world to collectively address structural weaknesses in the garment sector.

Much attention has been devoted to parsing differences between these two initiatives. Our analysis concludes that the Accord and the Alliance are fundamentally similar and that in key aspects, both are insufficient. Neither the Accord nor the Alliance addresses the role of indirect sourcing practices in their members' supply chains. Both are prioritizing rapid inspection of those factories that maintain direct relationships with their member brands, but neither initiative has yet developed a coordinated and clear system for financing remediation efforts based on the results of their inspections.

It is impossible to consider the long-term viability of Bangladesh as a major garment production center without addressing significant gaps in the country's infrastructure. Despite the extraordinary growth of the garment sector over the last 30 years, Bangladesh's infrastructure is among the most underdeveloped in the world.

In some respects, the demands of the garment sector have actually exacerbated the problem, placing even greater demands on an already overtaxed system. Erratic electrical supply and poor transport networks aggravate production delays and raise production costs. Ultimately, it is workers who pay the price for the country's poor infrastructure, in the form of long hours in unsafe facilities, where an electrical spark can lead to a deadly fire in a cramped building.

Many experts argue that moving garment production into export zones should be a key feature of a forward-looking strategy for the sector. We discuss the positive infrastructure attributes of the export processing zones, as well as longstanding governance challenges and weak labor law protections in the zones.

Foreign funding – from donor governments and international financial institutions like the World Bank and IFC – should be part of a response to the infrastructure challenges that underlie many safety risks in the garment sector. But our analysis reveals that while significant funding is being directed at training, inspection, and empowerment programs in the garment sector, relatively little funding is directed at infrastructure development. Corruption remains a significant obstacle to funding large-scale projects such as power plants and bridges, but these are essential for the sector's sustained growth and safety.

Filling the governance gap will require a network of interconnected actors – national and international companies, governments, civil society, unions, and international organizations – to enhance governance in the garment sector through a mix of public and private mechanisms. This means fostering greater transparency in business relationships, investing in enhanced regulatory oversight, coordinating financing systems for making factories safer, and prioritizing infrastructure development.

This report delves into the nuances of the garment business in Bangladesh, but the lessons of the garment sector there apply broadly to all companies that rely on global manufacturing supply chains. Subcontracting and indirect sourcing relationships are increasingly prevalent in global business models everywhere. We hope this report sparks a discussion about increasing transparency, control, and oversight in the supply chain and what this would mean for the workers who are the heart of the system.

In the aftermath of Rana Plaza, “business as usual is not an option” was a popular refrain among people in the garment sector in Dhaka. We believe business has been and will continue to be a force for good in Bangladesh. Achieving better working conditions and a sustainable garment sector will require that business operate differently. We present this report as a reflection of a year of listening, research, and close observation of the way business operates in the supply chain. Our goal is to make it possible to discuss publicly what many people in the sector already know. This report attempts to connect the pieces of a complex business landscape and their relationships to workplace safety and workers’ rights. This represents a new way of viewing human rights challenges through a business lens that we hope will make a positive contribution to the sector and the country’s continued growth.



## Elements of sustainability in the garment sector in Bangladesh

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National governments take responsibility for the health of their own societies by spurring economic growth, enhancing social and political development, and protecting rights. In an ideal world, governments in each country would be rooted in the rule of law, with an open and inclusive political system, a free press, open access to the Internet, and a strong civil society, including labor unions.

But until that ideal is realized, we are left with an imperfect world in which countries, particularly those at the bottom of the development scale, do not sufficiently protect the rights of their own people.

The ad hoc growth of the garment sector in Bangladesh over the last 30 years is a quintessential example of weak rule of law coupled with strong business opportunities. But lax regulation across the sector has created serious risks that were major factors in the tragedies at Tazreen and Rana Plaza, among others.

Many of the challenges for the future sustainability of the garment sector in Bangladesh have their origins in Bangladesh's weak rule of law and the ad hoc nature of the sector's development. We begin the report with a historical overview of the sector's growth since the country's founding in 1971. In the following sections, we look at three key areas essential to the sector's sustainability: business practices, public and private governance, and infrastructure development.

### **ORIGINS OF THE GARMENT SECTOR IN BANGLADESH: GROWTH WITH FEW RULES**

When the British Empire ended in South Asia in 1947, Pakistan became independent, divided into East Pakistan and West Pakistan, separated by a thousand miles of India. In 1971, the Bengalis in East Pakistan launched a war for independence, driven as much by economics as by ethnicity. The Bengalis felt they were mistreated by Islamabad, that the capital in the west was taking all the profits from the Bengali jute fiber industry, and returning little in the form of services. It was a brief, but brutal war, marked by large-scale atrocities, most committed by the military forces from Pakistan.

Most jute factory owners and managers were ethnic Pakistanis, and when the war ended they fled. The post-independence government felt it had little choice but to nationalize the factories and have them run by civil servants. Nationalization was also in keeping with the government's socialist ideology. (Geopolitically, Bangladesh joined the Non-Aligned Movement, which was seen as a counter to the United States.) The jute companies failed, in part because of mismanagement by civil servants, and massive corruption, but the workers, who were frequently on strike often for political reasons, received most of the blame from the public. "It was the seeds of the polarization between entrepreneurs and workers that still exists," said Zia Ahad, director of human rights and social responsibility at PVH, whose brands include Calvin Klein, Tommy Hilfiger and Speedo.

In 1975, the military stepped in, reversed nationalization, encouraged private enterprise, and in an effort to attract foreign investment, established export processing zones where unions were banned.

The first outsiders lured by the benefits of Bangladesh – low wages, a large labor force, and almost no regulation – were the South Koreans. "Koreans came here like Christopher Columbus – they saw a land of opportunity," said David Hasanat, owner of Viyellatex, one of the largest and most progressive manufacturers today whose history goes back to 1979 when South Koreans set up in the export processing zone.



BISHAWJIT DAS

It was before the era of globalization on the scale we now know, but the world was still economically and politically interconnected, and domestic politics in the United States and Europe were an unseen hand in the South Korean ventures. Under pressure to protect their domestic textile industries, the United States and European governments placed quota limits on exports from developing countries under the Multi-Fibre Arrangement, a multinational system that governed the textile industry from 1974 to 2004. Once South Korean companies reached their quotas, they looked around at nearby low-wage countries. India was subject to quotas, Vietnam and Cambodia were sundered by war. So they turned to Bangladesh, which had no quota for exports to the EU, and an ever-rising quota for exports to the United States.

Agricultural land outside Dhaka City is being overtaken by industrial production, including garment factories.

Though at the time no one could have foreseen it, the cornerstone for growth of the garment industry was laid when the South Korean industrial giant Daewoo formed a joint venture with a Bangladeshi garment company, Desh Garments, which had been started by a former civil servant. Few Bangladeshis had the education or skills to work as supervisors in a garment factory, so the joint venture sent 130 young men to South Korea for six months of training. When they returned, and after Daewoo and Desh split, many of them went out on their own, becoming the fathers, as it were, of what is known in Bangladesh as the readymade garment (RMG) industry.

It was an easy business to enter. Capital investment was minimal – it didn't cost a lot to buy a few sewing machines. And high population density coupled with poverty ensured a ready supply of cheap labor, primarily women migrating to Dhaka from rural villages.

"Everyone saw a lot of money to be made here," said Ahmed Sohail Fasiur Rahman, who with his brother, Salman, started Beximco Garments in the 1970s, after their father's jute business had

been nationalized. “Everybody and his uncle was getting into the business – engineers, police officers, military officers, civil servants,” Salman interjected. “Everybody.”

In the early 1980s, the government of General Hussain Muhammad Ershad, who had taken power in a coup, took two actions aimed at promoting businesses and decreasing the role of the state in the economy. One was to allow businesses and banks to use back-to-back letters of credit, a financing arrangement that puts the burden of default on banks. “This was a game changer,” Salman Rahman said. It relieved the garment manufacturers from having to come up with the huge capital needed to buy fabric.

The second was the government’s approval of bonding facilities or bonded warehouses. For the garment sector, this meant that a manufacturer could import fabric and other materials duty free as long as they were used only in making garments for export and not for domestic consumption. “This is a bonded area,” Rahman said of his factory compound where individual factory buildings spread across 220 acres are five and six stories tall, each floor containing up to 100 rows of sewing machines. There is a dye house and a chemical spray unit. There is also a helicopter landing pad.

Today, Beximco is one of the largest garment manufacturers and textile producers in the country, an integrated operation that turns out 100,000 yards of non-denim fabric a day. Customers include American Eagle, JCPenney, Macy’s, Calvin Klein and Wal-Mart, as well as European brands H&M, River Island and Zara.

The growth of the garment industry has been exponential. There were 384 factories, with 120,000 workers in 1984, the first year for which records were kept by the industry’s primary trade association, the Bangladesh Garment Manufacturers and Exporters Association (BGMEA). In the next decade, the number of factories increased five-fold, to slightly more than 2,000, and the number of workers was over a million.

This expansion has been ad hoc, driven by entrepreneurs, rather than the result of any grand government policy to lift the country out of poverty. “No one who understands economics, then or now, thought of it as a panacea for sustainable development,” William Milam, who was the American ambassador to Bangladesh in the early 1990s, said.

By 2004, there were two million Bangladeshis working in textile factories, whose number had now reached 4,000. But the end was nigh, or so it was feared. The Multi-Fibre Arrangement (MFA) was set to expire in 2005, which meant the end of quotas. Everyone predicted that no country would be able to compete with China’s low wages.

“You could have filled a large room with the reports by consultants telling the government that the industry was about to collapse with the end of the MFA,” said Sarah Altschuller, who studied the garment industry as a Fulbright Scholar in Dhaka in 2002. She is now a lawyer in Washington, and briefly represented former Foreign Minister Dipu Moni in 2013.

Armageddon didn’t happen. On the contrary, the end of the MFA led to more growth. Again, domestic politics in the United States and Europe played a role. In the first months after the MFA expired, China’s textile exports to the U.S. and Europe soared by nearly 80 percent. Under pressure from the textile industry and labor unions, and their congressional allies, the George W. Bush Administration imposed quotas on China. China voluntarily cut exports to the EU to avoid a trade war.

The scene in Dhaka was another gold rush, a rerun of the 1980s. Almost overnight, more American and European companies arrived, as rising wages in China made Bangladesh’s low wage garment sector even more appealing.





Garment workers living on an island slum in central Dhaka begin their morning commute by ferry.

Bangladesh has one of the highest population densities in the world, with 160 million people living in a land mass approximately the size of the state of New York. The incredible size of the labor force has been a key driver of the low cost production that makes Bangladesh an attractive sourcing destination. It is also a driver of low wages in the garment sector. Even after a much-anticipated minimum wage increase (from \$38 USD to \$68 USD per month) in November 2013, garment factory wages in Bangladesh remain the lowest in the world.

## PART 1 BUSINESS PRACTICES

Since the 1980s, rapid economic growth in Bangladesh has been accompanied by profound challenges, including the prevalence of substandard garment factories that lack basic protections for worker safety and rights and strains on the country's infrastructure. In advancing policies to address these challenges, it is first essential to understand the way business operates – how companies make commitments, trade-offs, and money in this complex system – throughout the supply chain.

### The Garment Business and Economic Growth

Business, especially in the garment sector, has been an incredible driver of economic growth and societal development in Bangladesh. As the World Bank notes, the country's economy has grown nearly six percent per year since the mid-1990s, coupled with significant gains across human development measures. Since the arrival of the garment sector in the late 1970s, the country's poverty rate has fallen from 70 percent to less than 40 percent, accompanied by increases in life expectancy, literacy, and per capita food intake.<sup>2</sup>

The status of women in Bangladesh has also risen with economic growth. As a poster hanging in the offices of one of the nascent trade unions in Dhaka reads, "Female workers are the heart of [Ready-made Garments]. Save Them to Save the Industry." From the industry's earliest days, women have streamed to Dhaka from rural villages, drawn by the prospect of employment in the garment factories. One female trade unionist described her own history in the sector: "It was a big revolution for women," she said. When she was young, she could not go out of the house without a male escort, a brother or nephew, even if he was only 4 or 5 years old. "Now, at night women are on the streets." At Bangladesh's latitude, the sun sets before 7 p.m. on the longest day of the year and it is dark on most days when women leave work. "We don't even need a *big* brother anymore," said the trade unionist.

Susan Davis is the head of the U.S. branch of BRAC, one of the biggest development organizations in the world that was founded in Bangladesh in 1972. She recounted her time in Dhaka in the 1980s as a program officer with the Ford Foundation: "The garment girls were the path-breakers – before the garment factories, most women didn't walk in the streets alone or earn money. The garment sector changed that."

The garment sector has fostered significant economic growth, gains in human development, and the empowerment of women in Bangladesh. The export garment sector was almost non-existent at the country's founding in 1971, but in a few decades, Bangladesh has become one of the world's leading suppliers of apparel. According to the ILO, in 1990 Bangladesh accounted for only 0.6% of global apparel exports; by 2011, its share had risen to almost 5%. Over the same period, garment exports grew from around 5% of Bangladesh's GDP to over 23% in 2011. And today garments represent more than 80% of the country's export economy.<sup>3</sup>

There is no doubt that the garment business has been a driving force for societal development in Bangladesh. But industrialization also has come with significant costs, especially for the health, safety, and wellbeing of workers. The hundreds of deaths at Tazreen and Rana Plaza, and ongoing unrest throughout 2013 protesting low wages in the garment sector<sup>4</sup> (the lowest by far of anywhere in the world) are stark reminders of the unfulfilled promise of large-scale industrial development in Bangladesh.

Policymakers, business leaders, and civil society groups in Bangladesh and around the world are eager to find ways to more fully realize the benefits of globalization in Bangladesh. If there is one thing on which people across the sector agree, it is the goal of sustaining and enhancing

employment in garment factories so that the country can continue to develop. When asked if they have a message for shoppers in the United States and Europe, factory workers in Dhaka consistently say, “Keep placing orders!” People across the sector want the ‘made in Bangladesh’ brand to be a sign of pride for the country.

Meeting the shared objective of a sustainable garment sector in Bangladesh will require a range of actors to work together to meet policy challenges in the areas of business practices, governance, and infrastructure development. But the policy conversation to date has been narrowly rooted in a limited view of the top of the garment sector. Our research reveals that a significant portion of the supply chain in Bangladesh is comprised of factories that do not maintain direct financial relationships with American and European brands and retailers in the majority of their business operations, but that nonetheless produce products for these companies. Addressing the needs of this group of factories is essential to any strategy to upgrade the garment sector and achieve minimum standards for safety and labor rights.

## Indirect Sourcing

As the garment industry has developed in Bangladesh, local manufacturers and global brands have come to rely on a system of what we term ‘indirect sourcing’ throughout the supply chain. Indirect sourcing is the routine practice of subcontracting, often through purchasing agents and in a manner that is not transparent to buyers or regulators. It has become an essential feature of the garment sector in Bangladesh as a means to increase margins and boost production capacity while keeping costs low.

Given an effective regulatory framework and efficient markets, the indirect sourcing model could allocate and re-allocate production according to the competitive advantages of each actor in the supply chain. In the absence of those conditions however, it has resulted in a supply chain driven by the pursuit of the lowest nominal costs. This has undermined wages and working conditions, investment in technology and training, and improvements in productivity and quality.

As contracts are subcontracted to one factory and sometimes re-subcontracted to another, margins get smaller and smaller and oversight becomes more distant. Factory owners at the bottom of the sector cannot afford the most basic investments to improve safety and working conditions. These facilities often lack clean drinking water and toilets, conditions are cramped, and basic safety equipment is missing. Regulations that are difficult to apply at the top of the sector – either by the government or private companies – are much less likely to extend to this network of indirect suppliers. As one compliance manager for a major European brand cautioned, “Subcontracting is one of the scariest aspects of producing in developing countries.”

Yet the business of garment production in its current form would not be possible without subcontracting. These are the factories that have been the auxiliary engines of Bangladesh’s incredible production capacity. A November 2013 article in the *Dhaka Herald* described the role of subcontracting in the sector: “[M]any big companies take huge volume[s] of direct export orders from the international buyers and give sub-contract[s] to different factories as they are not able to produce such huge [volumes of] clothing items and supply [them] in time as required by the international buyers.”<sup>45</sup>

Financial structures and incentives help explain the rationale for a model in which large factory groups are supported by a network of small subcontracting factories. Suppliers that demonstrate the highest order and export volumes have the greatest access to capital. This is because financing and export credits are made available on the basis of total order and export volume, not production capacity.





BISHAWIT DAS

Access to capital has allowed the largest factory groups to upgrade to higher value-added production such as machine stitched embroidery.

Different export incentives over the years have provided up to 5% cash credits on the basis of total export volume. In January 2014, the finance minister announced a 0.25% cash incentive based on the “*freight on board value of export of all types of RMG items*”<sup>6</sup> (emphasis added). Higher volumes mean bigger cash credits. Moreover, as one mid-sized factory owner said, “Bank[s] give financing on the basis of sales contracts.” Factories that want to expand or upgrade their facilities or make investments in technology need bank financing. And the number of sales contracts is the basis for considering credit-worthiness. Therefore, the biggest factory groups get the largest number of orders and subcontract actual production to a network of other facilities.

Numerous interviews across the garment sector reveal that different forms of subcontracting have long been an essential feature of the industry. An experienced compliance manager for a different European brand recounted a typical example in which a factory with a capacity of 100,000 pieces/month takes orders for 10 times that many pieces, does the most complicated (and therefore profitable) orders in the main factory, and subcontracts the rest. “Only the basic work goes to subcontractors,” he said.

Several factory owners described the largest factory groups as featuring several ‘showcase’ factories with higher safety and production standards as the face of the group to foreign buyers, while maintaining additional, less compliant facilities as the productive engine of their operations. People across the sector acknowledge the reality that an extensive network of small, less compliant factories undergirds the production capacity of the big factory groups that maintain the primary, direct relationships with Western buyers. “Small factories support the big factories,” said one owner.



Whether contracts are subcontracted to external factories or the order is produced in the lower standard facilities of a larger group, subcontracting serves to increase margins for the larger factories. At the same time, holding contracts for very high order volumes has increased the big factory groups' access to capital and other financial incentives.

Small factory owners that rely mostly on subcontracts benefit in the indirect sourcing model, as well. The international financing systems for sourcing garments are complex. The capital investment and sophistication of the relationships required to make this financing work create barriers to entry for smaller factories. Subcontracting can be appealing because, as one small owner said, there is “no banking problem, no transport problem” as there is in international, credit-based orders taken by larger “mother” factories.

Factories that take direct orders from international buyers assume all responsibility for every aspect of production from procuring materials, to cutting, sewing, finishing, packaging, and transport. This requires significant investment of capital, sophisticated international relationships, and capacity to withstand production delays due to late delivery of materials or other factors. Subcontracting is therefore an attractive business model for those in the middle and lower end of the supply chain. Policy solutions must take into account the high barriers to entry for direct relationships with international buyers and the needs of small business owners in the supply chain.

Western buyers also are profiting from the indirect system of sourcing. Despite strong language in their policies about non-transparent subcontracting, factory owners report that many buyers

Factories that rely mostly on subcontracts often struggle to implement even basic safety standards, such as fire extinguishers.

devote little time and attention to understanding the nature and scope of this practice. As one mid-sized owner described, “[Some] brands want to ignore subcontractors. They have their targets, too – 98% on-time shipment – and they don’t care how they get the products.” Another owner recounted how customers will sometimes subtly suggest the use of a subcontractor, asking the factory owner if he has an “alternative source” to complete production.

The sector has begun to take some steps to acknowledge the need for better regulation of subcontracting. In November 2013, the government announced plans for new guidelines “establishing a transparent and accountable sub-contracting system” that would require all factories taking subcontracts to be members of one of the two trade associations, the BGMEA or the Bangladesh Knitwear Manufacturers and Exporters Association (BKMEA).<sup>7</sup> But concerns about low levels of compliance among unregistered factories have reportedly caused the trade associations to restrict membership for fear of bringing substandard factories into their ranks. Our assessment is that the government’s proposal and other efforts by brands to eradicate ‘unauthorized’ subcontracting will not be successful until they acknowledge and address the role of indirect sourcing strategies as a key driver for the prevalence of risky, unregistered factories.

### The Role of Agents

Purchasing agents are a key element of an indirect sourcing strategy. An agent acts on the buyers’ behalf identify and select suppliers, negotiate the terms of the order, and ensure delivery to the freight forwarder. Additional services may include market research, raw materials sourcing, quality control, labor and environmental compliance, pre-shipping inspection and customs clearance, shipping and logistics all the way to retail. Agents are generally paid by commission (a percentage of the free on board price), but may also operate on a retainer basis. Large agents are able to offer economies of scale due to their greater bargaining power with materials suppliers and manufacturers. As one agent described his business, agents are matchmakers between buyers and factories, including assessing whether the buyer wants a ‘compliant’ or ‘non-compliant’ factory.

Agents offer buyers a one-stop-shop that simplifies their supply chain but, in turn, reduces transparency to buyers and their control or understanding of their supply chain. Agents also offer flexibility, allowing buyers to expand or contract their supply base at will. This leaves suppliers in a highly insecure situation, without long-term sourcing relationships. This can result in factory owners foregoing investments that would improve working conditions, fire and building safety, and productivity. The loss of transparency and control that agents facilitate, coupled with a lack of long-term commitments and a heavy reliance on subcontracting, contributes to the risks of indirect sourcing.

The BGMEA members’ guide<sup>8</sup> lists about 1,000 agents in operation throughout Bangladesh, servicing the 4,417 factories listed in the guide. BGMEA president Atiqul Islam estimated that fully 80% of orders are run through agents, though like all statistics in Bangladesh, it is very difficult to independently assess the actual breakdown.

Some of the largest multinational companies are heavily reliant on agents to source their products. These firms essentially operate as design, marketing, and retail firms that buy finished products from intermediaries. For smaller brands, agents provide an almost necessary entrée into the manufacturing world. One factory owner described his customer base as being primarily comprised of small importers or agents, who operate on behalf of small brands in Europe.

Some leading agents such as Li & Fung offer buyers a package that includes quality and labor compliance audits. Li & Fung’s “Supply Chain Responsibility and Our Partnerships” webpage describes their program for social and environmental compliance: “Our global vendor



compliance team regularly monitor[s] compliance and work[s] with our suppliers to meet our Code of Conduct, as well as industry- and customer-specific audit standards, protocols and methodologies.<sup>9</sup>

Agents work with their own networks of suppliers. An agent may maintain relationships with a variety of factories that represent different capacities for quality production and compliance, depending on the needs of the buyer. As one small agent who works with about 40 factories said, “Quality, price, and standard of the customer – that is how we choose the factory. We evaluate the buyer – is he low-end or high street – and then we choose a factory.” He remarked that a compliant factory costs more, and some buyers simply are uninterested in absorbing those costs. Another factory owner reported that a friend who runs a buying house is currently “looking for non-compliant factories because of the price.”

## Transparency of Sourcing Relationships

News reports, interviews, focus groups, and our research all support that indirect sourcing is a major component of garment production in Bangladesh. Almost all global brands and retailers, as well as leading exporters, benefit from this system. But how transparent is the practice?

Many factory owners report that some buyers are quite familiar with their actual capacity because the brands’ systems for quality control require capacity audits. Yet some brands place orders in quantities that exceed known capacity, with the understanding that some of the order will be produced elsewhere in a practice known as ‘oversourcing.’ As one owner described, “Third party audits typically assess the capacity of a factory and so many buyers know that the deliveries will be made through subcontracting. But buyers turn a blind eye on the subcontracting because they know that the volumes they want and the prices they want cannot be produced without a huge production capacity, which in most cases can only be achieved by subcontracting.”

Many brands and retailers have strong policies against so-called ‘unauthorized’ subcontracting. Our research reveals that while subcontracts may not be authorized by the buyer, the trade associations require registration of subcontracts between their members. The BGMEA issues an ‘interbond license’ for all subcontracts conducted between two of its members. This is a straightforward permitting process, in which the BGMEA and the two parties to the subcontract record basic information about the terms of the arrangement in a one-page, typewritten form. Both parties sign the license, as do two representatives of the BGMEA.<sup>10</sup>

This means that subcontracting among BGMEA members is, in fact, authorized in some form. While they may not be transparent to the government or international buyers, subcontracting among registered members is recorded with the trade associations. Factory owners who are members of the BGMEA confirm that while many subcontracts are not reported to buyers, they are almost always reported to the trade association. This is a means of managing the risks of subcontracting. As one factory owner said, “the BGMEA gives authorization to transfer the goods [through the] interbond license. It’s very risky not to go through BGMEA.” What constitutes an ‘authorized’ subcontract is therefore an important policy consideration for buyers, regulators, and factory owners.

But there is a third tier of factories comprised of ‘undeclared units’ that are unregistered with the trade associations or the government. These are some of the riskiest factories in Bangladesh. They operate on extremely tight margins, often receiving less than \$1.00 per piece to assemble a finished garment or embellish garments with embroidery, crochet work, beading, sequins and stones, or flowers, which often are the final tasks in the production process.<sup>11</sup> There is very little reliable data about this subset of factories, but several people knowledgeable about the



“Application for inter-bond transfer for the purpose of cutting/ stitching/finishing/ dyeing/washing/ embroidering/etc...by subcontract” issued by the BGMEA. Many brands have strong policies against ‘unauthorized’ subcontracting, but the interbond license shows that subcontracts between members of the trade associations are, in fact, authorized, even if they are not transparent to buyers.

**Bangladesh Garment Manufacturers & Exporters Association, Dhaka.**  
 BGMEA Complex, 23/1 Panthapath Link Road, Karwan Bazar, Dhaka- 1215, Bangladesh. Tel : 8115751, 8115597, 8113592 Fax: 880-2-8113951 Sl. No. \_\_\_\_\_  
 APPLICATION FOR INTER-BOND TRANSFER FOR THE PURPOSE OF CUTTING/STITCHING/FINISHING/DYEING/WASHING/EMBROIDERING/ETC... BY SUB-CONTRACT.

| Sl. FROM NO PARTICULARS OF FIRST PARTY (TRANSFERER)   | TO: PARTICULARS OF SECOND PARTY (TRANSFEREE)  | REMARKS   |
|---|---|---|
| 01. NAME & ADDRESS  | 01. NAME & ADDRESS  | <p><b>Approved</b></p> <p>Deputy Secretary<br/>BGMEA, Dhaka.</p> <hr/> <p>SIGNATURE OF AUTHORISED OFFICER OF BGMEA</p> <p><b>Checked</b></p> <p>Senior Executive (Customs)<br/>BGMEA, Dhaka.</p> <p>REF NO. BGA/DHK/IN-BOND/2000/.....<br/>DATE .....</p> |
| 02. MASTER L/C NO. & DT.  | 02. BONDED WARE HOUSE LICENCE NO/NAME OF GARMENT INDUSTRY.  |   |
| (a) SHIPMENT DATE   | 03. DATE OF RETURN TO THE PARTY ON COMPLETION AS PER CONTRACT.  |   |
| (b) DESCRIPTION OF GMTS & QTY   |   |   |
| 03. BONDED WARE HOUSE LICENCE NO  |   |   |
| 04. L/C NO & DT.  |   |   |
| STYLE NO. & DESCRIPTION   |   |   |
| 05. FOR INTER-BOND :  | <p>WE REMAIN BOUND TO RETURN THE GARMENT AFTER MAKING AS PER AGREEMENT &amp; IN DEFAULT, WE SHALL BE LIABLE FOR CONSEQUENCES.</p> |   |
| (a) QTY. IN DOZS :  |   |   |
| (b) FABRICS : .....   |   |   |
| CONSTRUCTION .....  |   |   |
| (c) KNIT FABRICS GSM-FABRIC NAME  |   |   |
| CONSTRUCTION .....  |   |   |
| (d) YARN COUNT .....  |   |   |
| COMPOSITION .....   |   |   |
| (e) REQUIRED ACCESSORIES AS PER LIST  |   |   |
| AS PER LIST .....   |   |   |
| APPLY FOR THE TRANSFER AT OUR OWN RISK & RESPONSIBILITY WITHOUT PRE-JUDICE TO GENERAL BOND FURNISHED BY US IN THIS RESPECT. |   |   |
| CHAIRMAN/MD/DIRECTOR Signature (TRANSFERER)   | CHAIRMAN/MD/DIRECTOR Signature (TRANSFEREE) WITH Seal.  |   |

sector estimated that there may be as many as 2,000 unregistered facilities in Bangladesh. These factories are so far removed from oversight and operate on such small margins that without some changes in the business models, compliance with codes of conduct, local regulations, or industry standards is impossible.

In their 2013 study of home-based workers in the export garment sector, Simeen Mahmud and Lopita Huq of BRAC Development Institute, a training and research center on poverty alleviation in the Global South, outline the process of subcontracting for embroidery and embellishment work:

If any garment product requires hand stitching and hand embroidery, the garment factory decides how this work will be completed; buyers are not involved in decisions about who does the work or where. The process of subcontracting a particular task may be initiated by the shop floor managers or by the contractors and their agents. In the former case shop floor managers will contact contractors or agents known to them who may have been former workers in the factory or relatives or acquaintances in some cases. Agents or contractors may also contact factory management on their own initiative. An agent is selected by examining their sample products and usually the entire order is placed with one agent, although the same factory may be working with several agents for different tasks. The contracted agent may either distribute the work to women if s/he has a direct network or s/he may sub-contract this out to another agent who has her own networks. Clearly the sub-contracting process can go through several “hands” and the greater the number of hands, the greater the number of cuts (or commissions) and the lower the piece rate paid to the women workers.<sup>12</sup>

In August 2013, Al Jazeera’s Fault Lines program broadcast an investigative film, “Made in Bangladesh,” which revealed underage workers producing Old Navy and Wal-Mart brand garments in a facility called Samie’s Finishing House. (Note that Samie’s Finishing House is not listed as being a member of the BGMEA, indicating that is likely an unregistered facility beyond the reach of even weak regulation.) In response, Gap Inc. (the parent company of Old Navy) and Wal-Mart both asserted that any product that may have been produced in the unregistered

facility was “improperly acquired” or in violation of the brand’s “zero-tolerance policy for unauthorized subcontracting” in their statements to Al Jazeera:

“Gap Inc. does not do business with Samie’s Finishing House. An immediate inspection of the facility found no Gap Inc. products and no evidence that Gap products had been produced there. If the facility at one time had products with a Gap Inc. brand label, those products were either counterfeited or *improperly acquired by the facility*.”<sup>13</sup> [emphasis added]

“For a factory to produce good for Wal-Mart, the factory must go through an audit called the Factory Capacity and Capability Audit. This audit is used to determine the installed capacity of a particular factory and must be completed prior to initially placing production in a factory. Wal-Mart relies on its suppliers to ensure the factories with which they place orders have sufficient capacity and understand the obligations of producing merchandise that will ultimately be sold in a Wal-Mart retail location. *We have also implemented a zero-tolerance policy for unauthorized subcontracting. This includes any undisclosed subcontracting conducted with or without the supplier’s knowledge.* [emphasis added] Suppliers are responsible to communicate our Ethical Sourcing requirements to their supply chain. Any factory subcontracting sourcing of Wal-Mart merchandise to an undisclosed facility will be permanently barred from sourcing merchandise to Wal-Mart for all retail markets.”<sup>14</sup>

Based on the Center’s examination of multiple data sources, we estimate that there are between 5,000 and 6,000 factories and facilities producing for the export-oriented garment sector, including both registered and unregistered factories. This assessment is based on review of newly published government data, the three most recent years of the BGMEA members’ guide, the BKMEA’s online factory list, the Accord and the Alliance’s factory lists, and interviews with factory owners of different sizes.

According to the Accord and the Alliance’s April 2014 data, the two initiatives encompass 1,894 factories between them. But our assessment is that this number dramatically underestimates the number of factories likely producing garments for their member companies. The Accord and the Alliance’s inspection and remediation regimes are unlikely to reach the factories where workers are most at risk.

Documents shared with the Center reveal that this kind of ‘subcontracting’ is not contracted at all. Rather, the terms of the agreement are negotiated verbally, and materials and finished goods change hands on the basis of bills and receipts. The materials required to complete the order are delivered to the unregistered facility as they are available – if the mother factory cuts enough fabric for 500 pieces of a 5,000 piece order, the unregistered owner picks up whatever material is available, transports it back to his factory, and completes assembly there. The mother factory collects the finished garments, as they are ready and pays the unregistered owner in cash for each tranche of the order. This process can proceed every day over the course of a week or two until all material is delivered and the order is complete.



Materials and finished goods move between subcontracting factories on rickshaws and small trucks.

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### Subcontracting in Unregistered Facilities

The owner of one of these small, unregistered factories described his operation to the Center, which produces garments that end up in the supply chains of major international brands and retailers: “We’re hiding. Those customers won’t like my factory because it’s a tin shed.” In fact, his factory is a small concrete facility in a garage-like space in an area in front of his house. He employs 110 workers on 65 machines. Workers are tightly cramped in the space, along with piles of fabric and finished garments. There is one small door and a gate with a hefty lock. The boys’ pants the workers are sewing bear the label of a major European brand.

The factory owner started his business with 5 or 10 people doing tailoring work for the local market. A friend who works as a cutting manager at a neighboring factory asked him if he would help produce a few thousand pants as part of a larger order. He did the job well, and has expanded his business to take subcontracted orders from a network of local factories.

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## Drivers of Subcontracting

There are several key reasons why subcontracting is a rational response to business pressures and incentives. The need to meet these challenges will not disappear because of new regulations or policies aimed at cracking down on subcontracting. Policy options for upgrading the sector must take into account the business realities of access to capital, strict sourcing practices, production delays, and fluctuating demand:

- **Access to capital:** Suppliers that demonstrate the highest order and export volumes have the greatest access to capital. This is because financing and export credits are made available on the basis of total order and export volume, not production capacity. Factories that want to expand or upgrade their facilities or make investments in technology need bank financing. And the number of sales contracts is the basis for considering credit-worthiness.
- **Buyers' strict sourcing practices:** Brands meet consumers' demand for fast fashion – high volumes of very low cost clothing sold in up to 12 'collections' per year – by cutting prices and lead times to suppliers. Suppliers have two options to absorb these time and price pressures: investing in productivity and efficiency, or cutting costs. In a country like Bangladesh where the delivery of electricity is inconsistent, improving efficiency by investing in machines that require significant energy inputs is not necessarily a viable option. Most suppliers therefore opt to reduce labor costs by hollowing out wages and benefits, and subcontracting to even cheaper producers.

From the manufacturer's perspective, the downward pressure on prices and lead times – combined with increasing costs of energy, materials, and labor – lead them to seek savings wherever they can find them. Factory owners face huge losses if they cannot complete an order and stiff financial penalties if they do not complete it on time. Factory owners frequently talk about “phoning a friend” if they are up against a production deadline and need some help completing an order. One owner of a small factory described a time when he had an order for several thousand pants that proved to be more difficult to assemble than he had anticipated. Production took longer than expected, and so he sent part of the order to a friend's factory to complete. He was able to meet the all-important delivery date and keep the customer happy.

- **Production delays:** Production delays can arise when materials are delivered late, as a result of electricity shortages, or when the buyer makes last-minute style changes. The financial and logistical burden of importing materials falls on the factory owner or agent. In Bangladesh, this most often means importing fabric, buttons, zippers, labels, trim, and other supplies from China. If the fabric supplier is late, production is delayed, creating the potential need for a subcontractor.
- **Efficiency:** Owners of several factories of different sizes described the goal of subcontracting as being to ensure that their lines were filled. (A 'line' is comprised of the number of machines required to complete each step in the production of a garment.) In this arrangement, the same factory can be both a so-called 'mother' factory that holds the original order *and* a subcontractor, depending on whether it is dealing with an order that is too large or trying to fill empty lines. As one small agent said of his business, “We work on a line basis – [it's] line forecasting.”

One set of business partners described the process of pitching their factory to other factories and agents if they know they will have empty lines in the coming month. “If we have three lines open, we take subcontracts. We receive the fabric, do the cutting and sewing. Whenever there's going to be a gap in the next month, I keep hammering ten factories, sending them a sample and a price.”



- **Fluctuating demand:** The apparel industry is notoriously volatile. On an annual basis, the Christmas season in December requires a major upswing in production in the summer and early fall. Unpredictable fashion events create further swings in demand, for example when Kate Middleton’s blue engagement dress became an overnight best-seller, or Greece’s unexpected win in the EuroCup drove demand for the team’s signature blue soccer jerseys. Subcontracting allows bigger factories to accommodate these swings by increasing capacity without additional capital investment. One owner of a small factory said, “My factory is vacant because of seasonal lows, so I just take subcontracts.”

As another factory owner said, “Subcontracting depends on the market situation.” In interviews in February 2014, many smaller factory owners bemoaned the decline in orders they attributed to the political turmoil around the January 2014 elections, and several reported having to suspend work in their factories due to lack of orders. “We won’t get subcontracts now because of the political situation,” said one owner. “But in one to two months, orders will increase.”

### An Alternative Model: Direct, Strategic Sourcing

Indirect sourcing enhances risk by reducing control and transparency in the supply chain. While this is the most prevalent sourcing model in Bangladesh, an alternative model is beginning to emerge. A small group of leading buyers and suppliers are starting to practice a more direct, transparent sourcing model in which the buyer works with partner suppliers on a long-term basis. The elements of this model include:

- **Long-term order forecasting:** The buyer provides the supplier with a multi-year perspective on expected order volumes. The buyer and supplier agree on quality, delivery, and price expectations over this period. (Contracts have clauses that allow the buyer to revise order volumes if market conditions so require.)
- **Investment in technology, training and facilities:** The longer-term time horizon gives the supplier the security to invest in new technology and training to improve efficiency, reducing non-labor costs.
- **Purpose-driven compliance monitoring:** Suppliers audit their own performance against social and environmental metrics, which are spot-checked by the buyer. Remediation is viewed as collaborative exercise in problem solving, not a “gotcha” exercise.
- **Trust-based negotiation around unexpected challenges:** When problems arise – production delays, cost overruns, social or environmental non-compliance – the buyer and the supplier communicate transparently about the problem and take steps to remediate the root cause of the problem, including adjusting sourcing practices by the buyer.
- **Business incentives for high performance on working conditions:** Buyers offer business incentives for the outcomes they want, by rewarding high-performing suppliers with longer-term contracts, higher order volumes, and favorable pricing.

The direct sourcing model is increasingly common in footwear production and is now spreading into the apparel sector, as well. A growing body of research concludes that this long-term, trust-based, business-driven model also produces better outcomes with respect to working conditions and code of conduct compliance.<sup>15</sup> This approach may not completely eliminate non-transparent subcontracting, but it significantly changes the incentives for obfuscation.



The direct model leads to better working conditions by prioritizing transparency and long-term commitments in a mutually beneficial sourcing relationship between the buyer and its supplier factories. Longer time horizons give factory owners the confidence to invest in technology, training, and facilities upgrades. Transparency about challenges leads to fairer pricing and greater flexibility on both sides.

In the broader supply chain, buyers adopting this approach tend to be those that are most concerned with brand reputation, quality, research and development, and stability in their supply chains, such as Nike and Uniqlo. It is often the most price-sensitive brands that employ short-term sourcing relationships in which they have little leverage to demand higher standards of labor compliance from suppliers they may not work with in the future.

But there are notable examples of low-price retailers that are working to better understand and consolidate their supply chains and to forge deeper partnerships with their suppliers. One noteworthy example is H&M, a Swedish retailer specializing in low-cost fast fashion. The company sources clothing from 300 factories in Bangladesh, which comprise a significant portion of its global supply chain.

Interviews with H&M's Dhaka office and several of its suppliers (that we identified independently of the company) suggest that H&M is endeavoring to establish a different kind of relationship with its suppliers. Consistent with H&M's official policy, factory owners report that H&M permits subcontracting, as long as the factory is inspected. H&M and its suppliers say that they work together find an approved subcontractor if one is required. H&M issues a warning the first time production is discovered in an unapproved facility, and cuts the contract the second time.

H&M also offers business incentives for better working conditions. H&M includes social compliance factors in its supplier relationships management system, rewarding strategic suppliers who demonstrate high performance. As one experienced agent-turned-supplier (who does not source for H&M) said, "The easiest way to get compliance is through the business relationship."

Fast Retailing, owner of the Uniqlo brand – and one of the fastest growing retailers in the world<sup>16</sup> offers another example of this strategic, long-term, trust-based model. It calls its suppliers 'partners' and goes so far as to place technical experts in supplier facilities to act as trainers and coaches to improve production.

One Chinese supplier that works with a range of European and American buyers described how Uniqlo provided him with 18-month forecasts of order volume. If the company deviated by more than a certain percentage, Uniqlo would apologize and offer to compensate him for the lost production. Other buyers, in contrast, would simply cancel orders or reduce volumes with neither an apology nor the offer of compensation.

The supplier said he never accepted monetary compensation when Uniqlo deviated from its order projections. The respect the company showed him and the long-term nature of the relationship were worth more than the money. Strategic and trust-based relationships are mutually beneficial. With stronger commitments from both buyers and suppliers, flexibility increases because each side is more likely to help the other when market conditions require a rush or last-minute order.

Strengthening the buyer-supplier relationship involves a frank reconsideration of other aspects of the purchasing process. Buyers have to review their costing and lead-time calculations to make sure the assumptions are realistic and the model accommodates unforeseen contingencies.

Prioritizing transparency in the sourcing relationship means moving away from a "gotcha" exercise in compliance policing. Growing out of sweatshop scandals in the mid-1990s, many global companies developed an auditing-based model for monitoring their supply chains. Justine Nolan and Auret van Heerden are among a small group of scholars that have examined the limits of this model. They write:

[C]ode of conduct audits have provoked a veritable industry of falsified wage and hour records as suppliers attempt to ‘comply’ with code standards. Newspapers in south China for example, carry advertisements by consultants offering to game audits and by software providers offering programs that fake wage and hour records. Social auditors have become adept at exposing fake records but this cat-and-mouse game has not gotten them off the treadmill. The overall levels of compliance remain largely unchanged. This does not mean to say that a lot of improvements have not been made; nor does it detract from the hundreds of thousands of wrongs that have been righted as a result of audits. But overall, code of conduct audits are not changing the culture of non-compliance that reigns in many exporting countries.<sup>17</sup>

As many factory owners acknowledge, “You can do a lot of things to get your audit passed.”

Being willing to work on challenges in a long-term, strategic relationship between buyers and suppliers represents a different way of doing business, in Bangladesh and throughout the supply chain. Subcontracting can be a healthy part of this model, as long as it is transparent and conducted with oversight from a combination of the ‘mother’ factory, the buyer, and the government.

Some of the biggest, most progressive Bangladeshi manufacturers we spoke to point out that they would prefer to work only with trusted and approved subcontractors and would assume responsibility for ensuring that they meet the labor standards expectations of their buyers. The sheer volume of orders going to Bangladesh, however, coupled with decreasing prices and increasing costs has overwhelmed them and led them to resort to wider and wider networks of subcontractors.

Manufacturers argue that buyers need to make longer-term sourcing commitments and offer fairer prices in order to equip manufacturers to make the investments develop their capacity to achieve higher standards for safety and working conditions.

One Bangladeshi manufacturer outlined a vision for a “future buyer-supplier relationship [that] does not just revolve around mere sourcing strategies; it must evolve...and must take into consideration the issues of workers’ welfare, sustainable pricing structures and rewards for commendable corporate compliance strategies.”

In short, align business incentives with desired outcomes.



## PART 2 PUBLIC AND PRIVATE GOVERNANCE

The government of Bangladesh should be the principal regulator of the garment sector. But the government lacks the political will, technical capacity, and resources necessary to protect the basic rights of its own workers. Bangladesh ranks at or near the bottom among the 97 countries measured in the World Justice Project's annual Rule of Law Index<sup>18</sup>, across all measures of good governance. It ranks 97th in civil justice, 90th in regulatory enforcement, and 89th in absence of corruption. In these areas, it ranks alongside Sierra Leone, Venezuela, Zimbabwe, Ethiopia, and Pakistan.

After years of halting progress, the government launched a National Action Plan to upgrade the garment sector in 2013. This plan is ambitious in scope, but unrealistic in terms of the government's ability to implement it. The ILO and IFC's Better Work Bangladesh program is intended to augment the government's efforts and compensate for its deficiencies in protecting the rights of workers.

In the absence of public regulation, private actors have stepped in, including many of the largest brands and retailers in the world. Two private initiatives have been formed around the issue of fire and building safety, the Accord and the Alliance. While these initiatives have both undertaken ambitious programs to inspect the top tier of factories, neither is targeting the most vulnerable factories producing for the export market.

This chapter looks at public governance – the domestic legal framework and efforts to improve it – and initiatives by private actors, including brands and retailers, to conduct oversight of the garment sector.

### Labor Law in Bangladesh

A strong framework for labor law is the first element of good governance in the garment sector. Prior to Rana Plaza, foreign governments, companies, unions, and civil society groups put pressure on the government to amend its labor laws and bring them in line with international standards. They were particularly focused on the legislative framework for freedom of association and collective bargaining, labor rights in export processing zones, and wages.<sup>19</sup>

In the wake of Rana Plaza, Bangladesh's parliament finally enacted changes to the Bangladesh Labor Act (BLA) on July 15, 2013. The law now includes several provisions to improve workplace safety, including by strengthening the labor inspectorate, mandating the creation of safety committees and workplace health centers, and making some improvements in the compensation regime.<sup>20</sup>

However, important sections of the amended Labor Act still do not fully meet international standards. Bangladesh ratified the ILO's core conventions on freedom of association and the right to organize and bargain collectively in 1972.<sup>21</sup> The ILO issued a statement following the labor law reform, highlighting some of its shortcomings:

“A number of restrictions to workers' freedom of association rights which have been the subject of ILO concerns were not addressed by the amendments. For example, major areas that remain to be addressed include the reduction of the 30 per cent minimum membership requirement to form a union. The amendments also do not extend freedom of association and collective bargaining rights to workers in export processing zones. Some new provisions of the law, for example with respect to rights of workers who are contracted for services and new exclusions from coverage of the labor law of certain sectors, may raise new and additional concerns about conformity with ratified conventions.”<sup>22</sup>



The garment sector enjoys outsized influence in parliament. According to Transparency International Bangladesh, this leads to delays in regulatory reform, implementation of favorable tax and other legislation for the sector, and strong links between the ruling party and the BGMEA.

Human Rights Watch charged that even after the reform, the labor law falls far short of protecting workers' rights. They point out that under the law, "The government will be able to stop a strike if it decides it would cause 'serious hardship to the community' or is 'prejudicial to the national interest,' terms that are not defined but can easily be misused."<sup>23</sup>

The Solidarity Center is an international labor advocacy group affiliated with the AFL-CIO. Its Dhaka office points out that parts of the amended law on Freedom of Association and Collective Bargaining do not apply in export processing zones (EPZs). The Solidarity Center calls the amendment a "half-hearted legislative reform,"<sup>24</sup> noting that EPZ workers continue to have weaker protections for freedom of association and collective bargaining than those employed outside the zones.

### The Relationship Between Government and Industry

The close relationship between government and the garment industry is a primary cause of weak enforcement of the labor law, especially in the context of pervasive corruption. Transparency International's Corruption Perception Index 2013 ranks Bangladesh 136<sup>th</sup> out of the 175 countries it examines.<sup>25</sup> A 2013 report by Transparency International Bangladesh (TIB) concludes that corruption penetrates all levels of the garment industry and that a combination of government and private corruption creates barriers to ensuring workers' rights.<sup>26</sup> The report highlights that the business models of buyers undermine law enforcement because both buyers and suppliers profit from avoiding compliance with legal regulations.

Garment manufacturers enjoy outsized influence in parliament; most estimates put the number of parliamentarians with investments in the garment sector at 10%.<sup>27</sup> TIB's 2013 report provides an in-depth analysis of the influence of the garment sector in the legislative process, including through introduction of favorable tax and financial legislative, blocking legislation that would impose additional regulations and oversight on the sector, use of political power for the personal benefit of parliamentarians, and strong links between BGMEA leadership and the ruling party.<sup>28</sup>

Slow progress in hiring much-needed additional labor inspectors is emblematic of the challenge of labor law enforcement. The government identified the need for 800 additional labor inspectors in a stark acknowledgement of the lack of oversight in the garment sector. It committed to hiring the first 200 of this group by the end of 2013, but little progress has been made to date.



Labor inspections by the government should regulate heavy loading and large piles of flammable materials, among other safety risks. But the government has yet to hire even the first 200 of the 800 labor inspectors it estimates will be required to monitor the garment sector.

The trade associations play a strong role in implementing regulations that would normally be enforced by the government. As the BGMEA Members' Directory notes, "BGMEA plays a very strong role to lead the industry in concurrence with the government."<sup>29</sup> One important example is the BGMEA's role in issuing the 'utilization declaration' that is required to import materials duty-free.<sup>30</sup> This is a customs document, intended to monitor compliance with regulations for payment of import and export duties to the government. But it is issued by the trade association, not a government ministry.

In response to pressure to control the practice of non-transparent subcontracting, the government has again turned to the trade associations. Its new plan for establishing a transparent and accountable subcontracting system rests on formalizing unregistered factories by requiring them to join the trade associations in order to receive subcontracts.<sup>31</sup> The BGMEA and BKMEA already authorize subcontracts between their members by issuing the interbond license. The government's solution to the subcontracting problem is to double down on the outsourcing of oversight by expanding the universe of factories monitored by the trade associations. But the BGMEA and BKMEA do not want small factories that cannot meet minimum standards for safety and working conditions among their ranks. They are now restricting new membership, illustrating that there are limits to the pseudo-regulatory role the trade associations are willing to play.

For many people in Bangladesh, the BGMEA's multi-story glass headquarters stands as a stark reminder of the close relationship between business and government in the garment sector. Environmentalists protested its construction as early as then-prime minister Sheikh Hasina

laid the building's foundation stone in 1998. A lawsuit contesting the building's construction and continued occupation of land designated for wetlands protection advanced to the country's Supreme Court and a three-judge panel issued a fiery judgment against the trade association. They ruled that the building was "an obnoxious symbol of sheer disdainfulness of a group endowed with fleshy economic muscle." The justices continued their rebuke, noting that "the very presence of the building shows that a conglomerate of financially affluent people can scorn and unravel our law with impunity..."<sup>32</sup>

In April 2011, the court ordered that the building be demolished within 90 days. Three years later, the BGMEA has just completed a luxurious new Apparel Club on the top two stories of the building. It shows little anxiety about the enforcement of the high court's judgment.

## Compensation and Access to Remedy for Victims of Industrial Accidents

The magnitude of the Rana Plaza tragedy has highlighted the urgent need for a robust legal and practical framework for delivering compensation and access to remedy for victims of industrial accidents. While much remains to be done for victims of Rana Plaza, the government and some brands have adopted new approaches for reaching victims and their families that can serve as a useful model for the establishment of a standardized system for compensation and access to remedy.

In the case of Rana Plaza, the government has gone beyond minimum legal requirements to administer more aid than it has for any previous disasters. After the collapse, the prime minister announced the creation of the Prime Minister's Relief and Welfare Fund to provide immediate and long-term support for victims based on donations from a number of governmental, non-governmental, and private donors. The Center for Policy Dialogue (CPD), a Dhaka-based think tank, has described this fund as a "significant source of funding for the victims."<sup>33</sup>

As of January 2014, reports indicated the prime minister's fund had received around \$1,290,000 in donations.<sup>34</sup> By April 16, the government reported that approximately \$285,000 (Tk 22.11 million) had been disbursed to 909 family members of the victims.<sup>35</sup> The government has also covered other costs, including initial treatment and short-term allowances for 1,800 injured workers.

Since the collapse, local civil society and legal advocacy groups have fought to apply compensation provisions of the labor law to the victims of Rana Plaza. According to the labor law, employers must deposit funds for compensation for workplace death and injury with the labor court. In November 2013, a subcommittee established by the High Court after the collapse recommended guidelines for compensation be paid to families for each deceased, missing, or disabled worker. In the face of continued objections from the BGMEA, the amounts were revised down in January 2014.<sup>36</sup>

In its monitoring report issued 100 days after the collapse, CPD mapped out commitments for compensation, treatment, and rehabilitation made by governmental bodies, brands, the BGMEA, international organizations, NGOs, and foreign governments.<sup>37</sup> The report shows a complicated web of actors pledging different types of aid administered through different channels. The disparate nature of this aid makes it difficult to assess the total amount contributed and who it has reached.

In September 2013, representatives from the government, local industry, international brands, and NGOs came together to form the Rana Plaza Coordination Committee as a potential alternative to this ad hoc approach. The Committee aimed "to develop a comprehensive and



independent process that would deliver support to the victims, their families and dependents in a predictable manner consistent with international labour standards.” With the ILO acting as a neutral chair, the group proceeded to establish the Rana Plaza Arrangement (“the Arrangement”), which includes a coordinated claims process for victims and a Rana Plaza Trust Fund for compensation.<sup>38</sup>

The Arrangement draws on ILO Convention No. 121 on employee injury benefits to determine the amount of financial support and medical care to be provided to Rana Plaza victims. While the government has not signed this convention and Bangladeshi labor law falls far short of its requirements, the Ministry of Labor has endorsed the Arrangement’s “practical roadmap” based on the convention’s standards. Leading buyers, the Ministry of Labor, BGMEA, Bangladesh Employers’ Federation, IndustriALL Bangladesh National Council, Bangladesh Institute for Labour Studies (BILS), IndustriALL Global Union and Clean Clothes Campaign have also signed on.

The Arrangement could serve as a useful precedent for coordinated compensation and support in the aftermath of other disasters. But it remains underfunded. The Arrangement has identified \$40 million as the total need for compensating victims. Only around half of the 28 brands linked to Rana Plaza have committed funds. These include: Bonmarché, C&A Foundation, El Corte Inglés, Inditex, KiK, Loblaw, LPP S.A., Mango, Mascot, N Brown Group, Premier Clothing, and Primark. An additional group of companies – Asda, Gap Foundation, The Children’s Place, VF Foundation, Wal-Mart, and Wal-Mart Foundation – have contributed a combined \$ 2,205,000 to the fund through BRAC-USA.<sup>39</sup> As of April 4, the Arrangement’s Rana Plaza Trust Fund had about \$15 million available in total, almost half of which comes from a single brand, Primark.<sup>40</sup>

### The National Action Plan

The government of Bangladesh initiated a “National Tripartite Plan of Action on Fire Safety in the RMG Sector” in 2013. This National Action Plan (NAP) identifies many of the issues that are relevant for transforming the garment sector, including setting up a transparent and accountable system for subcontracting. But the plan includes an overly ambitious timeline, and deadlines have passed for the majority of its 21 actions steps and most targets remain unmet. A February 2014 working paper by the Ministry of Labor and Employment outlines the actions that have been taken to date, and acknowledges, “Many remain incomplete till now.”<sup>41</sup> The plan’s complex administrative and programmatic activities simply are not realistic in the context of weak enforcement capacity, corruption, and lack of resources.

Despite the government’s lackluster performance in implementation, the NAP is an important part of efforts to upgrade the garment sector. Foreign governments, the ILO, civil society, and industry have long pressured the government to enhance its oversight of the sector. The NAP represents a step forward in terms of a clear outline of the government’s commitments.

The most important feature of the NAP is the number of factories it covers. Unlike the Accord and the Alliance, which are limited to the 1,894 factories in the country, the government’s newly released database of registered factories encompasses 3,497 factories and could be expanded to include the universe of as-yet unregistered factories. Developing a governmental process for registering this group of factories that does not rely on the trade associations should be a priority for the government, the ILO, and local industry.

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## “National Tripartite Plan of Action” on Fire Safety in the RMG Sector

The NAP identifies a series of activities that fall within the responsibility of its tripartite partners and seeks to create coordination mechanisms among buyers, international development organizations, and donors. It includes proposals for the following improvements across the sector:

- Development of a **National Occupational Health and Safety Policy** with input from the ILO.
- **Review and update of fire safety regulations** and the establishment of a **fire safety task force**.
- **Recruitment of added factory inspectors** and support staff to fill vacant positions in the Department of Inspection for Factories and Establishments.
- **Review of factory licensing and certification procedures** with respect to fire safety, which were previously the responsibility of several government authorities. The NAP recommends consolidating this authority and potentially creating a so-called “one-stop shop” for administering certification. The NAP also proposes for the development of a fire safety checklist for use by the government.
- **Assessments of factory-level fire safety needs, development of a factory fire safety improvement program, and fire safety information and training programs** tailored for union leaders, workers, mid-level factory managers, and inspectors.
- Creation of a **fire safety hotline** for workers, as well as improved equipment and additional staff in the **Fire Safety and Civil Defense** department.
- Development of a **tripartite protocol for compensating victims of industrial accidents and their families**.
- A more **transparent and accountable subcontracting system**.

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## Better Work Bangladesh

Better Work is the ILO and IFC’s signature program for enhancing compliance with international labor standards and national labor laws in key garment-exporting countries. The government of Bangladesh, foreign governments, unions, brands, and local industry are all looking to the ILO and IFC’s Better Work program as a solution to poor governance in the garment sector. As Better Work launches in Bangladesh, it will have to overcome the many challenges that the program has faced in the six other countries where it operates, in addition to sizeable governance challenges unique to Bangladesh.

The size of the garment sector in Bangladesh and the obvious need for improvements on a range of labor rights and workplace safety issues make the country a natural venue for the program. But in the context of serious concerns about inadequate labor law protections, lack of commitment by local actors, and scalability, the ILO and IFC declined to launch the program in Bangladesh prior to Rana Plaza.

Under intense international pressure to launch the program despite challenges in meeting the program's minimum requirements, the ILO and IFC launched Better Work Bangladesh in October 2013. Bangladesh is unique among its competitors in the outsized political role of local industry in the garment sector, and in the scope of its governance challenges. Our assessment is that these factors, coupled with ongoing challenges with the broader Better Work program, will severely test the Better Work model.

Better Work uses trade agreements and increased market access to create incentives for governments and local industry to participate in its monitoring programs. Cambodia was the pilot for this model, where Better Work first launched in 1999 as part of the United States-Cambodia Bilateral Textile Trade Agreement. The trade agreement contained a precedent-setting commitment to protect workers by linking Cambodia's garment export quotas to improvements in its labor rights performance. A new ILO project was developed to audit export garment factories and publicly report on their levels of compliance as a means of determining increasing access to quota.

Foreign governments and international buyers have generally welcomed Better Work in the countries where it operates for a variety of reasons: it has the potential to prevent nations from exploiting low labor standards to attain competitive advantage in the global marketplace; it shifts the burden of labor inspections in exporting countries from private actors to the public sector; and it pools resources for coordinated action to improve working conditions in this jurisdiction.

Better Work launched in Jordan in 2008, Haiti and Vietnam in 2009, Lesotho in 2010, and Indonesia and Nicaragua in 2011. Morocco remains under consideration. As the program has expanded to these countries, it has generally followed the same model used in Cambodia: leveraging trade agreements to encourage national-level export garment sectors to participate in a monitoring project.

But the program has faced significant challenges as it has expanded. By 2012, Better Work covered only 570 of the 3,000 enterprises the ILO set as its target by that date. Despite ambitious plans to expand the program, the ILO's own feasibility studies have caused the ILO and IFC to slow down plans to grow the program in additional countries and sectors. Examining these challenges is helpful for understanding prospects for Better Work Bangladesh:

- **Potential to undermine national enforcement capacity:** Better Work relies on ILO inspectors and enterprise advisors to conduct its monitoring and remediation programs. The program has the potential to undermine national enforcement capacity by effectively usurping the role of government labor inspectors.
- **Limited leverage:** Better Work has limited leverage over participating suppliers and international buyers. The program does not certify or rank factories, so it cannot de-certify or downgrade them as a sanction for non-compliance. And it does not publish factory-specific data or scorecards (except in Haiti), so there is little public pressure on suppliers to improve. In some Better Work countries, exporters are required to participate in the program as a condition of obtaining export licenses (Cambodia, Jordan, and Haiti). But even in these countries, there are no real practical sanctions for an exporter that does not want to participate. The program also has limited leverage with buyers and relies on their often sporadic, voluntary cooperation with the program.<sup>42</sup>



- **Public reporting:** Linking the audit results of specific factories to the brands they supply is a hotly contested issue. Some studies argue that the failure to link audit results to brands has relieved the pressure on the brand-name buyers to put pressure on suppliers make improvements. For example, the Mills Legal Clinic and the Worker Rights Consortium at Stanford Law School found that local suppliers ignore audit findings when they are not reported publicly<sup>43</sup>. The Better Factories Cambodia program observed a decline in rates of compliance between 2011 and 2013, when factory names were not made public, and decided to return to its pre-2005 practice of naming factories in its reports<sup>44</sup>.

In addition to these design and operational challenges, there are questions about the program's effectiveness in improving respect for ILO core labor standards, including freedom of association, non-discrimination, and forced and child labor, as well as minimum wages, hours of work and regular employment contracts.<sup>45</sup> The Thirtieth Synthesis Report issued by Better Factories Cambodia noted that child labor, discrimination, and freedom of association violations in Cambodia persisted even after 12 years of auditing. The Better Work Global Synthesis Report for Phase II<sup>46</sup> presents average aggregate baseline non-compliance rates for Haiti, Indonesia, Jordan, Lesotho and Vietnam. It will likely take several years before clear trends in compliance performance emerge, but the preliminary data show that there is much work to be done to achieve the program's objective of enhancing compliance with core labor standards.

The Better Work model is fundamentally an auditing model. A growing body of research shows that systems based on labor inspections that are conducted independently of any sourcing incentives are largely ineffective in achieving better working conditions. Better Work's compliance data is a clear illustration of this point. Audits, whether conducted by Better Work, multi-stakeholder initiatives, or

The government's National Action Plan, supported by the ILO/IFC's Better Work program, covers the largest universe of factories in Bangladesh. Many of the smallest, riskiest factories are not covered by the Accord and the Alliance. One of these factories is registered with the government and the BGMEA; the other is not. Neither is covered by the Accord or the Alliance.



buyers, generally do a poor job of capturing the causes of non-compliance issues and consequently struggle to contribute to their resolution. In many cases, compliance issues stem from competitive pressures in the global supply chain that lie outside the scope of Better Work. Compliance issues relating to hours of work, wages, precarious contracts, child labor, undeclared subcontracting and even fire and building safety are all related to the downward pressure on prices and lead times that drive manufacturers to cut costs and seek flexibility by almost any means possible.

As Better Work expands, particularly in a very challenging environment like Bangladesh, it should focus on several key areas:

- **Transfer oversight functions to national institutions:** Better Work must define an exit strategy in the countries where it operates, even on a very long time horizon. Systems that substitute foreign oversight for domestic regulatory capacity are not sustainable.
- **Develop incentive-based compliance models:** Inspections are an important foundation for regulatory oversight, but they do a poor job of driving sustainable compliance over the long term. Better Work should focus on innovation in creating incentive-based systems for improved compliance with labor standards. Strengthening labor-management dialogue and cooperation as a means of resolving compliance issues at the enterprise level should be a key feature of this model.
- **Include buyers as key partners:** Sourcing strategies are a key component of sustainable compliance. Participation of large groups of buyers would expand the scope of the program and enhance incentives for all sides.

### Private Governance - the Accord and the Alliance

In the absence of adequate public oversight, private actors have stepped in, including international brands and retailers. The most prominent recent examples of private governance in the garment sector are the formation of the Accord and the Alliance in the summer of 2013.

The formation of the Accord and the Alliance represents an unprecedented collaboration among global brands to collectively address structural weaknesses in the garment sector through compliance with common safety standards. For the first time, many of the largest global garment brands and retailers in the world are working to define and implement a common human rights standard on factory safety, monitor compliance with that standard, and offer training and resources for factory improvements over a five year period. This is a significant step forward for a standards-based, collective approach to solving a pressing problem of business and human rights.

However, in our view, the attention and energy that continues to be devoted to parsing the differences between the Accord and the Alliance misses the point. The Accord and the Alliance serve very similar functions in Bangladesh: they create a short-term inspection regime among the top tier of factories, conduct trainings for management and workers on fire and building safety, and provide some level of resources to their primary suppliers for remediation efforts.

Both initiatives are racing to complete inspections in the 1,894 factories that maintain direct relationships with their members. But the universe of factories producing for these brands includes a network of indirect subcontractors that are not covered by either the Accord or the Alliance. These are also the factories that, as a group, contain the greatest risk.

The Center for Business and Human Rights at NYU Stern included a detailed comparison of the Accord and the Alliance in its February 11, 2014 submission to the Senate Foreign Relations Committee hearing “Prospects for Democratic Reconciliation and Workers’ Rights

in Bangladesh.” An update of this comparison is included as an appendix to this report. We assess the Accord and the Alliance across five dimensions: participation, decision-making and governance, commitments, program and approach, and fees and funding:

- **Participation:** The Accord includes a group of more than 150 companies from the United States and Europe. The Alliance includes 27 of the biggest American retailers. The Accord includes unions in its decision-making structures, but not local industry. The Alliance includes local industry, but not unions.
- **Decision-making and governance:** Both initiatives have small governing boards with an independent chair. Each initiative maintains a separate office and staff in Dhaka, as well as a range of employees, consultants, and advisors based internationally.
- **Commitments:** Each initiative is envisioned to last for five years, through 2018. The Alliance requires that members participate for two years; the Accord requires five years, with some requirements for maintaining order volumes for the first two years. If a member company leaves the Alliance, the member pays a financial penalty. If an Accord member is subject to a dispute, the issue is referred to the Steering Committee, whose decision either party can appeal to binding arbitration. Advocates of the Accord have emphasized that this constitutes a legally binding agreement, but it is not clear that the penalties associated with dispute resolution are significantly different from the more straightforward financial penalties contained in the Alliance.
- **Program and approach:** In total, the two initiatives encompass approximately 1,894 factories out of the approximately 5,000 – 6,000 factories we estimate are part of the export garment sector in Bangladesh. Neither addresses the indirect suppliers of their members. The two initiatives offer similar programs, focused on factory safety and building inspections, worker training and empowerment, and making some funds available for factory remediation. All program activities in both initiatives focus on building and fire safety and do not address broader issues of labor rights, freedom of association, or indirect sourcing in the supply chain.
- **Fees and funding:** In both initiatives, corporate participants make an annual contribution based on dollar volume of exports to cover inspection and training programs and operational expenses. A heated debate is now playing out about who will pay for the necessary remediation efforts identified through inspections. Our conclusion is that for all practical purposes, both the Accord and the Alliance put the burden of funding repairs on factory owners, with the option of financing from brands to be negotiated bilaterally between Alliance and Accord members and their suppliers.

The lack of a clear and coordinated system for financing remediation is a deficiency of both initiatives. Neither initiative imposes a firm obligation on brands to fund repair of safety deficiencies uncovered by their audits:

- **Accord, “Remediation”:** “Where corrective actions are identified by the Safety Inspector as necessary...the signatory company...shall require that factory to implement these corrective actions.”<sup>47</sup>
- **Alliance, “Affordable Capital for Building Safety (‘ACBS’)”:** “ACBS funds will be administered solely by the Member who makes such funds available to Factories, on terms and conditions to be established solely by that Member....Participation in ACBS is not a condition of membership in the Alliance.”<sup>48</sup>

But both initiatives require factories supplying their members to be in compliance in order to continue to receive orders:

- **Accord, “Supplier Incentives”:** “Each signatory company shall require that its suppliers in Bangladesh participate fully in the inspection, remediation, health and safety and, where applicable, training activities, as described in the Agreement. If a supplier fails to do so, the signatory will promptly implement a notice and warning process leading to *termination of the business relationship if these efforts do not succeed.*” [emphasis added]
- **Alliance, “Purpose”:** Members commit to “Work with factories that ensure a safe working environment, with each Member committing *not to source from any Factory that the Member has deemed to be unsafe.*” [emphasis added]

Factory owners are caught in a Catch-22. They are required to be in compliance in order to maintain relationships with Accord and Alliance members, but if they cannot afford the remediation the initiatives determine is necessary, no one is obligated to assist them. Furthermore, there is no unified system of oversight of the bilateral negotiations between Accord and Alliance members and their individual factories. This means that each factory is subject to separate, voluntary funding terms depending on their arrangements with individual brands and retailers. Factory owners and the trade associations understandably are opposed to this arrangement.<sup>49</sup>

The confusion is exacerbated by conflicting reports about the nature of financing obligations under the Accord. Proponents of the Accord have emphasized that one of its distinguishing features is “mandatory repairs and renovations *financed by brands*” [emphasis added], as described in a Clean Clothes Campaign and International Labor Rights Forum report on the six-month anniversary of Rana Plaza.<sup>50</sup> As of early April 2014, United Students Against Sweatshops, a national student labor movement in the United States, continues to use this language in letters urging universities to require their licensees to sign on to the Accord.<sup>51</sup>

This is not accurate. As quoted in a March 10, 2014 Reuters article, Accord international executive director Alan Roberts made clear, “*factory owners* are responsible for paying to address safety issues raised by inspectors, although brands [have] agreed to help find funding if the owners cannot afford it”<sup>52</sup> [emphasis added].

Similarly, support for displaced workers is a key issue as inspections reveal significant safety risks that are forcing some factories to close or suspend operations. In an article about major safety flaws found in 10 factories supplying Accord members, the *Daily Star* quotes Rob Wayss, the Accord’s Bangladesh executive director, as saying “*Factory owners, not the retailers or brands, are responsible for such payments*” to workers for any production suspensions caused by inspections “[emphasis added].<sup>53</sup> For its part, the Alliance sets aside 10% of fees directed to the Worker Safety Fund to support temporarily displaced workers.

In short, neither the Accord nor the Alliance addresses the role of indirect sourcing and the routine reliance on subcontracting in their members’ supply chains. Both the Accord and the Alliance have devoted significant resources to quickly inspecting factories that maintain direct relationships with their member brands, but neither initiative has yet developed a coordinated and clear system for financing remediation efforts based on the results of their inspections.

In our view, a revised approach is needed that prioritizes efficiency in existing operations and expands the scope of both initiatives. Factory owners and workers will benefit if the Accord and the Alliance can set aside their differences and develop efficiencies in the following areas:

- Establish a pooled fund for safety remediations and support for displaced workers. Include contributions from members of both initiatives. Administer it under the auspices of the secretariat staffs of the organizations, in collaboration with local banks and the BGMEA/BKMEA. Establish and publicize clear guidelines for the fund.
- Agree on an approach for inspections of the 351 shared factories that supply both Accord and Alliance members.
- Encourage greater supply chain transparency by working with primary suppliers to identify an expanded list of subcontracting factories supplying products to Accord and Alliance members.

Encouraging greater supply chain transparency by identifying the universe of indirect suppliers is surely a daunting prospect, for Accord and Alliance members and their supplier factories. Understanding what lies beneath the surface of an individual company's supply chain does not feel like a safe conversation for many buyers and their primary suppliers. What kinds of risks will be uncovered? Who will take responsibility for remediating them? Can current sourcing and pricing practices be sustained in light of new information? These are all reasonable questions, and responsibility for answering them should not fall to the Accord and the Alliance alone. Undoubtedly, the conversation about greater supply chain transparency is a policy discussion that will play out over many years, in Bangladesh and around the world.

But the Accord and the Alliance can play a valuable role in initiating this discussion. Taken together, the initiatives encompass more than 175 global brands and retailers and a significant portion of Bangladesh's export-oriented garment sector. What does not feel like a safe conversation between an individual buyer and an individual supplier becomes much more so when a group of buyers and suppliers address the problem collectively.

Some suppliers are already beginning to think in these terms. Rubana Huq, Managing Director of the Mohammadi Group, one of the country's leading factory groups, shared a presentation with the Center that she made to the BGMEA in October 2013. In it, she calls on "each leading exporter to mentor and monitor at least 5 tier 3 factories." There is an acknowledgement among some of the biggest factory groups that the system of indirect sourcing is not sustainable and is contributing to a negative perception of Bangladesh as a sourcing destination. They recognize that these issues require action not just on the part of brands, but first-tier suppliers, as well.



## PART 3 INFRASTRUCTURE DEVELOPMENT

Bangladesh's infrastructure is among the least development anywhere the world. The World Economic Forum's 2013-2014 Global Competitiveness Report ranks the country's infrastructure 132nd out of 148 countries under review.<sup>54</sup> It is impossible to consider the long-term viability of Bangladesh as a major garment production center without addressing significant gaps in the country's infrastructure. In some respects, the demands of the garment sector have actually exacerbated the problem, placing even greater demands on an already overtaxed system.

### Electrical Supply

Power shortages and power black outs contribute to manufacturing delays, which often lead to excessive overtime and increased costs that cause owners to hollow out wages and benefits. The heavy use of generators was also a major contributing cause in the collapse of Rana Plaza and electrical failings caused by short circuiting or sub-standard wiring are a leading cause of factory fires across the sector.<sup>55</sup>

The country currently is unable to meet the rising demand for electricity from increasing industrialization. Electricity consumption increased by an annual average of 12% from 2000 to 2010, which has strained Bangladesh's electricity grid virtually to the breaking point.<sup>56</sup> The World Bank estimated in 2010 that only about 47% of households have access to electricity, electricity supply meets less than 75% of peak demand, and gas supplies meet less than 85% of daily demand.<sup>57</sup>

The World Bank in Dhaka has pointed out that permanent solutions require large, long-term investments which span election cycles. They estimate that an investment of \$1.5 billion per year or more over the next ten years is needed for gas and power sector investments.<sup>58</sup>

To date, the government has demonstrated neither the political will nor the economic capacity to address infrastructure challenges on its own. As a McKinsey study on the prospects of the RMG industry in Bangladesh found in 2011, poor infrastructure (utilities and transport) is the single largest issue that is hampering further industry growth.<sup>59</sup>

There is little doubt that corruption is a key limiting factor in expanding much-needed infrastructure. In 2012, the World Bank canceled its contract with the government of Bangladesh for the \$1.2 billion Padma Bridge. In announcing the cancelation, the World Bank said it had "credible evidence corroborated by a variety of sources which points to a high-level corruption conspiracy among Bangladeshi government officials, SNC Lavalin executives [the largest engineering and construction company in Canada that won the contract bid], and private individuals in connection with the Padma Multipurpose Bridge Project."<sup>60</sup> Padma Bridge has become emblematic of the effects of corruption as a constraint on development.

### Export Processing Zones

Many experts argue that moving garment production into purpose-built zones should be a key feature of a forward-looking strategy for the sector. Export processing zones (EPZs) are designated specialized industrial estates that produce mainly for the export industry. Moving production into the zones would have significant benefits for factory safety, but the zones are governed by a separate governance framework that weakens protections for workers' rights.

There are currently eight export processing zones in Bangladesh. The EPZs are located in Dhaka, Chittagong, Karnaphuli, Adamjee, Comilla, Mongla, Ishwardi and Uttara.<sup>61</sup> The general manager for public relations at the BEPZA, Nazma Binte Alamgir, said in a recent interview with *The*



BISHAWJIT DAS

*Daily Star*, that there are currently 425 enterprises inside EPZs and 73 are under construction<sup>62</sup> Global apparel brands such as Adidas, H&M, Tommy Hilfiger or Wal-Mart have production in the zones.<sup>63</sup> Approximately 382,000 workers are currently employed in the EPZs, with an estimated 300,000 workers employed in garment factories in the zones.<sup>64</sup>

The objective of the EPZs is to attract foreign investment and create jobs. The government provides numerous incentives for companies to open factories in these zones. EPZ factories in Bangladesh currently enjoy a 10-year tax holiday and duty free machinery import facilities. Factories inside the EPZs also get uninterrupted gas and power supply, which reduces overhead and makes them more competitive.<sup>65</sup>

The zones offer multiple advantages when it comes to workplace safety. Purpose built buildings and the uninterrupted supply of oil, gas, and electricity in the zones improve safety conditions and help mitigate potential sources of production delays which contribute to loose control in the supply chain.

Since the inception of the EPZs in Bangladesh, no deadly fire accidents have occurred in any EPZ facility and no building has collapsed. The buildings in the zones are purpose built for industrial activity. Unlike the multi-purpose buildings in which many garment factories are located outside the zones, these facilities must meet more robust safety requirements outlined in the EPZ building code.<sup>66</sup> In the event of a fire or another kind of structural accident, basic infrastructure would be in place. Unlike in the areas outside the zones, water pipes in EPZs have sufficient pressure so that fire hoses can actually function and there is enough space for fire engines and other rescue vehicles to navigate to factory buildings.

Purpose-built factory complexes reduce building and fire safety hazards with stronger building code compliance, reliable access to electricity, and better access for fire fighting vehicles.

But protections for workers' rights in the zones remain weak. EPZs operate under a separate authority from factories outside the zones. Especially in the wake of Rana Plaza, the U.S. government, the ILO, and civil society organizations have pressured the government to bring EPZ law in full conformity with international standards.

The U.S. Department of Labor's 2013 Action Plan sets out conditions for the restoration of Bangladesh's participation in the Generalized System of Preferences trade program, including a provision that the government of Bangladesh guarantee that workers in the EPZs have access to the same freedom of association and collective bargaining rights as other workers in the country.<sup>67</sup> The ILO's statement on Bangladesh's reformed labor laws in July 2013 pointed out that the amendments do not extend freedom of association and collective bargaining to workers in EPZs.<sup>68</sup> The Bangladesh government responded to these comments by announcing that the right to strike would be granted to workers in the EPZs by 2014 and further reforms on the rules related to EPZs will follow.<sup>69</sup> It is not yet clear if these reforms have been implemented.

### Who Bears the Cost?

A globalized economy is intended to benefit people in both developed and developing countries. Through global supply chains, consumers in developed countries gain wide access to affordable products, while workers in places like Bangladesh are lifted out of extreme poverty. Yet the recent tragedies in Bangladesh provide a grim reminder of the risks associated with this highly unregulated system. Foreign governments and international organizations play an important role in sharing the burden of filling governance gaps.

At present, most foreign development funding is focused on investments in Better Work Bangladesh, worker empowerment and skill development programs, food security, labor inspections, and combatting human trafficking. With respect to funding for the garment sector, the Dutch government has played a very helpful role in coordinating the activities of various foreign donors. The Dutch embassy in Dhaka manages a database that lists the activities of a wide range of donor countries as well as other associated funds that others have committed to help support the garment industry.

But in the absence of major investment in overhauling Bangladesh's faltering infrastructure, development programming in the garment sector will have an insufficient effect. Workers empowered to work in crumbling buildings still face grave risks. Investing in the kind of major infrastructure development Bangladesh needs has proven to be a frustrating and often fruitless task because of corruption. It is up to the government and local industry to make the case that Bangladesh is a sound investment.

Compounding the problem, the World Bank has not been a major presence in efforts to upgrade the garment sector. While the Bank has made a long term commitment to improving health and education and to supporting improvements in rural infrastructure, it has not been a driver of any broad donor initiative to address the link between poor infrastructure and significant safety risks for workers in the country's largest export sector. Without the World Bank's leadership in this area, other international donors will be reluctant to make contributions of their own.



Upgrading the garment sector in Bangladesh so that it is sustainable for business and society will be a long-term challenge. It will require concerted and coordinated efforts among global brands, local factory owners, government agencies, civil society, unions, and the international donor community.



## A Forward-Looking Agenda

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This report identifies a series of daunting challenges that confront the garment sector in Bangladesh one year after the collapse of Rana Plaza. As we identify a series of practical next steps, it is clear that no one actor or sector can tackle these challenges single-handedly.

Filling the governance gap will require a network of interconnected actors – national and international companies, governments, civil society, unions, and international organizations – to enhance governance in the garment sector through a mix of public and private mechanisms. This means fostering greater transparency in business relationships, investing in enhanced regulatory oversight, coordinating financing systems for making factories safer, and prioritizing infrastructure development.

We also recognize that in the last year, a series of significant actions have been taken by the government of Bangladesh, the private sector, and international donors and intergovernmental organizations to address pressing problems in the garment sector. These are important steps and we commend those involved in these initiatives – the government of Bangladesh's National Action Plan, the Better Work Bangladesh program, and the Accord and the Alliance.

We know that substantial resources already have been invested in these efforts and that future resources have been committed to continue their work. We also recognize that the principal actors driving these initiatives have invested significant time and in some cases exposed themselves to political and reputational risk by sitting at the table with unlikely allies. In analyzing the existing landscape, our intention is to strengthen current efforts and complement their work in pursuit of the shared objective of a sustainable garment sector in Bangladesh.

### CONCLUSIONS

Global buyers and national-level suppliers in Bangladesh benefit from an indirect sourcing model that relies on the routine practice of subcontracting, often through agents and in a manner that is not transparent to buyers and regulators. This purpose of this strategy is to increase margins and boost production capacity while keeping costs low. The indirect sourcing has been an essential, though poorly understood, feature of the garment sector in Bangladesh and is likely to continue to be important in the future.

While indirect sourcing has been a key driver of booming growth in the garment sector and the export economy of Bangladesh, it enhances risks by reducing control and transparency in the supply chain. Indirect sourcing is a root cause of many of the problems associated with poor working conditions and lack of factory safety in Bangladesh.

Public governance in Bangladesh is extremely weak. The government lacks the resources, legal framework, and often the will to protect the basic human rights of factory workers. While its National Action Plan represents a clear and ambitious agenda for the future, implementation has been halting and the government lacks the resources to fully implement this plan.

The domestic garment sector in Bangladesh plays an outsized role in the politics, regulation, and enforcement of oversight in its own industry. Coupled with corruption and fundamental shortcomings in government capacity, the outsized role of local industry has served to disempower the government's ability to regulate factory safety.

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A series of efforts over the last year to compensate the victims of Rana Plaza and their families have recently begun to yield positive results, though significant numbers of victims and their families have yet to receive sufficient compensation. In situations where remedial steps are being taken either to upgrade or replace dangerous factories, too little attention is being paid to the plight of workers who risk losing their jobs and their family's livelihood.

In the absence of strong government oversight, private actors have stepped in. The two major private initiatives created in 2013 by global brands and retailers – the Accord and the Alliance – represent an unprecedented collaboration among global brands to address structural weaknesses collectively. For the first time, many of the largest global garment brands and retailers in the world are working to define and implement a common human rights standard on factory safety, monitor compliance with that standard, and offer training and resources for factory improvements over a five-year period. But these two initiatives continue to operate separately and Redundantly, despite the fact that their similarities far outweigh their differences.

Neither the Accord nor the Alliance goes far enough in addressing workplace safety and workers' rights. These initiatives have not developed a coordinated and clear system for financing remediation efforts based on the results of their inspections. And neither has addressed the role of indirect sourcing practices in their members' supply chains that present the greatest risks for workers.

Foreign governments and international financial institutions play an important role in sharing the burden of filling governance gaps. At present, most foreign funding is focused on investments in Better Work Bangladesh, worker empowerment and skill development programs, food security, labor inspections, and combatting human trafficking. Foreign governments and international financial institutions have not focused sufficient attention and funding on the underlying problems, particularly the infrastructure failings that exacerbate risks to factory and worker safety.

## RECOMMENDATIONS

Upgrading the garment sector to ensure its safety and sustainability must begin with a thorough assessment of the overall universe of garment production. Global brands, including the members of the Accord and the Alliance, local factory owners, academic institutions, and the BGMEA should pool their resources to determine how many factories and facilities – big and small, registered and unregistered – participate in garment manufacturing for the export market. Together with the government of Bangladesh, they should compile and publish a single, comprehensive list of all factories and facilities, which should be updated periodically.

Global brands should acknowledge the role of indirect sourcing in their supply chains and begin to build more transparent, trust-based, and long-term relationships with their primary suppliers. Beginning with their closest suppliers, they should work to identify the full scope of subcontracting in their supply chains. Brands should prioritize transparency, rather than continuing empty rhetoric about policies against 'unauthorized' subcontracting.

International brands and retailers should continue to invest in Bangladesh, making firm long-term commitments to doing business in Bangladesh. Subcontracting can be a viable feature of this system, as long as it is done transparently and in accordance with minimum standards.

Upgrading registered and unregistered subcontracting facilities is a long-term project. The government, local industry, and civil society should work together with buyers and international organizations to develop a comprehensive public policy strategy, consistent with business objectives, to achieve this goal.

The government of Bangladesh must reclaim ownership of the country's regulatory system. It can no longer outsource these functions to the ILO, global brands, or the trade associations. Better Work and donor funds should double down on building the government's regulatory and enforcement capacity. The government should commit to work with the BGMEA and BKMEA to develop a strategy to reabsorb the customs and trade functions they now serve.

A system is now in place for compensating the victims of Rana Plaza, which holds the potential to provide a broader framework for compensation for victims of industrial accidents. Learning from the experience of Rana Plaza, the government, industry, and civil society should establish a simple and effective system for compensation for industrial accidents in the garment sector. The government of Bangladesh, local industry, and global companies all need to contribute to such a system.

The task of repairing and rebuilding the most hazardous factories in Bangladesh will take years and many tens of millions of dollars to complete. The time has come for companies across the sector – global buyers and leading Bangladeshi exporters – to join forces to create a single, unified fund for building repairs and remediation. It is inefficient and confusing for the Accord and the Alliance to run separate programs with separate funding schemes. The BGMEA and the largest factory owners in Bangladesh also must step up to the plate and contribute generously to efforts to upgrade the garment sector.

The private sector alone should not be expected to bear the burden for all that needs to be done in Bangladesh. As we mark the one-year anniversary of the Rana Plaza tragedy, this is a propitious time for an appropriate intergovernmental body such as the United Nations or the IFC to host a major donors conference on factory safety and infrastructure in Bangladesh. Each government should commit resources based on their capacity and connection to the garment industry in Bangladesh. The international community would thus create a common fund designed to help provide significant immediate resources to address the most egregious factory safety problems and longer-term funding to address gaps in critical infrastructure.

# Appendix 1:

## A Primer on Buying and Selling Garments in Bangladesh

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### Making an inquiry

Either directly or through a purchasing agent, the brand makes an inquiry about a factory's capacity and availability to produce a given garment – say 100,000 shirts – to certain quality specifications and by a specified delivery date. The factory may be subject to inspections to assess its capacity, levels of quality, and social compliance.

### Negotiating the sales contract

If the factory is available, it will be asked to make samples of the garment. A sales contract is then negotiated, including design and materials specifications, quantity, price per piece, protections for intellectual property, and a delivery date. (Note that design specifications often are not finalized at this stage and may be adjusted up until the time of production.) The delivery date is often several months ahead to allow time to import the necessary materials and manufacture the order. The factory owner reserves the appropriate number of lines in the factory to meet the delivery date. (A line is the number of machines it takes to complete a given garment, ranging from 10 machines up to 50 machines, depending on the complexity of the product.) To illustrate how this works, let's say we will produce 100,000 shirts at \$1.00 per piece by September 1, for a total order value of \$100,000.

### Opening an export letter of credit

The buyer sends an export letter of credit ('export L/C') to the factory or agent's bank. Under the export L/C, payment will be remitted only when the buyer has received the finished goods. This means that the factory owner must procure all of the materials, pay workers, and cover operational expenses well before receiving payment.

### Opening a back-to-back letter of credit to procure materials

The export letter of credit is a guarantee that the factory owner or agent will receive payment in the future if the goods are delivered as specified. On the basis of this guarantee, the factory owner or agent is able to open another letter of credit for the purpose of importing materials (hence the "back to back" L/C). In our example, we will need fabric, buttons, zippers, labels, trim, thread, and packaging materials in order to complete the jackets, in addition to the cost of utilities and labor. Most banks allow an owner or agent to borrow up to 75% of an order's total value, or \$75,000. The remaining \$25,000 will cover labor costs, utilities, and any goods purchased on the local market.

### Getting permission to import from BGMEA or BKMEA

To import materials duty free, the owner requires a 'utilization declaration' or 'UD,' which is issued by the BGMEA or the BKMEA. The UD ensures that goods imported duty free for the purpose of export production do not end up on the local market. This means that in Bangladesh, the trade associations issue import and export authorizations, rather than the government's trade or customs ministry. The UD includes authorization for a specific quantity of imported material matched to the specifications of the order. So if we need two yards of fabric for each shirt, the BGMEA will authorize the import of 200,000 yards of fabric.

### Procuring materials

The factory owner procures materials, most likely from China. Once the fabric is shipped, the factory owner's bank pays the fabric supplier. This is called a bank guarantee and allows the factory owner to borrow against the value of the export letter of credit in order to import fabric. If the factory owner fails to deliver the goods to the buyer, he is still liable for the bank guarantee and the purchase price of the fabric. In this way, the system for financing pushes risk downward from the brand to the factory owner.



## Production

Once all materials have been procured and the design specifications are finalized, production can begin. But if the materials arrive late or the buyer delays in submitting its final design, the factory owner's system for reserving lines is thrown off, while the delivery date remains the same. Production is closely monitored by a series of people from inside and outside the factory management structure. The factory's production manager is responsible for all aspects of production quality and delivery time. Quality control specialists from the agent or the brand visit the factory sometimes two or three times per week. Social compliance auditors, either from a third party auditor or the brand itself, visit factories at intervals ranging from every few weeks to once a year. Once the garments are sewn, they are finished with labels and tags listing the retail price and even the plastic security devices that will be removed once the garment is sold. Garments are wrapped in plastic and packed in boxes for transport.

## Transporting the finished goods and receiving payment.

If everything goes smoothly and the order is completed on time, the goods are transported by truck to the port in Chittagong (about three hours from Dhaka) and sent by ship to the U.S. or Europe. Once the goods are 'free on board,' the factory owner submits the appropriate documentation to his bank, which requests payment from the buyer. The time buyers take to process payments is notoriously slow, and factory owners may not receive payment for six months to a year after the order is shipped.

But often, everything does not go smoothly. If the design is complicated and production takes longer than expected, or if other delays have created time pressure against the delivery date, a factory owner has several options. If he has the space, he can open up additional lines in his own factory. He can either offer workers overtime or require them to work extra hours. If he has a strong relationship with the buyer, he can negotiate for an extension on the delivery date. In the worst case scenario, he can pay the significantly higher costs of sending the goods by air rather than by sea.

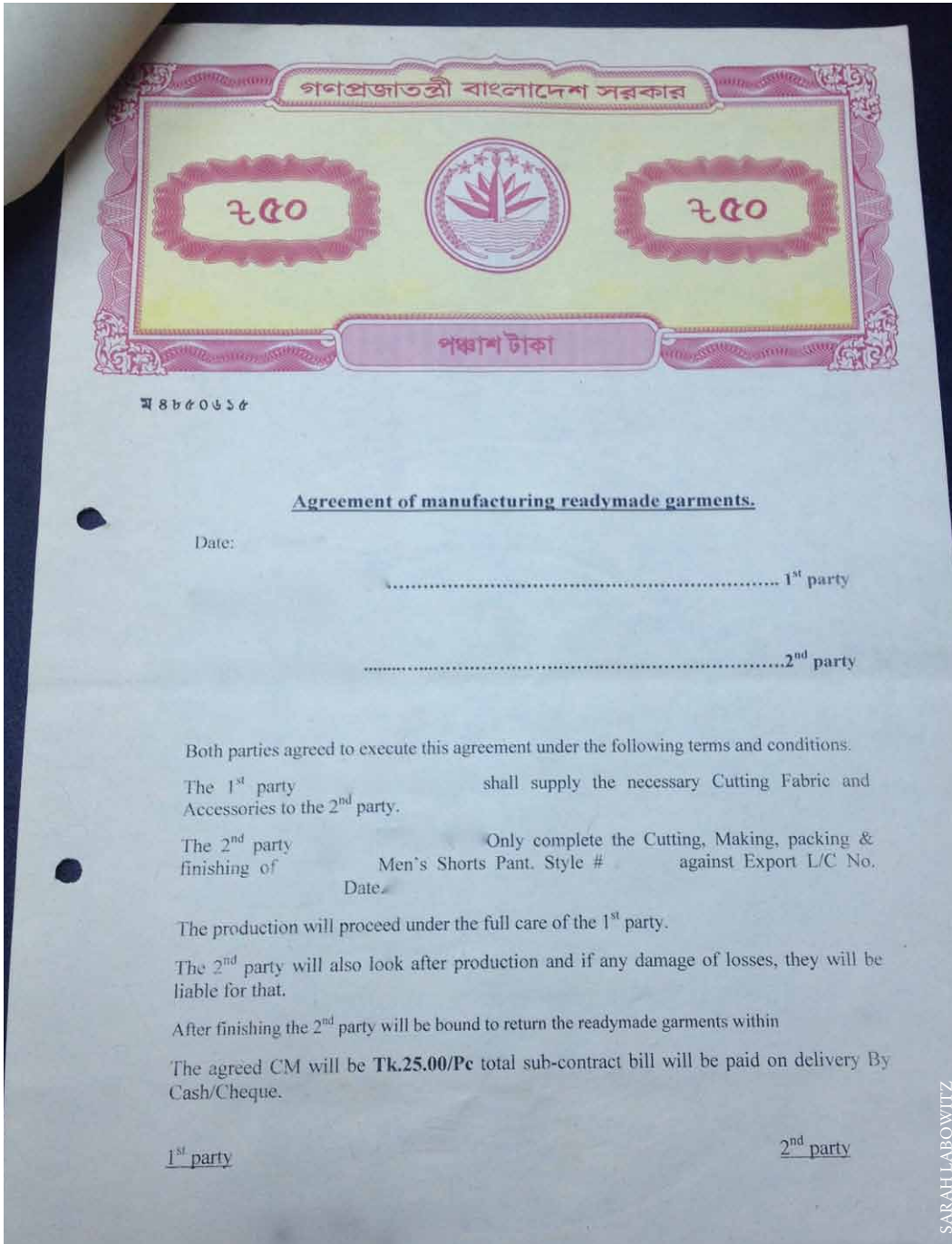
Or he can subcontract.

In our example, let's say the mother factory needed to subcontract 25,000 pieces of the original order. In the best case scenario, the mother factory would announce its need to subcontract to the buyer, which would work with the factory owner to identify a pre-approved subcontractor that meets the mother factory's level of quality and social compliance. A CSR manager for a European brand walked through the process for authorizing a subcontractor, saying, "[The factory] informs the agent they need a subcontractor; we [the CSR team] send the request to Germany and we do an assessment [of the subcontractor]. If the subcontractor meets the minimum standard, then they are in the list" and the order can proceed.

But the process of notification, inspection, and authorization can take a long time, which often does not meet the needs of a factory facing a looming delivery deadline. So in another, more common scenario, the subcontract is negotiated bilaterally between the two factories or through an agent without the knowledge of the buyer. If both factories are members of one of the trade associations, the trade association registers the subcontract through an 'interbond license.' The license is important for certifying that the materials imported duty free remain within the 'bonded area' of export production. The interbond license is a one-page, typewritten form signed by the mother factory, the subcontract factory, and two representatives from the BGMEA or BKMEA.

In addition, the two factories will draw up a short contract specifying the terms of the agreement. In one subcontract shared with the Center for Business and Human Rights, the subcontract was a simple one-page document that contained information about price, quantity, and delivery, but no provisions related to intellectual property, labor compliance, or design.

All transactions up to this point have been conducted in U.S. dollars and based on credit, with the exception of wages and any materials purchased on the local market. Subcontracting transactions are conducted in Bangladeshi Taka (Tk) through local banks on the basis of bills and receipts that are paid directly by the mother factory.



“Both parties agree to execute this agreement under the following terms and conditions: The 1st party...shall supply the necessary Cutting Fabric and Accessories to the 2nd party. The 2nd party... Only complete the Cutting, Making, packing & finishing of 8,000 pieces of Men's Shorts Pant Style #... against Export L/C No... The production will proceed under the full care of the 1st party. The 2nd party will also look after production and if any damage of losses, they will be liable for that. After finishing the 2nd party will be bound to return the readymade garments within (date). The agreed CM will be Tk25.00/Pc total sub-contract bill will be paid on delivery by Cash/Cheque.”

The mother factory sends the required materials to produce 25,000 pieces and a supervisor to instruct workers at the subcontracting facility in design and production specifications. Upon delivery of the 25,000 finished shirts, the mother factory pays the subcontractor in Taka, often through a bank transfer. The subcontracted order is combined with the rest of the order and all 100,000 pieces are transported to Chittagong for shipment.

In the third tier of subcontracting – the unregistered, informal system – documentation and contracting is even looser. In our example, the factory that took the subcontract for 25,000 shirts has also faced production delays. So a mid-level cutting manager at this factory phones a friend who runs a very small, unregistered facility with the capacity to produce 5,000 pieces. The manager negotiates with the unregistered factory owner and they reach a verbal agreement on a price and delivery date. The original subcontractor has now become the mother factory.

Unregistered subcontracting is a cash-based system run on bills and receipts. One set of receipts shared with the Center for Business and Human Rights illustrates how the movement of material and finished garments takes place. If, for example, the sub-subcontracting agreement is for 5,000 shirts, the now-mother factory will deliver the component materials as they are available. The mother factory may only cut 500 pieces of the 5,000 piece order on the first day of production. The mother factory calls the subcontract factory, which is responsible for picking up the available materials, including fabric, thread, and other inputs and accessories. The unregistered subcontract factory then hires a truck or a rickshaw to go to the mother factory to get the materials. One example of a receipt for this kind of transaction follows.

| Sl. No.       | DESCRIPTION OF GOODS | QUANTITY | UNIT  | REMARKS |
|---------------|----------------------|----------|-------|---------|
| 1             | Golden Thread - 2/2  | 90       | Cones |         |
| 2             | Navy Thread - 40/2   | 105      | Cones |         |
| 3             | Elastic - 1/2 cm     | 35       | Rolls |         |
| 4             | Twill Tape - 1/2 cm  | 25       | Rolls |         |
| for sub work. |                      |          |       |         |

Received the above goods in good condition & found no discrepancy

Receiver's Signature: [Signature] Store-charge: [Signature] Addressor's Signature: [Signature]

The delivery ‘challan’ lists the materials that have been delivered to the unregistered subcontractor, including 90 cones of golden thread, 105 cones of navy thread, 35 rolls of two kinds of elastic, and 25 rolls of twill tape. The materials are delivered “for sub work.”

The transport of materials proceeds over the course of several days or a week until all of the inputs for the 5,000 pieces are delivered. At the start of the order, a line manager from the mother factory will visit the subcontractor to demonstrate the proper production process and ensure that production meets its standard. When the order is completed, the 5,000 pieces are combined with the remaining 20,000 pieces of the original subcontract, which are returned to the original mother factory and transported to the port for shipment.

## Appendix 2: The Accord and the Alliance

The following analysis updates the comparison of the Accord and the Alliance included in the Center’s February 11, 2014 submission to the U.S. Senate Committee on Foreign Relations Hearing, “Prospects for Democratic Reconciliation and Workers’ Rights in Bangladesh.” It is intended as a snapshot of the two initiatives at an early stage of their development, not as an exhaustive comparison. The Center’s conclusion is that the similarities between the two initiatives far outweigh their differences.

### Dimension 1: Participation

Both the Accord and the Alliance are comprised primarily of multinational corporations from North America and Europe. The Accord includes two global trade unions as signatories and several Bangladeshi unions. In this respect, it reflects the European industrial relations context, which has been characterized by political involvement through labor parties, worker participation in company decision-making, and relatively high levels of union membership. The Alliance includes the participation of local industry on its board.

|   | Accord   | Alliance  |
|---|--|---|
| <b>Brands and retailers</b>                       | Over 150 retailers. The majority of participants are based in Europe; a smaller group is from the Americas. Also includes Asia’s largest retailer. | 27 retailers. All are North American companies, representing 90% of readymade garment exports to the United States from Bangladesh.     |
| <b>Worker organizations or unions</b>             | Two global union signatories, and a minimum of four unions from Bangladesh   | None  |
| <b>Local industry</b>                             | None   | The BGMEA President sits on the board.  |
| <b>Other participants, observers, or advisors</b> | Four international labor rights NGOs are “witness signatories.”  | “Supporting associations” include several North American trade associations and the NGO BRAC. Li & Fung serves in an advisory capacity. |



## Dimension 2: Decision-making and Governance

Both initiatives have small governing boards with an independent chair. Membership in the Accord's steering committee is split between retailers and unions. The Alliance's board is split between retailers and outside experts. Both have some international staff, as well as offices and staff in Dhaka.

|                             | Accord  | Alliance   |
|-----------------------------|---|--|
| <b>Decision-making body</b> | The steering committee is comprised of 3 representatives selected by trade union participants and 3 representatives selected by retailer participants. The ILO selects a neutral chair. | The board of directors includes 4 brand representatives, 4 outside experts, and an elected chair. The Board of advisors comprises 12 multi-stakeholder industry experts. |
| <b>Staff</b>                | Led by an Executive Director for International Operations and an Executive Director for Bangladesh Operations, with an office and staff in Dhaka.                                       | Formerly led by a President and CEO in Washington, DC; now led by consultants in Washington, DC and Hong Kong, with an office and staff in Dhaka.                        |

## Dimension 3: Commitments

Each initiative is envisioned to last for five years, through 2018. The Alliance requires that members participate for two years; the Accord requires five years, with some requirements for maintaining order volumes for the first two years. If a member company leaves the Alliance, the member pays a financial penalty. If an Accord member is subject to a dispute, the issue is referred to the Steering Committee, whose decision either party can appeal to binding arbitration. Advocates of the Accord have emphasized that this constitutes a legally binding agreement, but it is not clear that the penalties associated with dispute resolution are significantly different from the more straightforward financial penalties contained in the Alliance.

|   | Accord  | Alliance  |
|---|---|---|
| <b>Overall program commitment</b>           | 5 years (2013 - 2018)   | 5 years (2013 - 2018)   |
| <b>Individual participant commitments</b>   | 5 years of participation in the initiative. Member companies commit to maintaining order volumes for two years with Tier 1 and 2 suppliers as long as such business is commercially viable and the factory meets the member company's requirements. | Minimum commitment of 2 years participation in the initiative.  |
| <b>Penalties for leaving the initiative</b> | Disputes between parties are referred to the Steering Committee, whose decisions can be appealed to a binding arbitration process.  | Financial penalties assessed if a member leaves the initiative before the 2-year mark; lesser financial penalties if a member leaves after the 2-year mark. |

## Dimension 4: Program and Approach

In total, the two initiatives encompass 1,894 factories out of the approximately 5,000 – 6,000 factories and facilities we estimate are part of the export garment manufacturing sector in Bangladesh. The two initiatives offer similar programs, focused on factory safety and building inspections, worker training and empowerment, and making funds available for factory remediation. All program activities in both initiatives focus on building and fire safety and do not address broader issues of labor rights, freedom of association, or business relationships in the supply chain.

|                              | <b>Accord</b>  | <b>Alliance</b>   |
|------------------------------|--|---|
| <b>Core program elements</b> | Safety inspections, remediation, fire and building safety training, member-sponsored funding for factory improvements.   | Safety inspections, safety and empowerment training, voluntary loans for factory improvements.  |
| <b>Transparency</b>          | A single aggregated factory list was published on October 3, 2013 and is updated on an ongoing basis. Inspection reports will become public within a maximum of 6 weeks after the inspection. The stakeholders of the factory are informed at least 2 weeks after the inspection, except in the event of immediate danger, when they are informed immediately. | Since October 2013, an up-to-date factory lists is released every month. Inspection reports will become public after a remediation plan has been agreed, or in case of imminent danger. |
| <b>Factories covered</b>     | “All suppliers producing products for the signatory companies”; approximately 1619 suppliers across three tiers.   | “100% of factories in the members’ respective supply chains”; approximately 626 factories.  |

## Dimension 5: Fees and Funding

In both initiatives, corporate participants make an annual contribution based on dollar volume of exports to cover the inspection and training programs and operational expenses. A heated debate is now playing out about who will pay for the necessary remediation efforts identified through inspections. Our conclusion is that for all practical purposes, both the Accord and the Alliance put the burden of funding repairs on factory owners, with the option of financing from brands to be negotiated bilaterally between Alliance and Accord members and their suppliers. Neither initiative imposes a firm obligation on brands to fund repair of safety deficiencies uncovered by their audits, but both initiatives require factories supplying their members to be in compliance in order to continue to receive orders. This means factory owners are caught in a Catch-22. They are required to be in compliance in order to maintain relationships with Accord and Alliance members, but if they cannot afford the remediation the initiatives determine is necessary, no one is obligated to assist them.

|  | Accord   | Alliance   |
|--|--|--|
| <b>Participant fees to support core programming and operations</b> | Company signatories make a maximum annual contribution of \$500,000 on a sliding scale basis relative to volume of sourcing from Bangladesh. Fees cover safety inspections, trainings, and operational expenses.   | Members contribute up to \$1,000,000 per year to a Worker Safety Fund. Fees are assessed on a tiered basis, based on dollar volume of exports in the previous year. Fees underwrite fire and building safety initiatives in factories supplying member companies and operational expenses. |
| <b>Additional costs to support factory-level remediation</b>       | Factory owners are responsible to pay for structural repairs or renovations in factories where remediation is required; brands have agreed to find funding if the owners cannot afford renovations.  | Individual members may make affordable financing available to suppliers in their individual supply chains to help finance factory repairs and improvements on a voluntary basis. Terms are set by the individual member company.   |
| <b>Support for displaced workers during remediation</b>            | Factories must continue paying workers for up to 6 months during the remediation period. Signatory companies shall make reasonable efforts to ensure that displaced workers who cannot return to their original job can find employment with safe suppliers. | 10% of fees directed to the Worker Safety Fund are reserved to support temporarily displaced workers.  |

## Appendix 3: People Consulted in Our Research

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This is a mostly-complete list of the many people who shared their time and expertise with us in the production of this report. Thank you to all of them.

A.B. Siddique Khan, Rio Fashion Wear Limited  
Ahmed Sohail Fasiur Rahman, Beximco Group  
ABM Monwarul Islam Bhuiyan, Glister Tex Sourcing  
Afshana Choudhury, BRAC University  
Alonzo Glenn Suson, ACILS  
Ambassador Dan Mozena, U.S. Embassy Dhaka  
Americo Beviglia Zampetti, Delegation of the EU to the UN  
Amy Luinstra, International Finance Corporation  
Andrew Morgan, Untold  
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