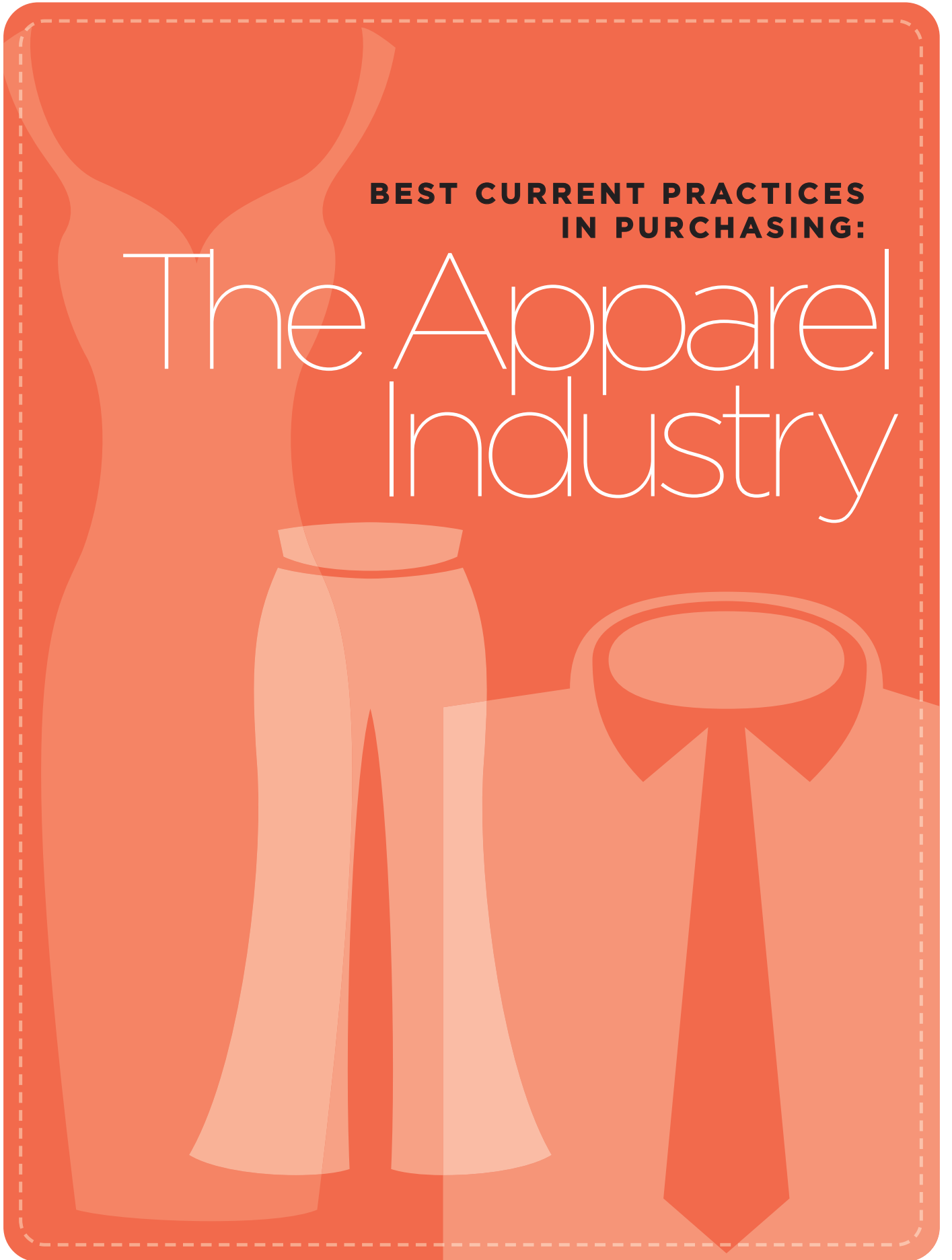


**BEST CURRENT PRACTICES
IN PURCHASING:**

The Apparel Industry



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As You Sow is a nonprofit organization, founded in 1992, dedicated to increasing corporate environmental and social responsibility. Its Corporate Social Responsibility Program is one of the nation's leading proponents of shareholder engagement providing research and advocacy to catalyze positive change within publicly held companies. www.asyousow.org

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Best Current Practices in Purchasing: The Apparel Industry

For the past 15 years, many apparel companies have been actively monitoring their supply chains. Throughout, the majority has looked to factory owners and managers to make changes in factory conditions and operations to comply with local laws and meet brand compliance requirements. To meet requirements, demands were placed on suppliers to increase wages, minimize excessive overtime hours, secure freedom of association, and improve health and safety systems for workers. Simultaneously, brands were dictating lower and lower prices for products. Increasing demand for products at lower prices frequently prevents suppliers from having the resources necessary to abide by the standards laid out in codes of conduct.

More recently, labor activists and socially active investors have turned to the inner workings of apparel companies to see how the companies' activities have had an impact on factory conditions. A study by Oxfam UK concluded that “[u]ntil companies recognise that their own sourcing and purchasing practices are one of the root causes of poor labour standards, they will not resolve the problems in their supply chains.”¹

Many of the compliance violations whose root causes were considered to be in the hands of the factories are now being traced back to corporate purchasing practices. The MFA Forum conducted research “to identify the practices among brands that most significantly undermine manufacturers’ ability to comply with the brands’ codes of conduct.”² The researchers identified six practices that had the most impact on compliance violations: unstable relationships, downward pressure on prices, increased quality demands, shorter time pressures, changes to orders, and cancellation of orders.³ Each of these behaviors is encompassed in the purchasing practices of a company and underscores that improving purchasing practices makes it easier for suppliers to comply with codes of conduct and, hence, creates more favorable conditions for factory workers.

In addition, improving purchasing practices not only minimizes compliance violations but also saves companies on their total costs of bringing a product to market, moves a product to market faster, improves quality and prevents burn out. A study by Acona found that “More commonly ethical breaches are driven by failures that are also commercially undesirable.”⁴

Because of the relationships between commercially undesirable practices – practices that increase costs – and those that have negative impacts on working conditions, brands have increased their efforts to examine and adjust these practices. Doug Cahn, former VP of Human Rights Programs at Reebok International finds that, “Thoughtful companies will find ways to identify and measure the negative impacts of their purchasing practices on factory workers and take steps to mitigate them over time.”⁵

The following report presents how apparel industry leaders have made changes to their purchasing practices – and even their corporate structures – in continued efforts to improve working conditions in factories and to reap the benefits of having an effectively managed supply chain. The report is based on interviews with seven companies: Gap Inc., Jones Apparel, Levi Strauss & Co., Nike, Nordstrom, Phillips-Van Heusen, and Timberland. These companies were identified by members of the Interfaith Center on Corporate Responsibility as innovative leaders in Purchasing Practices.

The report looks at changes in corporate culture, designing and buying, forecasting, production management, and pricing. For the companies highlighted here, and also for those not interviewed, improving Purchasing Practices is a work-in-process and many of the programs mentioned in this report are in the pilot phase or recently implemented. As such, the full implications of these changes are yet to be seen.

Corporate Culture

Leaders in the apparel industry recognized that if compliance is a division unto itself, then it functions alone. Integrating corporate responsibility and sustainability throughout the supply chain, instead of as a separate “add-on” has significant impacts on compliance and cost-savings. Linking factory performance to headquarter staff’s annual reviews, and training management and staff on compliance issues further integrates responsible practices into corporate culture.

Industry leaders have moved corporate responsibility and/or compliance into their sourcing business units. A significant change came at Levi Strauss & Co. when “each global sourcing team became accountable for social and environmental standards.” Nordstrom realigned its independent Corporate Social Responsibility (CSR) team into each of its business units – Men’s, Women’s, Footwear, etc. The CSR experts now “sit with the brand and the team and they have a dotted line reporting into the Director of Supply Chain responsible for sourcing decisions.” Nordstrom finds that this fosters “consistent messaging and standards.”

Companies also link factory performance to management performance reviews and compensation. At one company, “many people at various levels of the organization have social and environmental sustainability targets included in their work plans, and they are evaluated on them annually. Bonuses and annual increases are dependent upon achievement of all targets, including those related to sustainability.” Gap Inc. has begun to tie factory compliance to performance of production personnel at the Vice President and above levels.

In order to evaluate corporate staff and management on compliance issues, training is necessary. Staff must understand the “bigger picture” of the true and total cost of bringing goods to market. Phillips-Van Heusen considers it important that training in the ripple-effects of purchasing practices be extended throughout the company. Managers in all divisions as well as retailers “need to understand the impact of late decision making and how the supply flows are affected. Because it is a very competitive market, it is hard [for a brand] to upcharge a retailer for late decisions, the retailers have the upper hand.” The company further noted that “retailers today have been having some of these same issues with their private brands and are clearly learning from their own experience and have shown significantly improved attention to timelines.” To enhance training within the brands, Gap Inc. is using simulations in which trainees “have to make decisions and see the impact of the downstream affects of their decisions.” These trainings are offered to new hires and in the development of new managers. At Levi Strauss & Co., in-coming or newly hired designers and merchants receive product management training and social and environmental sustainability education that “underscores how even the smallest decisions can directly affect a factory’s ability to meet our Terms of Engagement.”

Levi Strauss & Co. internally evaluates product management and manufacturing staff on social and environmental sustainability issues, and is in the process of developing a supplier-rating tool which will allow contract suppliers to rate the company’s performance. “When we’ve asked for feedback from our suppliers, we’ve discovered that sometimes the best insights actually come from the people working in the factories.” By talking to suppliers, Levi Strauss & Co. headquarters has learned that in some cases “our expectations simply haven’t been realistic. But when suppliers are offered the chance to provide feedback, we’ve seen how our decisions play out at the factories, and from there, expectations begin to change.”

Designers and Buyers

Designers and Buyers are responsible for one of the most dramatic causes of compliance violations – last minute changes to either the design or quantity of an item. The last-minute nature of their decisions is intricately related to the essence of fashion. The need to be on the cutting-edge pushes designers and buyers to want to make changes to designs, trims, quantities, and colors as close to market as possible in order to respond to the latest trends.

Designers

Designers at Gap Inc. and other companies are “in the market looking at what is going to be the next big thing and building products based on those inputs.” In order to avoid last-minute design changes, Gap Inc. has created an “orchestrated dance where every day is mapped with the tasks to bring the product to market. The design team works within the calendar. There is a checklist of who does what and when. The designers are familiar with the vendor base and its capabilities. The production team sits with them and educates and guides them from the standpoint of ‘yes, you want to make this sweater, but we can only make it for December, not November’.” By implementing this element of production capability into the design process, designers are not creating pieces that cannot be produced within a reasonable schedule.

Nike has taken a different approach to minimize last minute changes. The company is exploring “setting a palette of standards for designers. Instead of every component of a shoe being redesigned each time, standardization helps with efficiency, engineering, and waste, as well as time-to-commercialize. This all makes a difference. Standardizing 40-50% of the shoe – the parts the customer wouldn’t recognize – helps downstream decisions. It helps, for example, in the manufacturing where you can reuse the cutting dies for each size and use standardized components.” This has the potential for huge cost savings both for Nike and its suppliers, as well as saving time in the manufacturing cycle. Nike noted that this type of standardization is more difficult for apparel than it is for footwear.

Although not through standardization, Gap Inc. has noticed that “less complexity in a product is correlated with fewer overtime hours.” Timberland is looking to “longevity” for its apparel products. By designing styles and using fabrics that are “classic Timberland” the company is able to utilize “base fabrics and styles that will repeat every year. Longevity of fabrics enables us to book raw materials in advance on 55% of our main line styles. Booking raw materials ahead of time gives us flexibility in the supply chain so that we aren’t pushing last minute and decreases risk to us and our vendors.”

Buyers

The two primary areas where buying decisions have an impact on compliance are initial sourcing decisions and last minute changes.

Supplier reviews help to both inform buyers of factory capacity and identify order patterns that have a negative impact on compliance. Nike found that looking at the capacity of factories and helping them better plan their production flows makes a big difference. Gap Inc. found that in pre-screening factories “most capacity analysis is focused on quantity, not capability” and that both need to be taken into account. When looking at the capabilities of a new factory, Nordstrom sends “quality engineering people to ensure the factory is capable of doing what they say they are, and that they have the equipment, staffing, capacity, etc.”

Nordstrom focused “on planning. [They initiated a pilot that] allowed us to give the factories a capacity plan. We have time periods where we need to tell them by a certain date if we need to reduce the order, and if it is beyond that date, we will pay them for the lost time.”

To help avoid overbooking factory capacity when a number of Gap Inc.’s brands are sourcing from the same factory, the company noted that “it had recently developed a tool that should help it gain better visibility across multiple business units to its total sourcing picture with a vendor. That visibility will help facilitate coordination so that vendor can better manage its production.”

Sourcing decisions are often based on the extent to which rule of law exists and is enforced in the country where factories are located. Rule of law in the country from which a company sources has a significant impact not only on the factory’s ability to meet buyer purchase orders, but also on compliance. Nike does “an in-depth analysis before going into a new country. Countries that have a greater rule of law are more apt to have better working conditions in their factories.”

All of the above practices inform buyers’ initial sourcing decisions from factories and facilitate those orders being executed in a timely, high-quality fashion.

Another practice buyers can modify to improve purchasing practices is last-minute changes. Last-minute changes shorten the available manufacturing production time and force suppliers into an often-untenable situation because they want to meet the needs of the brands, but have limited time to do so. As a result, there is a risk that workers could be forced to work excessive overtime to meet deadlines and not receive an overtime premium because the buyer wants the change for no additional charge, even if this violates the vendor agreements. To reduce these strains on suppliers, Gap Inc. is implementing a new “social responsibility training to all production, sourcing, and merchant teams where we focus on how to make decisions better and differently that affect the workers in a positive way.”

Forecasting

Some of the challenge for buyers is a function of the accuracy (or inaccuracy) of forecasting. Forecasting is an art as much as it is a science – and no leaders in the apparel industry have a guaranteed system for forecasting demand for designs, quantities, sizes, or colors. Forecasters – like designers and buyers – also benefit from last-minute decisions because it allows them to amass more intelligence from the market and incorporate current data into their calculations.

Forecasts are based on prior years’ sales and analyzing trends in the current market. For this reason, it is possible to develop more accurate forecasts around core, or “classic,” styles and products. Nike uses a “demand-pull” for its core products (approximately 200 out of 900 products) and thereby “reduces inventories through the entire chain. As retail sells them, we replenish them.”

Gap Inc. is testing a new forecasting tool that “takes us to a more micro level and breaks it out more finitely to better plan capacity and resources which will, in turn, improve everything that goes into manufacturing.” Today, forecasting is seasonal, but the tool will enable them to “give suppliers monthly numbers and also get to the level of women’s tops and women’s bottoms instead of women’s units.”

The challenge in forecasting is evident in one company’s efforts to bypass it as much as possible. Marsha Dickson, Professor and Chairperson, Fashion & Apparel Studies at the University of Delaware, recounted that “Zara shortened its lead times and created a “fast fashion” approach. Zara puts small batches of merchandise in the stores very frequently. No reorders are allowed, there is no forecasting of high volumes, and there is not too much lost if the style is a dud.”⁶

Production Management

Technology enables brands to implement management tools that improve communication and transparency throughout the product life cycle – from designing through sample-making, order placement, production planning, workflow management, sample approvals, and tracking of shipment documentation. Leading brands are using web-based technology, capacity management, and scorecards to manage the production cycle.

Product Lifecycle Management

Looking at the entire lifecycle of a product enables decision-makers to better understand the ramifications different decisions, behaviors, and practices have on the total cost of goods, the timely delivery of goods, and the working conditions in factories. Product Lifecycle Management (PLM) tools encompass all of the processes that need to be undertaken to deliver a product to the store.⁷ Today, the best PLM products are web-based. These web-based products enable people at all points and locations in the supply chain to input the required data/approvals/action items and allow managers to best circumvent bottlenecks and manage the pipeline from the office, factory, or remotely.

Gap Inc. is in the process of doing a “life cycle analysis that identifies key decision-making points for which we can provide guidance and coaching that should result in improved decision-making that will affect the workers in a positive way. We are coming up with more formalized ways of teaching the brands to look at total life cycle in order to do their jobs better.”

Implementing a PLM tool has allowed Nike to “break its business model into multiple supply chain models. This gave us more predictability and performance across the supply chain. We now run 80% on-time, quality is better, inventory and work-in-progress are lower, and we feel like there are fewer compliance issues. Before we implemented the PLM tool, 8% of our product used to get air-freighted. Now it is less than 1%. That is an 80% reduction in air freight cost.”

Capacity Management

Technology also allows brands to better manage capacity in the factories from which they source. Timberland uses “two internal process systems developed to manage their resource workload – one for development and one for commercialization. For production there is a production plan and capacity commitment process based on agreed-upon factory capacity levels that are based on working hours that comply with local labor law. To determine the accurate capacity amounts, we did a lot of benchmarking with our factories to determine the exact time it takes to execute the different manufacturing procedures.” Timberland found this system to yield fewer overtime hours.

Timberland also uses “data from supplier reviews and audits to better manage how they match orders to supplier capacity. This minimizes overtime, outsourcing, and compliance violations that suppliers often resort to in order to be able to deliver on orders for which they do not have capabilities to meet.”

All brands operate on seasonal demand and there are periods of “peak production” for the suppliers. Gap Inc. uses technology “to look at seasonal swings ... to look at how to smooth out production volume, and to determine how they can use a facility during “off”-periods.” Gap Inc. found that “vendors appreciate assistance in managing production flows and trying to keep lines full as consistently as possible.” For its larger-volume styles, Timberland “produces 50% of the volume early and gets them out of the peak period. That helps us to level load, take stress out of the production cycle, and gives vendors a more efficient manufacturing volume.”

Scorecards

Scorecards are used for pre-evaluations of facilities, capturing the technical capabilities of suppliers, tracking the quality of product produced, monitoring customer service, encouraging innovation, as well as tracking adherence to codes of conduct. They also help raise a factory’s awareness about how it is or is not meeting key performance indicators set by brands.

Nike is using its balanced scorecard to “include direct correlations between business processes and resulting excessive overtime on the factory floor.” Gap Inc. and others are beginning to use scorecards to “demonstrate to vendors that good performers get rewarded and get our business.” Many companies have “preferred” or “designated suppliers” that are awarded by their grades on the scorecard. These preferred supplier programs are a reward for meeting compliance and delivery benchmarks. It is critical that the process by which such status is determined is transparent in order to prevent unwarranted favors or penalties.

One company is expanding its scorecard beyond compliance and using it “to give factories an opportunity to tell the company how it can improve the way it works with the factory. This “reverse scorecard” was piloted with 50 factories to look at communication issues, technical support, time-and-action calendars, and partnership issues. The results were varied because most factories do not want to say what the company is doing wrong.” The company hopes to put it into place with all the factories from whom it sources and to continue to build trust with its suppliers in order that they are comfortable being honest with their reviews. This will provide data points with which to improve its work processes with its suppliers.

Pricing/Costing

Buyers are under pressure to earn the highest possible margins on their product lines. Traditionally, many brand buyers would determine the price they believe retailers will pay for a product, subtract the profit they want to earn and their shipping costs, and then calculate the product-cost they are willing to pay their suppliers. MFA Forum’s research revealed, “one buying house stated that they get quotes from Bangladesh in order to negotiate lower quotes in Turkey and China.”⁸ This does not take into account the costs of production in different locations. The increased stress to produce for unsustainable prices causes significant compliance violations in the factories.

Costing

Because the prices for raw materials, overhead, and logistics are often perceived as fixed, without a product management, or lifecycle, approach to pricing, suppliers often resort to meeting buyers’ demands by squeezing the variable costs they control – including wages, benefits, and working conditions. This has frequently resulted in wages, labor standards, and environmental health and safety protocols being compromised.

Brands are encouraged to base their prices on cost-accounting methods that abide by local laws and international standards and minimize costs through proactive production management, human resources management, and worker empowerment. Nordstrom looks “at current wage rates, what the standard is by country and region, and uses that as a baseline. If the worksheet differs from current rates, we investigate why.”

Gap Inc. utilizes a “component costing system that sources fabrics and trims more efficiently and uses them more efficiently to get better at getting to the cost of the product with better quality at the same time.” One company also incorporates cost into design, and provides the example, “you can say to a designer you love the concept of a sweater made of a synthetic fabric, but polyester has a 30% duty while cotton has a 16% duty when brought in to the U.S. So when you add the materials, transport, and duty – you have 80-95% of the price of the product. Showing this to designers allows you to change design elements that enable you to save on costs.”

Another scenario that causes challenges for pricing is when prices are negotiated at the beginning of the season, often before designs are finalized, forecasters have determined quantities, or buyers know which design details will be popular with consumers. As a result, many changes can come into play after the price is agreed upon. Typically, contracts do not cover the price of any additional costs that these company-made changes to production demand. To mitigate this, Nike works with the factory and “evaluates a variety of scenarios with the aim of costing product at a rate that allows Nike and the factory to make a profit while meeting obligations to the factory’s workforce.”

Wages and Overtime

As one of the few variable costs controlled by suppliers, wages often suffer in order for suppliers to deliver product for ever-increasingly competitive prices. Purchasing practices and cost-accounting methods have significant impact on what workers are actually paid. Often poor wages are a function of poor purchasing practices, but even in cases of good purchasing practices brands are challenged to ensure fair wages for factory workers and NGOs continue to push them to go beyond payment of the national minimum wage towards a living wage. Companies such as Gap Inc. note that “getting prospective vendors to pay minimum wage is still a big step. The first step for the industry is getting everyone to comply with the law, which is a basic must-have for a factory to work with us.”

To stress the importance of good factory management, Gap Inc. noted that in a “well-managed factory, a higher wage does not necessarily translate into a higher price paid per unit.”

Overtime most often results from a factory accepting more orders than it has the capacity to produce or last-minute changes to orders that require employees to work overtime in order to make ship-dates. As part of an effort to minimize overtime, Nike “created an overtime tracking tool. The tool tracks overtime hours on a daily basis and pinpoints an area of concern and the root cause that contributed to it. The goals are to help with the upstream decision-making, be transparent, and implement solutions.”

Although industry leaders have started to share data and offer additional support to suppliers, companies need to take responsibility for their practices that force suppliers into excessive and underpaid overtime situations.

Unfortunately, given all of the effort it has put into the issue, Nike acknowledges that “some level of overtime is going to be part of the industry.” Other companies, too, mentioned that even the best practices in purchasing cannot prevent overtime and overbooked capacity 100% of the time due to shared factories, factory closures, and other economic conditions.

If, as Nike and others claim, overtime will remain a part of the industry, the real challenge for companies is to use best practices in purchasing to minimize the amount of preventable overtime and ensure that additional funds are available to pay workers for overtime when that overtime is a result of purchasing decisions made by the company.

Conclusion

Although best current practices in purchasing highlighted in this report often lead to decreased costs and reduced compliance violations, they are not a “silver bullet” for the apparel industry. While poor purchasing practices put strains on suppliers that often result in aggravated working conditions, better purchasing practices do not necessarily result in better conditions for workers without suppliers also taking action.

Even with the best purchasing practices, suppliers have a decisive role to play and must take responsibility for the elements under their domain that also affect workers – including the condition of machinery, efficiencies in the production line, and good management practices that ensure (among other things) that when brands pay fair prices those revenues are passed on to workers and are not pocketed by management. It is critical that brands continue to improve their purchasing practices. At the same time, they must continuously improve transparency and communication with their suppliers in order to ensure that the suppliers are also participating in improving the conditions in their factories.

Leading brands and retailers continue to make changes to purchasing practices that will mitigate compliance violations, improve conditions for factory workers, deliver product faster, and reduce overall costs. These are, for the most part, nascent efforts and the companies are eager to see additional results of their actions and continue to modify them in order to yield continuous improvement in compliance areas and cost reduction.

All brands can integrate best practices from the companies interviewed and continue to push internally to:

- 1) Implement product lifecycle management (PLM) systems and policies. Focusing on the full lifecycle of a product enables all actors in the supply chain to understand the time they have and the time they need to complete their stage in the production process, increase speed to market, adhere to drop dead dates, and save money. PLM implementation can be linked to individual and / or departmental bonuses to better assure its success.
- 2) Adopt, at minimum, activity-based or component costing for pricing. Being able to build a price from the “costs up” enables companies to negotiate truly fair prices with their suppliers. It is also recommended that brands and retailers move towards a Total Cost Management (TCM) system. TCM is “a systematic approach to managing cost throughout the life cycle of any enterprise, program, facility, project, product, or service.”⁹ In the apparel industry, TCM takes into account the total costs of getting an item from the raw materials stage to the stores and incorporates each cost into the price of a product.

- 3) Manage through technology. The development of web-based tools for project and capacity management, tracking, sampling, forecasting, and traceability enable two-way communication from headquarters to suppliers. Brands are aware of where each order is in its production cycle and factories can communicate with brands regarding expectations and needs in order to meet their commitments. Utilizing simulation tools in employee trainings enable company employees to learn the downstream affects of their decision-making processes.
- 4) Integrate best practices in purchasing into the corporate culture. Train and incentivize executive staff on the social health of factories producing product for the company as well as on meeting productivity and budget criteria. Train all participants in the production cycle to understand how their decisions impact factory workers and the total cost of products, and develop trust with suppliers so that they can provide honest, substantive feedback into the success of corporate practices.
- 5) Insist on best practices with retailers. Retailer pressure creates a bullwhip effect on brands and, in turn, factories. The best current practices featured in this report were gleaned from brands and vertically-integrated retailers managing production. However, for a retailer who is buying other brands' products, the timing of purchases, approvals, size breakdowns, cancellations, etc. affect each brand's purchasing practices, supplier's ability to meet compliance requirements, and the cost of products.

Resources:

Organizations:

Business for Social Responsibility <http://www.bsr.org/>

Ethical Trading Initiative <http://www.ethicaltrade.org/>

Fair Labor Association <http://www.fairlabor.org/>

MFA Forum <http://www.mfa-forum.net/>

Oxfam <http://www.oxfam.org.uk/>

Reports:

Business for Social Responsibility. "Beyond Monitoring: A New Vision for Sustainable Supply Chains."
http://www.bsr.org/reports/BSR_Beyond-Monitoring-Report.pdf

Ethical Trading Initiative. "Purchasing Practices: Marrying the Commercial with the Ethical."
<http://www.ethicaltrade.org/resources>

Insight Investment and Acona. "Buying your way into trouble? The challenge of supply chain management."
http://www.insightinvestment.com/Documents/responsibility/responsible_supply_chain_management.pdf

MFA Forum. "Assessing the Impact of Purchasing Practices on Code Compliance: Bangladesh garment industry (Case Study)."
<http://www.mfa-forum.net/themicworkinggroups/PurchasingPractices.aspx>

Oxfam. "Better Jobs in Better Supply Chains."
<http://www.oxfam.org/sites/www.oxfam.org/files/b4b-better-jobs-better-supply-chains.pdf>

Oxfam. "Trading Away Our Rights: Women Working in Global Supply Chains."
<http://www.maketradefair.com/en/assets/english/taor.pdf>

¹ <http://www.maketradefair.com/en/assets/english/taor.pdf> p. 83

² <http://www.mfa-forum.net/themicworkinggroups/PurchasingPractices.aspx> p. 1

³ <http://www.mfa-forum.net/themicworkinggroups/PurchasingPractices.aspx> p. 1

⁴ Ethical Trading Initiative. "Purchasing Practices: Marrying the Commercial with the Ethical." 7 July 2004. p. 8.
<http://www.acona.co.uk/>

⁵ Doug Cahn, personal correspondence, 18 May 2008

⁶ Marsha Dickson, personal correspondence, 9 March 2008

⁷ <http://www.product-lifecycle-management.com/>

⁸ <http://www.mfa-forum.net/themicworkinggroups/PurchasingPractices.aspx> p. 10

⁹ http://www.aacei.org/tcmfree/TCMFramework_WebEdition.pdf p. ix



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