

TRANSPARENCY, Compliance and Ethics are Needed in the Global Supply Chain

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The last few years have been an awakening for business and consumers on what globalization, unrestricted trade, and all out web communication really means—both the good and the awful—with dire consequences for consumers and society. Is the source of this technology complexity, or human dynamics? Yes!

But also, the source emerges from a lack of an ethical foundation—not values—though that has been an issue in several recent scandals. Then there is the issue of transparency, poor judgment and lack of knowledge about suppliers, the detailed nature of business transactions, and the unintended consequences of myriad business decisions that were not well researched. Lack of visibility, end-to-end of the supply, and poor technology for visibility and security disable our ability to reach a sustaining ethical foundation to many of our global business activities.

[See Ann's interview on SupplyChainBrain](#)

Ethics needed

We tend to think of business ethics issues today as largely associated with financial scandals. We tend *not* to think about supply chain management, as a function or profession, particularly plagued by illegality. Yet the supply chain is rich with decision making that can lend itself to a variety of 'temptations' in situations such as:

- winning a contract to become the supplier of choice,
- having your location winning the bid for the new factory,
- cutting corners to meet production schedules,
- disgruntled employees looking the other way as products are pilfered or tampered with,
- letting poor quality work pass by,
- distributing and shipping products to customers with 'after sale dates' or expired products, or
- talking about sensitive business topics in social settings with 'friends'.
- Delaying needed process or technology upgrade to assure security in business transaction.

Lack of scrutiny of supplier agreements: undocumented product material changes; lack of employee certifications in manufacturing, handling, and servicing products; and other lax behaviour all expose your firm—and more importantly, your customer—to possible harm. The ROI focus, although most critical to business, sometimes clouds our judgment on needed process changes to avoid harm.

And in all fairness, we are just too busy to focus in on details which often come to us in the mountains of paper work—valid business transactions that we deal with daily.

Too Global

When the outsourcing movement began in the 1990s, terms like collaboration and trust were bantered about quite a bit. But of late, concerns have taken centre stage about whether trust will be ultimately possible to achieve with globalization.

Intellectual property theft between manufacturers is growing. Examples include an auto manufacturer's workers being arrested for allegedly selling crucial car technology on various models to another manufacturer. Korea's National Intelligence Service identified 101 such cases of industrial espionage between 2003 and May 2007¹ with billions of dollars in losses due to corporate espionage in automotive, high tech, etc.

Nor do we invest much time in the review of our supplier sites to determine unsafe/hazardous working conditions.

Most emerging nations—the upstream of our supply chains—have daily occurrences of major illicit activity and ongoing bribery activities. Even countries such as China now provide bribery statistics with 17,084 bribery cases² announced last year. Each year the World Economic Forum puts out reports on the best trade attractive countries³, free from bribery, strong protection of property and consumer rights, and transparency of the legal system. Many of the strongest manufacturing nations do poorly on this independent rating.

When problems hit, a majority of companies deal with them quietly, shunning the press and public exposure, which they believe may magnify their problems. They fear that mistrust by the public will lead to loss of revenues. Therefore, statistics don't reflect the totality of the problem. In many examples, these ethical and criminal violations came from upstream supply chain situations, probably unknown or not understood by the prime supplier⁴. We spent a lot of time at several sites looking at recalls and various reports on product integrity issues—from seizures at the border, to FDA recalls. It doesn't look good. The number of incidents has gone up, as of late. This may, in the short run, be due to shining the spot light on the problem, which was swept under the rug in the past, and by the creation of agencies, reporting, and awareness. There is both a financial and reputation impact, though, to firms. Although generally, by the letter of the law, prime suppliers are not responsible for their supplier caused errors, they most often do shoulder most of the recovery, legal (biggest target for litigation), and reputation costs. Customers, often the most damaged, do not even know the name of the suppliers who corrupted the products.

Leading brand companies may not be legally responsible, and might even have insurances to offset the financial costs of recovery, but they still assume the 'leadership' role in recovery. Although companies may have codes of conduct and compliance programs, particularly in regulated industries (i.e., pharmaceutical, aerospace, medical devices, etc.), these 'documents' might be collecting dust, rather than providing a vital process and a real aid to securing the supply chain and the safety of customers. And recent pharmaceutical breaches have shown that even in regulated industries we lack transparency, knowledge, compliance and technologies implemented to avoid these incidents.

¹ Reported in *Financial Times*.

² Li Yubin, deputy director of the leading group on combating commercial bribery under the Central Committee of the Communist Party of China.

³ World Economic Forum Global Competitiveness Report

<http://www.weforum.org/en/initiatives/gcp/Global%20Competitiveness%20Report/index.htm>

⁴ By prime supplier we mean the brand company or original manufacturer. The reality is that fraud is often an inside job. Theft by employees on delivery routes, in warehouses and at factories accounts for a large percent of 'ethical violations' for many companies.

Fix it at the Source

Multiple constituencies are affected by ethical breaches; and the impact, cost, and challenges to recover become greater once products reach the marketplace. The affected population grows from one supplier or one disgruntled office worker with access to customer records, to multiple retailers, and on to potentially millions of customers.

So why are companies not more proactive before problems start—starting with their suppliers and employees where *containment* can often prevent disaster? Senior management usually is not involved in a large percentage of procurement activities, and often firms change contract suppliers frequently, seeking ‘one time buys, cheaper sources, or use middle men. These practices ‘shield’ buyers from the operational execution of sourcing, funding, and shipping product to market.

Even in established relationships, a code of conduct might be shipped to a supplier, but that is as far as it goes. Product standards are not documented and communicated to the complete upstream supplier. An awareness program of the reasons for these standards is not conducted.

Legislation and standards are lacking for the manufacturing of hazardous by-products and waste. In fact, some firms in developed nations have outsourced these hazardous facilities and processes to nations without such standards in order to avoid the implications in highly regulated societies.

We have found that many employees programs in firms to be lip service exercisers. We have recently seen what we once thought of as reputable firms—rating agencies—join the worst company lists of the corrupt, egging employees on to increase bottom line performance at the cost of ethics and damage to millions of customers and society.

No profiles in courage awards or whistle blower status seem to be in the offing this year!

Non-integrated processes are part of the issue. Even with the best of intentions we can just barely see. And that is where technology can be a big help.

Why do anything?

The costs and number of ethical breaches have been increasing. Many companies that have borne these costs then turn to various solutions, sadder but wiser. Their proactive industry peers head-off such experiences through strong compliance, culture, and fair labour practices, and implementation of technology solutions to provide visibility and safety. However, the full extent of exposures is often not known until companies begin to develop solutions that address these concerns⁵.

So, what can be done in order to grapple with far flung supply chains, where operations are fragmented and decision making is ‘on the floor’ with outsourcing partners, contract workers, etc.

The problem really needs to be looked at from several vantage points.

Expanding Concerns in Supply Chain Ethics. In terms of adherence to national and global laws, most companies think they have programs. But regulations keep changing, and we often don’t know what our brokers and middlemen are up to. SOX, although considered drudgery and non-value-added by many, actually has many ethical guiding lights on corporate responsibility and behaviour. SOX and the U.S. Sentencing Guidelines put a

⁵ Consistently supply chain consultants uncover breaches in data, process, and criminal behavior in operations, as projects unfold.

premium on creating an environment of review and a structure that embeds these reviews within the corporate processes. But in addition, firms need to put in place programs that reach multiple levels. If the executives now feel 'on the hook' for financial compliance, that is good. But what about the whole organization? Major corporations would not be putting in security technologies like RFID if they did not feel like their own employees were not helping themselves to the corporate assets. These frauds and thefts can be addressed beyond surveillance approaches to get at the root causes, such as integrated data systems that record work in progress, working conditions, incentives, and compensation, as well as educating employees on the laws and consequences.

Trade regulations are often violated, with firms that are unaware that they are doing so, with raw material not sanctioned in certain trade blocks, paperwork not filed, and their end products sold to companies that are on the denied parties list (or even competitors and illicit counterfeiters who 'reverse engineer' products, stealing their designs). Although these regulations can be dense, there are technologies that help firms to avoid trade violations in importing and exporting⁶, as well as to help them avoid customs and duty charges.

Supply Chain Ethical Alignment. As mentioned earlier, not much is done today on the procurement side of the business to deal with suppliers and rewards (and punishments) for breeches. Even in most contract organizations in emerging nations, the management and owners of these operations are highly susceptible to incentives—the old carrot and stick. Creating compliance and audit programs with real substance, quality standards, and educational programs can be done, with legal rewards versus bribes, such as bonuses for quality and timeliness, increased share of the business, etc. Procurement needs to test their broker's ethics.

But, more importantly, these concepts need to be based on ethical alignment from the purchasing or prime companies to their critical supply network. Such an integrated structure should also include concerns and strategies so that the program is not fragmented or just focused on a few suppliers.

Refinement of business practices—corporate responsibility and sustainability is not just green. Low cost country sourcing has opened us up to enabling and funding exploitative behaviours to people, communities, and environmental resources. Fair labour standards are the law in developed economies such as the EU and the United States. These national standards require occupational health and safety standards, unemployment and workman's comp; but this not the case in most undeveloped nations. In these nations, a job injury sends *mom or dad* home for life, leading to children being taken out of school and sent to work to support the family. A social dialogue by NGO's, the UN, nations, and emerging industrial leaders in underdeveloped nations is taking place, though⁷, with China working consistently on new worker standards, for example. But with over a third of the world subsisting on less than a few dollars a day, the ability to exploit workers will always be high. That is why reputable companies must put in programs that protect these vulnerable populations.

Monitoring the Supply Chain. Trading partner visibility has been talked about for years. Technology solutions do exist, but are not implemented nearly as much as benefits indicate. Following last summer's toy recalls, many firms are putting in place inspections. This is a good short term solution, but expensive and, quite frankly, only marginally effective, done at the final stage—at retail—as the final assurance that can protect customers. Yet, as we discussed, that is the most expensive place, and not at the heart of the potential offender site. *With current economic challenges, one wonders how committed firms will be until legislation currently under discussion forces*

⁶ Trade management software, the so-called International Trade Logistics software, can help here. EDI for transaction management, and of course, RFID.

⁷ For example, the 18th World Congress on Safety and Health at Work, in Seoul, Republic of Korea, 29 June – 2 July 2008, is the largest global event in occupational safety and health. The Congress aims to contribute to improving health and the prevention of accidents and diseases in the workplace through the exchange of information and good practices. This involves more than 4,000 policy makers, senior executives, safety and health professionals, employers' and workers' representatives, and social security experts. The triennial Congress is jointly organized by the International Labour Organization (ILO) and the International Social Security Association (ISSA). The XVIII World Congress is hosted by the Korea Occupational Safety and Health Agency (KOSHA).

them to be⁸. It is better to implement at the root—containment—process and product monitoring technologies and methods. The sooner issues are uncovered, the lower the impact and cost of recovery.

Technology solutions do exist, but need to be implemented. Basic transaction management with EDI (Advance Ship Notifications) combined with mobile solutions such as RFID and sensors hold much promise to address safety, security, authenticity and sustainability for goods entering in developed markets.

Organizations like the Forest Stewardship Council⁹ have pointed the way. An interesting organization that adopted similar practices is the seafood¹⁰ industry, with the Marine Stewardship Council. We are also seeing much more work in the pharmaceutical industry and high-end consumer product areas.

Moving Forward

Executives have to promote within their own organizations, as well as set an example with their employees, and by getting involved with suppliers, the community, and compliance programs. Not because it *feels good*, but because the alternatives—from both a humanistic and profit perspective—are not viable over the long term if we are only motivated by compliance. Then we are bound to be constantly pursued by regulation and regulators.

Current climates in the world economy are demanding more oversight by government on myriad business practices. Most businesses abhor regulation, and government sees its role, really, as the *court of last appeal*. So, take the first step!

That first step may be more involvement in industry consortia. Many companies do not consult across competitive lines, as a rule. But many of the solutions require industry standards and solutions. Industry groups can help companies to not go it alone, setting standards that they can all operate by, pooling ideas, resources, and technology platforms to commit the industry to better global practices. And suppliers will get the message—that in order to operate in the industry, they must adhere to these standards.

Codes of conduct are getting a fresh look by many leading companies. Many have active involvement from the top. *A firm's brand and financial value is bonded to the consumer's trust*. For firms that know this, and live it in their culture, the current issues have been a wake-up call for them to broaden and sharpen their ethical foundation. Codes of conduct are often looked at with cynical eyes by employees who do not see the right behaviors modeled at the top.

Beyond codes of conduct and compliance, active local social outreach should be part of an integrated ethical supply chain foundation. Such outreach could include: technology integration, process audits, reward systems that model and award behaviour, partnering with local organizations and institutions such as hospitals, clinics and schools; arranging for financial institutions to encourage savings for employees; creating micro insurance plans (which allows small business to provide worker compensation for on the job injury, loss of work due to health problems, etc.); and improving the quality of life, not just for employees, but for the community from which they extract value.

⁸ Nike, a great turnaround story, has about 100 auditors and inspectors for their seven Asia plants. Their metrics look at workplace incidents, worker hours, etc., as well as creating a culture of worker involvement.

⁹ <http://www.fscus.org/>

¹⁰ <http://www.msc.org/>

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