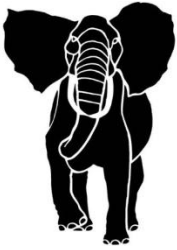


THE ELEPHANT IN THE ROOM

RESTORING TRANSPARENCY WITH YOUR CHINESE FACTORIES

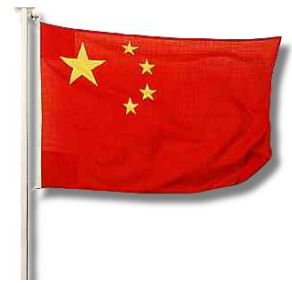
What Are Chinese Factories Really Doing & Why?



CHINA STATS: 85-90% of Chinese factories that produce for middle to lower cost consumer products brands and retailers do not pay legal wages and nearly all work excessive hours. Factories maintain double-books and/or hide working hours and wage practices in some way in order to pass audits; however, factories only show their falsified records to *some* buyers. "Comply or Die" buyer programmes get the fake records and those programmes driven by transparency and continuous improvement are shown the real records.

WHY 85-90% of CHINESE FACTORIES FALSIFY?

- Loss of Business Fear: Factories believe that showing the auditor the truth will get them terminated as a supplier. The more at stake, the more rigorous their efforts will be and more willing to bribe and pay expensive consultants.
- Actual Loss of Business: Many brands' and retailers' programmes reinforce their fears and terminate them.
- Cost: It would cost an export factory with 800 workers with average wage and working non-compliances about 6500 GBP / month to pay legal wages.



Does Your Audit Programme Give You "Corrupt" Data?

ASSESSING YOUR PROGRAMME TYPE:



If you analyse your audit results and add up all those factories that have been caught falsifying i.e inconsistent factories plus all those factories that have wage findings (never mind working hours issues), you should get a figure close to 85% (give or take).



If your results look different than those above it likely means the auditors (third party or internal) are not catching the falsification, or are being bribed. So you are believing that a higher % of your factories are compliant **or** at least showing **lower** working hours and **legal** pay rates. The truth is....they are not! Your auditors just could not catch the clever falsifying factories.

EXAMPLE 1 ("Comply or Die" Programme)

This is the most common programme type Level Works comes across. The programme is "Comply or Die" in design and actually creates an environment where falsification rates increase. It also does not inform what the actual real practices of the factories are. Additionally it does not educate, empower, train or hold accountable internal and/or external auditors for catching factories that falsify. Programmes where supplier factories are free to choose which audit firm they use are also the most susceptible to these higher rates of falsification.

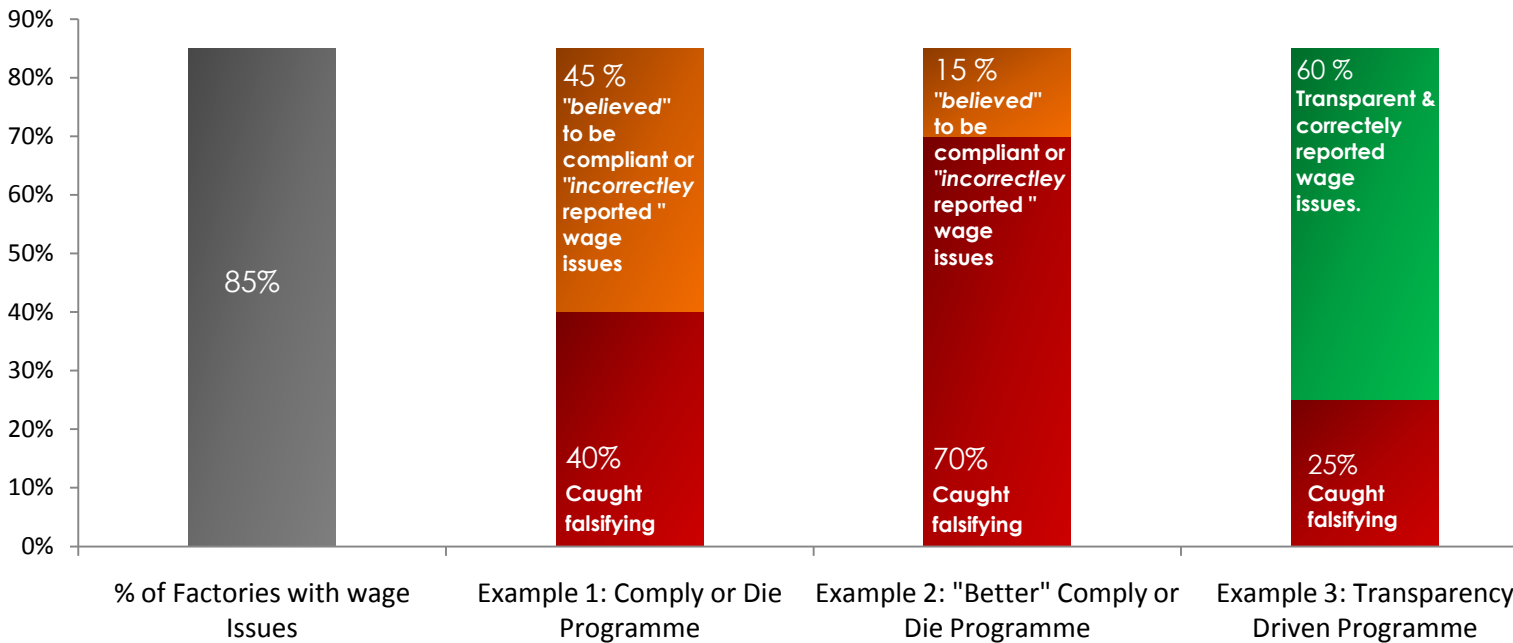
EXAMPLE 2 ("Comply or Die" Program – better executed)

This type of program is typified by Ethical Sourcing managers that are fully aware of the compliance realities in China and the degree to which factories falsify their records. However, instead of addressing the reasons for falsification and experimenting with a transparency driven path, they resign themselves to an intense 'cat and mouse' game with their factories which ends up with a revolving door process.

EXAMPLE 3 (Transparency Driven Programme)

This type of programme implementation and engagement philosophy is driven by a keen understanding of the root causes of factory record falsification and a fundamental desire to encourage realistic and continuous improvement of workplace conditions. The success of a transparency driven programme depends on the alignment of priorities between buyer and its vendors, factories, and service providers. Brands and retailers that implement this strategy are tired of the 'cat and mouse' game and have come to understand that the majority of their factories cannot meet their standards in the short term. Knowing this, they have calibrated their efforts to ensure honest dialogue with their factories and measureable improvements, albeit more gradually than they previously believed possible.

Graph Comparing Programme Types, Falsification & Transparency



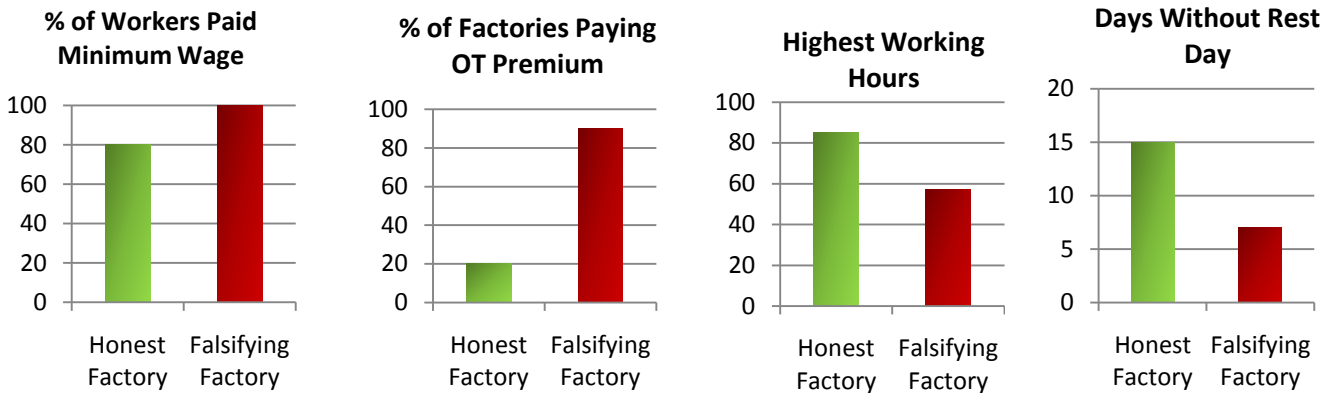
Do You Know What Transparent factories Look Like In China?



Typical falsifying factories providing false figures that they **think** you want to hear.



Typical honest factories showing actual wage and working hour's figures.



Why is Transparency & Honesty So Important?

- Without knowing what your factories actual practices are it's impossible to understand your risk.
- You don't know the scale of factories that are lying to you.
- The data you do have is mostly corrupt.
- You are passing on incorrect data to external stakeholders and databases.
- Without knowing the real practices of each factory there is no chance to drive improvements.
- Valuable time and resources are wasted.
- Most worker unrest in China results from wage-related issues.

诚实

How Do You Regain Transparency and Bring Value Back to Your Programme?

KEYS FOR REGAINING TRANSPARENCY:

- To demonstrate an understanding to your vendors and factories that you are aware of the extent that this is happening.
- Tag 'transparency/honesty' as a critical issue that will prompt termination after no more than 3 attempts.
- Be open to seeing the truth about wage and working hour practices, regardless of your stated standards.
- Take control of your audit programme. Brand/Retailer



programmes that give vendors the choice of which 'approved' firm to use (mostly unconsciously) drive the worst performance. The vendor will seek to use those firms that give them the highest probability of passing at the lowest price. We see this played out time again and have the data to prove that. Both the FLA and ICTI have also recognised this and abandoned that model accordingly.



How Does Auditor Integrity Fit in?

The vast majority of bribery situations results from factories that, in addition to falsifying, offer bribes to auditors and find a willing recipient. Any organization that employs auditors must put systems in place to discourage and identify if this is happening. However, the industry must understand that the drivers for record falsification are exactly the same as bribery. Programmes that drive transparency (that are calibrated to the above points) have a much lower risk for integrity issues; while other, high volume, 'comply or die', or well-recognised certification programs are fertile ground.