

The London School of Economics and Political Science

*Labor Standard Compliance and the Role of Buyers:  
The Case of the Cambodian Garment Sector*

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## **Declaration**

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## Abstract

This dissertation consists of four chapters investigating the role of buyers in regulating suppliers' compliance with labor standards in the Cambodian garment sector.

The first chapter evaluates an innovative monitoring scheme of the International Labour Organization (ILO) in the Cambodian garment sector, Better Factories Cambodia (BFC). The findings suggest that monitoring standards and procedures are rigorous and positive impacts are felt in monitored factories. Nonetheless, BFC runs in parallel to state institutions and enforcement depends on buyers, throwing its sustainability into question.

The second chapter examines the effects of 'reputation-conscious buyers' on labor standard compliance in supplier facilities. Using unique factory-level panel data, this chapter shows that factories producing for reputation-conscious buyers are associated with higher compliance levels than other factories, controlling for factory characteristics. Field interviews also demonstrate that reputation-conscious buyers regulate supplier compliance both 'reactively' and 'proactively.'

The third chapter explores the determinants of labor standard compliance across different issue categories (i.e. contract, wage, hours, leave, welfare, occupational safety and health, fundamental rights). Suppliers of reputation-conscious buyers are consistently associated with better compliance levels across many different issue categories including fundamental rights. The result lends support to the behavioral theory rather than the deterrence theory of regulatory compliance and challenges claims that buyer-driven regulation produces effects that are confined only to visible and easy-to-fix issues.

The fourth chapter exploits original survey data and examines different channels through which buyers influence their supplier compliance. The findings suggest that the main channel linking buyers and supplier compliance-performance is the *nature of their relationships*: market-based relationships mediated through agents are systematically associated with poorer compliance performance than established relationships. The result suggests the need to develop longer-term buyer-supplier relationships marked by open dialogue, trust, and commitment, which in turn help to foster an environment supportive of continuous improvement in working conditions.

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## Overall Introduction

This dissertation consists of four chapters on the role of buyers in regulating and influencing working conditions in their supplier facilities, with a particular focus on labor standard compliance in Cambodia's garment sector. Working conditions in global supply chains have come under increased public scrutiny. Faced with a growing demand for accountability, some multinational enterprises have come to play *de facto* regulatory roles in developing countries where they do business. The thesis seeks to contribute to the on-going debate on the effectiveness of non-state regulation of labor standards and the ways in which working conditions in global supply chains can be improved. Theoretically, this thesis aims at demonstrating the utility and limits of different theories, thereby reconciling disparate literature.

Initially, this PhD project was motivated by an innovative scheme in the Cambodian garment sector that subjects all exporting garment factories to labor standard monitoring by the International Labour Organization (ILO). Convinced of the potential benefits that factory-level data on working conditions can bring to our knowledge, I have chosen Cambodia's garment sector as my thesis topic. After conducting fact-finding fieldwork in the summer of 2007, it became clear to me that, amid various factors influencing working conditions in factories, buyers are playing an exceedingly important role, which then became the focus of my inquiry.

This dissertation exploits unique factory-level data on labor standard compliance and firm characteristics collected by the ILO monitoring program, Better Factories Cambodia (BFC). The dataset covers 344 exporting garment factories from 2006 to 2008, from which I created a panel dataset of 1230 observations. In addition, with the



help of ILO BFC, I conducted surveys of both suppliers and buyers to gather information not covered by the panel data. Survey results enabled me to delve into the causal mechanism of how buyers influence working conditions in supplier factories. In addition, I conducted 61 interviews during the summers of 2007 and 2008 with various stakeholders in the Cambodian garment sector including factory managers, buyer representatives, union leaders, government officials, industry experts, labor activists, and donor representatives. Further, participant observation at ILO BFC in Phnom Penh gave me an excellent insight into the context and dynamics surrounding the garment sector in Cambodia.

The richness of the data enabled me to mix different methods of inquiry, thereby increasing inferential leverage and enhancing the validity of hypotheses (Brady and Collier, 2004). Chapter 1 is purely qualitative based on interviews and participant observation in Cambodia's garment sector. Chapter 2 is a mixed piece, combining panel data regressions and interview materials. Chapter 3 and 4 are quantitative chapters based on the panel and survey data. The results of surveys targeting suppliers and buyers are summarized in Appendix I and II, respectively.

In terms of theoretical framework, this thesis does not operate in a single framework, but rather it tests competing hypotheses to identify the utility and limits of different theories. While Chapter 1 is an empirical piece, Chapter 2 operates in the rational expected utility framework, which emphasizes enforcement and deterrence to encourage compliance. Chapter 3 introduces the behavioral theory of the firm and shows the limits of rational assumptions. Chapter 4 goes one step further and contrasts the deterrence theory of regulatory compliance with the transaction cost economics and

relational exchange theory; the findings are supportive of the latter theoretical perspective.

The plan of the dissertation is as follows: Chapter 1 lays the groundwork for the following chapters by describing the context of the Cambodian garment sector and assessing the ILO monitoring program, Better Factories Cambodia (BFC), one of the most promising models of labor regulation. The findings suggest that monitoring standards and procedures are rigorous and positive impacts are felt in monitored factories. Nonetheless, the ILO program runs in parallel to state institutions and enforcement is dependent on buyers, leading to patchy outcomes and throwing the scheme's sustainability into question.

Chapter 2 examines the role of reputation-conscious buyers in regulating working conditions in their supplier factories. In consistent with the rational theory of deterrence, this chapter shows that factories producing for reputation-conscious buyers are associated with higher compliance levels than other factories, controlling for factory characteristics. Field-based interviews also demonstrate that reputation-conscious buyers regulate supplier compliance both 'reactively' in the sense that they respond to complaints and 'proactively' as evidenced by active involvement of local buyer representatives.

Chapter 3 extends the analysis of Chapter 2 and explores the determinants of labor standard compliance across different issue categories (i.e. contract, wage, hours, leave, welfare, occupational safety and health, fundamental rights). Factories producing for reputation-conscious buyers are consistently associated with better compliance levels across many different issue categories, supporting the behavioral theory of the firm. On the one hand, the results challenge the claim made by some critics that the effects of

buyer-driven regulation are confined solely to visible and easy-to-fix issues. On the other hand, the findings point to the growing gaps between rigorously regulated supply chains controlled by reputation-conscious buyers and other sparsely regulated supply chains, painting a more nuanced picture of buyer-driven regulation.

Chapter 4 seeks to investigate the different channels through which buyers influence their supplier compliance-performance. The regression results suggest that the main channel linking buyers and supplier compliance-performance is the nature of their relationships. Market-based relationships mediated through sourcing agents are systematically associated with poorer compliance performance than established relationships. The findings indicate the need to develop longer-term buyer-supplier relationships marked by open dialogue, trust, and commitment, which in turn help to foster an environment supportive of continuous improvement in working conditions.

The dissertation concludes by highlighting empirical, methodological and theoretical contributions made, pointing out limits, and suggesting future areas of research. In summary, this PhD thesis significantly adds to the literature on labor regulation in global supply chains and buyer-supplier relationships by providing new facts, offering new perspectives, and suggesting novel solutions.

## Chapter 1. The ILO Program in the Cambodian Garment Sector

### 1.1 Introduction

While the fundamental debate on the benefits and costs of labor regulation remains contentious, growing consensus is emerging on the concept of a ‘core set of labor standards’ as stipulated in the “Declaration of the Fundamental Principles and Rights at Work” adopted by the International Labour Organization (ILO) in 1998.<sup>1</sup> Moreover, activists, consumers as well as investors increasingly demand multinational enterprises (MNEs) to regulate labor conditions in their global supply chains. The focus of the labor regulation debate has therefore shifted from whether or not to regulate to how to design an effective regulatory framework.

Given that many developing country governments lack capacity to regulate their economies, various non-state regulatory approaches have been proposed and tried: labeling and certifying labor standards, corporate codes of conduct, transparent monitoring, and transnational solidarity to empower workers. Among these competing initiatives, one of the most promising models has been experimented in the Cambodian garment sector.

The ILO monitoring program called *Better Factories Cambodia* (BFC) harnesses public and private authority to bring about continuous improvement in working conditions: the Cambodian government obliges all exporting garment factories to be monitored by ILO BFC. With consent of factories, buyers can access to ILO monitoring reports by paying a modest fee to ILO BFC. When major non-compliance issues are

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<sup>1</sup> The fundamental principles and rights include i) freedom of association and the effective recognition of the right to collective bargaining, ii) Elimination of all forms of forced or compulsory labor, iii) effective abolition of child labor, and iv) Elimination of discrimination in respect of employment and occupation.

identified in the reports, buyers demand their suppliers to rectify problems. While the ILO monitoring program under the quota regime (i.e. from 2001 to end-2004) has been assessed elsewhere (e.g., Kolben, 2004; Polaski, 2006; Wells, 2006; Miller, 2007), the latest functioning of the program in the post-quota era has not been evaluated.

The purpose of this chapter is to describe the context of the Cambodian garment sector and evaluate ILO BFC, thereby laying the groundwork for the following analytical chapters. It is important to understand the potential and limits of ILO BFC given that it is a prototype of the next generation model, *Better Work*. The ILO, in partnership with the International Finance Corporation (IFC), has replicated and refined the Cambodian model and launched a global version, *Better Work Program*, to improve working conditions globally using value chain dynamics.<sup>2</sup> Evaluating ILO BFC, therefore, can provide insights into the next generation model while shedding light on the broader question about the effectiveness of non-state regulation.

This chapter is organized as follows. The next section discusses various non-state approaches to regulate labor conditions. The following section discusses the genesis of the ILO monitoring program and evaluates its rigor, legitimacy and accountability, perceived impacts, complementarity with state regulation, and sustainability. The assessment is based on 61 field-based interviews with stakeholders (i.e. factory managers, buyer representatives, union leaders, government officials, industry experts, labor activists, and donor representatives) and participant observation at ILO BFC office in Phnom Penh, Cambodia during the summers of 2007 and 2008.

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<sup>2</sup> Currently, programs are operating in Lesotho, Haiti, Jordan, and Vietnam, and other countries are expected to join. The major difference between the Cambodian model and Better Work is that monitoring is mandated by the government in the former while it is mostly optional (decided by buyers) in the latter. For details, consult their website: <http://www.betterwork.org/public/global>

The fieldwork demonstrates that the standards and monitoring procedures are rigorous and positive impacts are felt in monitored factories. Further, ILO BFC seems to perform better than other private initiatives in terms of cost-effectiveness, coordination, capacity building, and credibility. Nevertheless, the system lacks direct accountability to workers and enforcement depends on buyers. ILO BFC runs in parallel to the state institutions, and its sustainability is in question. In conclusion, this chapter highlights government and market failures facing developing countries and suggests solutions that require efforts on all fronts.

## **1.2. Non-state Approaches to Labor Regulation**

In response to the regulatory vacuum created by lack of government enforcement in developing countries, various private schemes to regulate labor standards have emerged, which can be classified as market, empowerment, and transparency approaches as described below.

### ***Market-based Approach***

The market-based approach seeks to improve working conditions by unleashing the market force. Freeman (1994) proposes treating labor standards as a normal consumer good and creating a mechanism to meet the demand for such commodity. The proposed mechanism to sort out the demand and supply for such product is *labeling* of the conditions under which products are produced. While accurate labeling requires a third party organization to correctly inform consumers, the scheme lets consumers determine the 'price' for labor conditions.

Based on consumer surveys, Elliott and Freeman (2003) claim that there is a market for ethically produced goods; the majority of respondents said they were willing

to pay a small premium for products made under good working conditions. Examples of labeling schemes include the *Rugmark* label, which certifies child-free carpets and the *Fair Trade* label, which ensures that their producers (e.g. coffee, bananas, tea etc.) are paid above world market prices.

Nevertheless, these schemes have been criticized for their limited reach and overestimation of consumers' good will. Those social labels account for a tiny market share while companies that command price premiums for being ethical are small operators in niche markets (Vogel, 2005). Moreover, those consumers ready to pay extra for ethical products are limited to a subset of educated, upper-middle class consumers, and even those who say they are willing to pay a premium often do not behave as they say they would.<sup>3</sup>

Another market-based approach emphasizes corporate social responsibility (CSR).<sup>4</sup> Faced with pressures from activists, investors, shareholders, as well as employees, a growing number of MNEs have embraced some sort of CSR policies (Graham and Woods, 2006). While CSR's positive contributions to corporate financial performance remain debated, the negative impacts of bad publicity arising from lack of CSR are well-recognized; the main driver for corporations to engage in CSR is to avoid damage to their reputation, which is a major source of corporate wealth (Klein, 1999; Conroy, 2007). Especially in garment, footwear, toy, and sport industries dependent on cheap labor, many international buyers have adopted codes of conduct (CoC) and

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<sup>3</sup> There exist large gaps between what consumers say they would do and what they actually do because respondents tend to give what they consider as the 'right' answer rather than their true opinions. Vogel (2005: 48).

<sup>4</sup> CSR remains an ill-defined and contested concept partly because societal expectations about the role of business keep evolving. Here, CSR is used as an umbrella term that refers to ideas and practices about expanding corporate roles in managing their social and environmental impacts as well as relationships with wider society. See the definition of CSR in Blowfield and Frynas (2005): 503.

monitoring procedures to regulate labor conditions in their supply chains (Schrage, 2004).

Nevertheless, these corporate-driven schemes have been criticized for manipulation of codes, ineffective monitoring, and lack of worker participation (Jenkins, Person and Seyfang, 2002; Esbenshade, 2004; Braun and Gearhart, 2005). Moreover, some criticize that these schemes depend on consumer/investor preferences and vigilant NGOs and that private regulation may end up weakening or substituting state regulation (Kolben, 2007; Seidman, 2007).

### ***Empowerment Approach***

Some critics of the market-driven schemes emphasize that empowering workers is the key to improving labor conditions. Esbenshade (2004) argues that private monitoring reinforces workers' vulnerability and that in order to counter the "triangle of power" made up of manufacturers, contractors, and the national government, there needs to be a "triangle of resistance" consisting of consumers, workers, and local civil society. Specifically, Esbenshade calls for an alternative model, which enables workers to be monitors of their own factories.

Rodriguez-Garavito (2005) concurs that it is vital to empower the countervailing forces through political alliances and institutional designs. He sees freedom of association and collective bargaining as the key institutional mechanisms to mitigate power asymmetries between workers and employers. He proposes "empowered participatory labor regulation," in which CoC are designed to empower workers and cross-border organizing strategies are used to hold MNEs accountable.

Hence, advocates of the empowerment approach call for greater participation and freedom of association to enable workers to defend their own rights. They are also in



favor of bottom-up schemes, notably the Workers Rights Consortium (WRC), a non-governmental organization which responds to worker complaints and conducts investigations at the local level. The WRC is generally considered to be “the most effective, transparent, and ‘participatory’ model of transnational labor monitoring (Barenberg, 2005: 38)”.

The empowerment approach is not without criticism, however. In particular, case-by-case, cross-border organizing strategy is time and resource-intensive and vulnerable to employers’ ‘cut-and-run’ strategies (Merk, 2009). Moreover, these transnational alliances are often driven and financed by union federations and NGOs in the North, and some Southern unions become dependent on external finance, creating client-patron relations (Spooner, 2005). Further, not all sectors are amenable to such transnational alliances and some countries are opposed to the freedom of association, requiring different tactics.

### ***Transparency Approach***

An innovative scheme to ‘ratchet up’ labor standards has been proposed by Sabel, O’Rourke and Fung (2001). The model called the *Ratcheting Labor Standards (RLS)* is based on transparency and competition among firms as well as monitors. The mechanism functions as follows: (i) all firms in a targeted sector (e.g. garment) submit to external monitoring, (ii) independent monitors inspect firms’ suppliers unannounced and disclose methods and monitoring results (by ranking firms’ social performance), (iii) consumers and investors pressure firms to compete for better working conditions in their supply chains, and (iv) monitors compete to improve their reliability (monitors are to be monitored by international organizations such as the ILO).

The RLS model is close to the market-based approach in that it seeks to exploit market pressures by providing information to the public and fuelling competition among firms that care about reputation. The RLS model has been criticized for neglecting unions and government involvement (Sabel et al., 2001). Indeed, the RLS model requires some kind of authority that obliges all firms to submit to standard monitoring, standardizes monitoring procedures, and ensures disclosure of information. In other words, the RLS model implicitly assumes government regulation although it was supposed to be an alternative (Levinson, 2001).

ILO BFC is unique in that it incorporates some elements of all the approaches discussed above. The scheme has sought to label Cambodia as a ‘sweat-free’ sourcing destination and to attract reputation-conscious buyers (i.e., market). The ILO has not only monitored factories, but also provided training for workers and empowered unions through wider institutional engagement (i.e., empowerment). BFC also resembles the RLS model as it conducts industry-wide and independent monitoring (i.e., transparency). The key difference is that factories are monitored by ILO BFC rather than private monitors and monitoring information is shared with buyers rather than consumers. This Cambodian model is also consistent with the proposal by Kuruvilla and Verma (2006) to combine soft and hard regulation, localize initiatives, and to bring national governments back in.

### **1.3. Background**

#### ***Genesis of the ILO Monitoring Program***

The ILO’s unique experiment in the Cambodian garment sector grew out of the 1999 bilateral trade agreement with the United States. The rapid growth in Cambodia’s

apparel exports to the US in the 1990s caused reactions from the domestic textile and apparel industry as well as labor unions. In 1998, the industry demanded import restraints while the American Federation of Labor and Congress of Industrial Organizations (AFL-CIO) petitioned the US government to review alleged worker-right abuses in Cambodian factories. It was against this backdrop that the US and Cambodia negotiated and agreed on the trade agreement with a clause on labor conditions (Polaski, 2006).

The social clause stipulated that the US would increase Cambodia's export quota, namely access to the US market, provided that working conditions in Cambodia's garment sector substantially improved in line with the local law and international core standards. As the Cambodian government clearly lacked resources and capacity to monitor labor conditions in all exporting garment factories, the US government turned to the ILO. The ILO, which had never conducted factory-level monitoring, initially hesitated but finally agreed to a compromise that included a technical assistance program (Kolben, 2004). Funded principally by the US government, the ILO Garment Sector Program started its operation in 2001.

Gradually, a quota-increase incentive became less important as categories of garment exports not covered by the quota grew rapidly. In fact, the quota incentive has been replaced by another unanticipated incentive, as buyers started using ILO monitoring reports to assess compliance performance of their suppliers (Kolben, 2004). Over time, the Cambodian government has come to see the ILO monitoring scheme as a niche strategy to attract reputation-conscious buyers while these buyers have come to appreciate ILO monitoring as a stamp of approval. This explains why the ILO

monitoring program has been renewed even after the expiration of the quota regime at the end of 2004.<sup>5</sup>

### ***Labor Relations in Cambodia's Garment Sector***

Before evaluating ILO BFC, it is essential to understand the context of labor relations in Cambodia's garment sector. Tense labor relations are corroborated by the consistently high incidence of strikes, about 80 incidents per year for an industry size of 300 exporting factories (Figure 1-1). The number of person days lost has significantly increased in recent years, indicating a rise in the level of participation and the duration of strikes (Figure 1-2). The Garment Manufacturers Association in Cambodia (GMAC) blames unreasonable demands of unions while unions blame employers' disrespect for the labor law and persistent low wages.<sup>6</sup>

Another feature of Cambodia's labor relations is a profusion of trade unions. As of mid-2007, 1113 trade unions and 30 union federations were registered with the Ministry of Labor and Vocational Training (Figure 1-3).<sup>7</sup> Since there is no system of de-registering, the number of active unions is lower. Nonetheless, for an industry of about 300 exporting factories, unions are exceptionally numerous; it is common to find a factory with three or four unions. Competition among unions to attract members leads to aggressive tactics, contributing to a higher incidence of strikes.<sup>8</sup>

According to insiders, unions proliferate because it is a "profitable activity."<sup>9</sup> Some unions operate like gangs and extort money from factory management by

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<sup>5</sup> For more information about the ILO monitoring program, BFC, consult their website:

<http://www.betterfactories.org/>

<sup>6</sup> Interview with GMAC representatives and union federation leaders, September 2007.

<sup>7</sup> These figures cover unions and federations in all the industries, but ministry officials estimate about 1000 unions belong to the garment industry.

<sup>8</sup> Interview with representative, Garment Industry Productivity Center, 30 August 2007.

<sup>9</sup> Interview with labor dispute officer of GMAC, 24 September 2007.

threatening to go on strike. Union federations notorious for such practices are not penalized because they share profits with high-ranking officials who protect them.<sup>10</sup> The majority of unions are paper-unions or yellow-unions supported by the government or management. Few independent unions, namely the Free Trade Union Workers in the Kingdom of Cambodia (FTUWKC) and the Coalition of Cambodian Apparel Workers Democratic Unions (CCAWDU) are linked to the opposition parties, making them prone to harassment and violence.<sup>11</sup> A few unionists have been murdered to date, notably the president of the FTUWKC, Chea Vichea in 2004 prior to the national election. Politically divided unions often politicize workplace disputes, complicating Cambodia's labor relations.

### ***Broader Engagement of the ILO***

Faced with difficult labor relations, the ILO has made broader engagement that goes beyond monitoring. While monitoring is the best known element of the ILO program, BFC is actively involved in remediation and capacity building of workers and supervisors. The training arm of BFC offers a variety of training courses to workers and supervisors upon request. For instance, factory-based training teaches workers' rights and obligations stipulated in the labor law as well as practical issues related to safety and health, HIV, and maternity. Since most workers are poorly educated, training is done through watching soap operas and playing games. BFC also offers training that helps improve quality, productivity, as well as negotiation and supervisory skills.

In addition to BFC, the ILO also operates Dispute Resolution Program, which helped establish the Arbitration Council. The Arbitration Council, set up in 2003 to deal

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<sup>10</sup> Interview with union federation leader, 10 September 2007.

<sup>11</sup> Interview with former president of union federation, 29 August 2007.

with collective disputes, is a tripartite body composed of arbitrators nominated by unions, employer organizations, and the government. Each case is decided by a panel of three arbitrators, two of whom are chosen by the parties to the dispute and the third is decided jointly by the two arbitrators. The summary of cases is published on their website both in Khmer and English, contributing to its transparency.<sup>12</sup>

One feature that compromises its effectiveness is that the awards of the Arbitration Council are generally non-binding unless both parties agree to have binding awards. In this sense, the system lacks enforcement capacity. Despite this non-binding and non-enforceable nature of awards, between 2003 and mid-2007, the Arbitration Council presided over 441 cases and 68 percent of them were resolved successfully.<sup>13</sup> Major issues that are brought to the Arbitration Council are the use of undetermined duration contracts, various cash payments (i.e. attendance bonus, severance pay), and unfair dismissal of union workers.<sup>14</sup> The Arbitration Council is seen as a successful alternative to judiciary reform in Cambodia, where the formal court system lacks capacity and suffers from corruption (Adler, 2007).

Currently, Dispute Resolution Program is mainly involved in capacity building at the institutional level. Specifically, it provides training for the Ministry of Labor and Vocational Training (MLVT) on conciliation and collective bargaining, promotes collective bargaining among employers, reviews the labor law to avoid conflicting

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<sup>12</sup> The website of the Arbitration Council [http://www.arbitrationcouncil.org/eng\\_index.htm](http://www.arbitrationcouncil.org/eng_index.htm)

<sup>13</sup> Here, success refers to either of the following: i) binding awards are implemented, ii) employers reject binding awards, but adopt similar solutions, iii) both parties agree to conciliation before awards are issued. Interview with Executive Director, the Arbitration Council Foundation, 30 August 2007.

<sup>14</sup> Interview with Executive Director, the Arbitration Council, 30 August 2007.

interpretations, trains the police about the labor law and appropriate use of force, and helps unions to work out representativity.<sup>15</sup>

The ILO also helps build capacity of workers and especially union leaders through Workers Education Program. One of the problems in Cambodia's garment industry is that workers' education level is very low. A recent survey shows 65 percent of workers attained only the elementary school level or less (EIC 2007: 67). Even some union leaders cannot read or write. WEP is in charge of training union leaders about the rights and obligations stipulated in the labor law. WEP is also the focal point of union coordination to form a united front vis-à-vis the government and employers. Nonetheless, union coordination is increasingly difficult with growing numbers of union federations.

#### **1.4. Assessment of the ILO Monitoring Program**

The desirability and effectiveness of any schemes need to be measured against a set of criteria. O'Rourke (2006) proposes the following criteria for evaluating non-governmental labor regulation: i) rigor of standards and monitoring ii) legitimacy of the system, iii) accountability to local stakeholders, and iv) complementarity with state regulation. Moreover, a successful model should cover all workers and all sectors beyond exporting consumer products (Verma, 2003; Elman and Verma, 2007). Further, it needs to be effective in the long-term. Thus, coverage and sustainability are also considered.

#### ***Rigor***

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<sup>15</sup> Interview with the Chief Technical Advisor of the ILO Dispute Resolution Project, 7 September 2007.

In terms of rigor, O'Rourke (2006) suggests examining whether the codes meet or exceed the ILO conventions and local laws, if standards are measurable, and if monitoring is technically competent. ILO BFC scores high on these dimensions. The current Cambodian labor law was drafted with the assistance of the ILO and adopted in 1997. Behind this revision lied mounting pressures from the US government during the trade negotiation to modernize the labor law.<sup>16</sup> Consequently, the labor law of 1997 is one of the most progressive ones in the region, encompassing all the basic international norms such as freedom of association and right to collective bargaining.<sup>17</sup>

ILO monitors assess nearly 400 checklist items of labor standards, which are based on the Cambodian labor law and the international labor standards. The monitored standards have been agreed by a tri-partite governing body, Project Advisory Committee, comprising of the Cambodian government, employer association, and unions in the garment industry. Standards are clearly measurable and ILO monitors check whether each item is in compliance or not.

The ILO monitoring program has been characterized by its industry-wide participation, independence, and credibility. First, the Cambodian model obliges all exporting garment factories to submit to monitoring by the ILO like the RLS model. In fact, participation in the program is mandated by the Cambodian government as a requirement to obtain an export license. Second, since ILO monitors are not directly paid by factories or buyers, conflict of interests often seen in private auditing is less severe.<sup>18</sup> Third, unlike some commercial auditors detached from local contexts and

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<sup>16</sup> Interview with representative of the US Solidarity Center, 29 August 2007.

<sup>17</sup> However, the law is silent on other important issues such as occupational safety and health, which are typically addressed by letters of instruction and Ministerial degrees.

<sup>18</sup> The ILO program has been mostly financed by international donors, namely the US Department of Labor (USDOL), USAID, the World Bank, the Agence Française de Développement (AFD), as well as by



unable to talk directly to stakeholders, ILO monitors are locally hired Cambodian nationals who understand the language and local context, increasing their sensitivity and effectiveness as monitors. Fourth, ILO monitors are hired through competitive procedures, extensively trained, and well-equipped, helping ensure the quality of monitoring.

As for monitoring procedures, ILO monitors make unannounced visits to factories every 6 to 8 months. Un-announced monitor visits span an entire day or longer for larger establishments. The process includes on-site inspection, meetings with human resource managers, union leaders, and shop stewards as well as interviews with workers. Copies of pay slips and hour records are collected for verification. ILO monitors assess each checklist item and determine whether a factory complies with a specified standard. When the factory is deemed out of compliance with a certain item, monitors make a standardized suggestion for improvement.

### ***Legitimacy and Accountability***

Legitimacy can be derived from expertise and authority on the issue in question or a democratic organizational structure that enables representation of voice.<sup>19</sup> The ILO certainly commands international respect for its expertise and authority on labor standards and rights. Moreover, the ILO program is mandated by the government to monitor and report working conditions in all exporting garment factories, strengthening its legitimacy despite dissatisfaction voiced by some factory managers.<sup>20</sup>

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the Cambodian Government, the Garment Manufacturers Association of Cambodia (GMAC) and international buyers. As the program seeks to be self-sustaining beyond 2010, the financing scheme is set to change and the issue of conflicting interests may arise.

<sup>19</sup> Hudson (2000) mentions expertise, democratic organizational structures and grass roots links as possible bases of legitimacy of NGOs.

<sup>20</sup> Some factory managers argue that only the government should have the right to monitor factories. Interview with factory manager, 10 October 2008.

Accountability consists of two concepts: *answerability* and *enforceability* (Schedler, Diamond and Plattner, 1999; Goetz and Jenkins, 2002). Answerability is the right to monitor and obtain explanation for actions. This requires wider access to accurate, relevant, and timely information, in other words, *transparency*. On the other hand, enforceability is the right to demand justification for actions and impose sanctions if necessary. In short, implied in the concept of accountability is a principal-agent relationship.

In terms of answerability, ILO monitoring has provided accurate, relevant, and timely information, but access to the information has become limited. Transparency was one of the original features of the program. Until 2006, the ILO published the compliance status of individual factories in their biannual reports on their website. This was revolutionary in the realm of social auditing as no private auditing firms or NGOs disclosed monitoring results by naming factories. Polaski (2006: 924) commended that “...the specificity of the reports allows for challenges by any actors that hold information to the contrary. This operates as a reality check and reinforcement of the credibility of the ILO.”

Since October 2006, however, the ILO stopped disclosing compliance performance for individual factories. Detailed monitoring reports are stored in the web-based database, and the right to access is reserved for monitored factories and authorized parties (i.e. buyers). This limited access to information precludes the “reality check” and transparency-driven competition among factories as envisaged by the RLS

model. This regression in transparency may reflect the ILO's need to placate the garment industry as the program seeks to raise funds from garment factories.<sup>21</sup>

As for enforceability, the scheme does not have any built-in enforcement mechanism like many other self-regulatory schemes. The ILO is an independent and credible monitor and a provider of information, but it lacks power to enforce the standards in case of non-compliance. The government ministry in charge of labor inspection and remediation suffers from incapacity and corruption, preventing it from effectively enforcing the labor law. Given the lack of enforcement, buyers often act as a virtual enforcement authority.

Buyers weary about sweatshop allegations in their supply chains have come to appreciate ILO monitoring given its independence and credibility. As internal monitoring is criticized for lack of independence and external auditing for conflict of interests, ILO monitoring provides a badly needed solution. Since 2006, willing buyers pay modest fees to access to the ILO monitoring reports of their supplier factories and they enforce labor standards through pre-order selection and post-order enforcement. Before placing orders, buyers check whether the compliance levels of potential suppliers meet their thresholds. After placing orders, buyers constantly oversee their suppliers' compliance performance through ILO monitoring reports and sometimes their own or third-party monitoring. When buyers identify major or recurrent issues, they ask their suppliers to provide corrective action plans and follow them up.

While the current system makes factories accountable to buyers, workers are largely left out. Factory-level ILO monitoring reports are not accessible to workers, and there is no system of complaint-based inspection. This lack of accountability to workers

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<sup>21</sup> Interview with industry expert, 30 August 2007.

may partly stem from the fear that ILO monitoring reports may be abused by unscrupulous unions and further fuel disputes and strikes. Also, the accountability gap has been partially offset by broader engagements of the ILO in Cambodia, namely the Arbitration Council and capacity building of workers and union leaders. Nonetheless, the monitoring system itself has scope for improving its accountability, for instance by publicly disclosing monitoring reports after a certain period and responding to worker complaints.

### ***Perceived Impacts on Working Conditions and Exports***

As a lack of comparable data before and after the ILO program precludes rigorous impact assessment, this section draws on interview materials to discuss *perceived* impacts of the ILO monitoring program. Field-based interviews show that working conditions have generally improved in monitored factories, but conditions remain substandard in non-monitored factories and sectors. In terms of export performance, although it is difficult to directly attribute export growth and resilience to the ILO program, some buyers find the presence of the ILO important or even crucial for their decisions to source from Cambodia.

In the mid-1990s, at the dawn of the garment sector in Cambodia, working conditions were dismal: 14 hour work day, forced overtime, no freedom of association, and a monthly wage of USD 35.<sup>22</sup> While the adoption of the labor code in 1997 marked a milestone, non-compliance was widespread. The 1999 bilateral trade agreement and factory monitoring by the ILO since 2001 changed industry dynamics and compliance improved markedly.

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<sup>22</sup> This paragraph is largely based on the interview with former union federation leader, 29 August 2007. Hall (2000) also describes abusive working conditions prior to the ILO program.

The post-quota era since 2005 has seen more competitive pressures, squeezing profit margins of factories and speeding up industry consolidation, with negative implications for working conditions. While the firm-level data after the quota regime (2006 onwards) show continuous improvement as will be shown in Chapter 2 and 3, a lack of comparable data during the quota regime hinders rigorous assessment of evolution in working conditions before and after the quota regime.

Currently, while issues remain regarding short-term contracts and anti-union discrimination, interviewees from labor activists to industry experts agree that ‘sweatshop’ conditions are no longer seen in Cambodia’s exporting garment factories. According to the latest ILO monitoring report, the average compliance level is at about 90 percent. Further, the majority of collective labor disputes brought to the Arbitration Council are concerned with interests rather than rights, indicating that workers are mainly fighting for future benefits rather than defending existing legal rights.<sup>23</sup> Nevertheless, working conditions are much worse in non-monitored factories, namely subcontractors and other sectors as discussed later.

Cambodia’s garment exports have grown significantly since the mid-1990. In 1995, only 20 garment factories existed with 18,700 workers and USD 26.2 million in export.<sup>24</sup> As of mid-2008, 312 factories were operating with 350,000 workers, and exports reached almost USD 2.8 billion in 2007.<sup>25</sup> Garment accounts for about 80 percent of exports, 12 percent of GDP, and employs 65 percent of the industrial

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<sup>23</sup> Interview with Arbitrator of the Arbitration Council, 19 September 2007.

<sup>24</sup> Figure from the U.S. Embassy in Cambodia.

<sup>25</sup> Figure from ILO BFC.

workforce.<sup>26</sup> The growth of the sector was spurred by the US-Cambodia trade agreement in 1999 as it promised increases in a quota, attracting both investors and buyers.

Although the Multi-Fiber Arrangement (MFA) expired at the end of 2004, the predicted demise of Cambodia's garment sector in the post-quota era did not materialize. Some see this resilience as a proof that Cambodia succeeded in becoming an alternative 'ethical' sourcing destination. Nevertheless, an industry expert points out that the safeguard measures placed on China and Vietnam temporarily shielded Cambodia from competitive pressures and that buyers simply preferred diversifying because "in a time of uncertainty, no one wants to put all eggs in the same basket."<sup>27</sup>

The global economic crisis has hit the Cambodian garment sector hard particularly since the US has been Cambodia's major export destination: 70 percent of garment exports were shipped to the US in 2007. The first quarter of 2009 saw a nearly 20 percent drop in garment export while 63,000 jobs have been shed—18 percent of garment sector workforce—and more than 70 factories have closed down.<sup>28</sup> Clearly, better working conditions did not make Cambodia immune to a downturn.

Since export performance is directly tied to the volume of orders placed by buyers, it is important to examine how buyers perceive ILO BFC. Some buyers, though not all, consider the presence of the ILO as an important factor for their sourcing decisions. Both Nike and Disney left Cambodia in the 1990s for child labor and other abuses in their supplier factories, but the ILO program has reportedly enabled them to come back to Cambodia (Wells, 2005: 368). One brand representative confirmed the vital

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<sup>26</sup> Figure from ILO BFC.

<sup>27</sup> Interview with industry expert, 30 August 2007.

<sup>28</sup> Figure from ILO BFC Newsletter No. 13, May 2009.

importance of the ILO in returning to Cambodia.<sup>29</sup> Another major brand said they would probably source from fewer factories without the ILO.<sup>30</sup>

Many buyers, however, have less pronounced views about how the ILO presence has impacted their sourcing decisions since they have other considerations such as price, quality and delivery.<sup>31</sup> Considering that these buyers participating in BFC are more reputation-conscious, the other buyers (buying about half of Cambodia's garment exports) are likely to care less. General consensus appears to be that the ILO program has not helped increase orders significantly, but rather it has enabled some reputation-conscious buyers to stay put and not to reduce orders.

This lack of uncontested commercial benefits of ILO monitoring antagonizes the garment industry association, GMAC. Although GMAC did not object to ILO monitoring when it was combined with quota increases, they started to fiercely oppose the ILO once trade benefits were removed. GMAC contends that Cambodia's garment sector is facing unfair competition from neighboring countries since only Cambodian factories are subject to ILO monitoring and obliged to pay the price of better working conditions.<sup>32</sup> Besides, these efforts are not compensated by increased price or orders. Further, factory managers complain that buyers demand better working conditions on the one hand and lower prices and faster delivery on the other, squeezing factory profits and their capacity to improve working conditions.<sup>33</sup>

### ***Coverage***

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<sup>29</sup> Conversation with buyer representative, 9 October 2008 at the Buyers Forum.

<sup>30</sup> Conversation with buyer representative, 9 October 2008 at the Buyers Forum.

<sup>31</sup> Conversations with buyer representatives, 9-10 October 2008 at the Buyers Forum.

<sup>32</sup> Conversation with GMAC representative, 9 October 2008 at the Buyers Forum.

<sup>33</sup> Conversation with factory managers, 9 October 2008 at the Buyers Forum.

Many scholars have voiced concerns that non-state or buyer-driven regulation is inevitably limited in terms of the kinds of workers and sectors it can cover. Workers employed by subcontractors often face the worst conditions and receive few or no benefits from buyer CoC and monitoring (Barrientos, 2008). Moreover, non-consumer and non-exporting sectors are not covered, leaving the majority of workers in the developing world unprotected (Verma, 2003). Furthermore, buyer-driven regulation is likely to create gaps as buyers choose the level of standards for their target consumers (Seidman, 2008). These gaps create “regulatory enclaves,” leaving the most vulnerable behind (Posthuma, 2008).

In this respect, ILO BFC does not fare much better than other non-state initiatives even though BFC monitors *all* exporting garment factories. The next chapter demonstrates that there are compliance gaps between factories producing for reputation-conscious buyers and other factories. Further, union representatives and government officials confirm that working conditions are much worse in subcontractors and other sectors. One garment factory manager remarked that many illegal small workshops are operating and that they are more productive and profitable since workers who want to earn more go there so they can work many hours without restrictions.<sup>34</sup>

While there is no official figure of subcontractors and domestically-oriented garment factories, it is likely to be in the order of several hundreds. The Ministry of Labor and Vocational Training (MLVT) has registered 525 garment factories while the ILO monitoring program has registered about 300 exporting garment factories. The difference indicates the number of non-exporting garment factories although it is likely to be larger given many illegal workshops operating.

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<sup>34</sup> Interview with factory manager. 17 September 2008.



Furthermore, workers in sectors without transnational linkage and buyer pressure suffer from substandard or dangerous conditions. Official at the Department of Occupational and Safety Health (DOSHS) points out that child labor and dangerous working environment are commonplace in brick-making and construction industry.<sup>35</sup> The official also notes that there is a growing gap in OSH compliance between ILO-monitored garment factories and other establishments.

Nevertheless, unionization and transnational solidarity linkages are growing in other sectors that are not typically dependent on ethical consumerism. In the construction industry, Cambodia Construction Trade Union Federation (CCTUF) is affiliated with Building and Woodworkers International (BWI), and BWI has lodged a formal complaint to the ILO committee on freedom of association against the Cambodian government on behalf of CCTUF.<sup>36</sup> Similarly in education, Cambodian Independent Teachers Association (CITA) is a member of Education International (EI), which has helped CITA to establish its branches in all provinces and train leaders.<sup>37</sup> In tourism, Cambodian Tourism and Service Workers Federation (CTSWF) is affiliated with The International Union of Food, Agricultural, Hotel, Restaurant, Catering, Tobacco and Allied Workers' Associations (IUF). IUF and its international members turned labor disputes in Raffles Hotel, Cambodia's most luxurious hotel, into an international campaign by demonstrating in front of Raffles chains, sending protest letters, and calling for boycotts, which ended in a settlement in 2004.<sup>38</sup>

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<sup>35</sup> Interview with official of the Department of Occupational Safety and Health. 21 September 2007.

<sup>36</sup> See the website of BWI: <http://www.bwint.org/default.asp?index=1762&Language=EN>

<sup>37</sup> See the website of Education International: [http://www.ei-ie.org/developmentcooperation/en/project\\_detail.php?id=147&country=cambodia&geography=asiapacific](http://www.ei-ie.org/developmentcooperation/en/project_detail.php?id=147&country=cambodia&geography=asiapacific)

<sup>38</sup> See the website of IUF: [http://www.iuf.org/cgi-bin/dbman/db.cgi?db=default&ww=1&uid=default&ID=2008&view\\_records=1&en=1](http://www.iuf.org/cgi-bin/dbman/db.cgi?db=default&ww=1&uid=default&ID=2008&view_records=1&en=1)

This growth in organized sectors in Cambodia does not owe to the ILO program, but to the international political dynamics that gave rise to the ILO program: pressure from the US government. Growing US pressure during the trade negotiation pushed the Cambodian government to revise and adopt the labor code in 1997, despite fierce opposition by the garment industry and the ruling political party.<sup>39</sup> The 1997 labor code acknowledges workers' right to freedom of association and collective bargaining. Behind this US pressure was American organized labor, namely the AFL-CIO, one of the key constituents of the Democratic Party. The AFL-CIO has established Solidarity Centers around the world including Cambodia to help organize workers and train local union leaders. In sum, transnational solidarity and local worker organization may help fill some of the regulatory gaps when the political environment allows organized labor to play an active role as in the case of Cambodia.

### ***Complementarity with State Regulation***

It is important that non-state regulation does not replace or weaken state regulation, but rather it should strengthen and complement it (O'Rourke, 2006). In essence, the ILO has created systems of monitoring and dispute resolution that run in parallel to the government systems of labor inspection and justice. While it was necessary given the prevalent government failure in Cambodia, the lack of convergence may compromise the long-term effectiveness of the ILO program.

Cambodia's Ministry of Labor and Vocational Training (MOLVT) has the Department of Labor Inspection (DLI) with 44 inspectors who conduct pre-announced inspection of all factories (garment and non-garment).<sup>40</sup> In 2006, inspectors conducted

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<sup>39</sup> Interview with representative of US Solidarity Center, 29 September 2007.

<sup>40</sup> This paragraph is based on the interview with official at the Department of Labor Inspection, 18 September 2007.

2105 “simple” routine inspections and 577 “special” inspections for control of non-compliance. In terms of sanctions, they issued 902 warnings and charged fines for 19 cases, of which 17 cases went to court. Fines range from USD 250 to 5000, depending on the severity of violation, but expensive fines are rarely charged. In egregious cases, suspension of export license is considered together with the Ministry of Commerce. Suspension has been ordered to only 5 firms so far.

Unfortunately, labor inspectors are not considered as the effective enforcement authority of the labor law. Labor inspectors often demand bribes from factories they inspect. One factory manager complains: “inspectors come so often that it’s like their house. They will find something to complain about, and rather than reporting, they ask for bribes, about USD 20 to 40 each time.”<sup>41</sup> Given that inspectors earn as little as USD 35 per month, which is lower than the minimum wage of USD 50 in the garment sector, visiting factories for them is a way of supplementing their meager salary.

Within MOLVT, there is also the Department of Occupational Safety and Health (DOSH) with 12 medical inspectors, who visit each factory about 4 times per year. Unlike the Department of Labor Inspection (DLI), DOSH has no authority to sanction firms even in case of egregious violations. Deprived of enforcement power, OSH inspectors sometimes collaborate with labor inspectors to impose fines and sometimes even turn to buyers. OSH inspectors contact well-known buyers when they find major violation of OSH standards in their supplier factories and ask them to pressure their suppliers to rectify the problems.<sup>42</sup>

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<sup>41</sup> Interview with factory manager, 14 October 2008.

<sup>42</sup> Interview with official at the Department of Occupational Safety and Health, 21 September 2007.

MOLVT also has the Department of Labor Dispute (DLD) with 25 staff charged with mediating workers and employers as well as overseeing collective bargaining agreements.<sup>43</sup> For collective labor disputes, unions and employers are expected to negotiate first. Once negotiations fail, they must turn to the DLD for mediation. Only when the government-led mediation fails, could parties bring the case to the Arbitration Council, a tripartite body set up by the ILO to resolve collective disputes. According to one former union federation leader, the DLD tries to prevent cases from proceeding to the Arbitration Council.<sup>44</sup> This is probably because MOLVT sees the Arbitration Council as a threat to their jurisdiction.<sup>45</sup>

All in all, there is clearly duplication between the work of MOLVT and the ILO. Although there is little cooperation between the ILO and MOLVT at the program level, there is some collaboration at the institutional level. The ILO has been helping to build the capacity of MOLVT through training and joint investigation of child labor cases. Currently, they are working together to create an enterprise physician accreditation scheme. These and other kinds of cooperation including joint factory visits should be strengthened to fill the governance gap. Further, to avoid duplication and enhance effectiveness, the ILO and MOLVT should coordinate their monitoring efforts. While ILO BFC continues to monitor exporting garment factories, MOLVT could concentrate their monitoring efforts on non-exporting garment factories and other sectors. In the

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<sup>43</sup> Interview with official at Department of Labor Disputes, 10 September 2007

<sup>44</sup> Interview with former president of CCAWDU, 29 August 2007.

<sup>45</sup> In fact, MOLVT and the Arbitration Council compete for the legitimacy of interpretations of the labor law. The labor law contains ambiguities, which covet different interpretations. For instance, the article 67 prohibits the use of the undetermined duration contract that exceeds 2 years. MOLVT considers that multiple short-term contracts of less than 2 years can add up to more than 2 years while the Arbitration Council interprets that multiple contracts cannot exceed 2 years. Interview with President of the Arbitration Council Foundation, 30 August 2007.

long run, however, these efforts need to converge and MOLVT needs to take center stage in labor regulation.

### *Sustainability*

Since 2006, ILO BFC has been going through a transition period. The ILO has continued to manage the program with the aim of transferring its capacity to a local independent entity in 2010. Funding of the program is also set to be self-sustaining beyond 2010 as donor funding is gradually taken over by contributions from the Cambodian government, GMAC, and buyers. This transition is not without problems, however.

Sustainability of any regulatory schemes requires both political and financial support. BFC has won solid political support from the Cambodian government and major buyers. The Cambodian government is keen to continue selling Cambodia as an ethical sourcing destination. Reputation-conscious buyers are pleased to have a stamp of approval from the ILO for compliance performance of their suppliers. Even though the industry association GMAC is not pleased with BFC, they will be obliged to go along with buyers and the government.

In terms of financing, BFC has not yet come up with a viable plan to become self-sustaining. The current minimal fees that buyers pay for BFC to view monitoring reports need to be substantially raised. As fees increase, buyers are likely to demand more value for money, requiring BFC to offer more buyer-oriented services. On the other hand, GMAC is putting increasing pressures on BFC to be a helpful partner rather than a watch dog. In light of the changing business needs, BFC is going through organizational changes to shift its core mission from compliance monitoring to

problem-solving. Monitors are being re-trained to become “factory advisors,” who identify issues and suggest solutions.

These on-going changes pose both opportunities and risks to BFC. Shifting its focus to problem solving and remediation may enable monitors to better assist the garment factories in meeting compliance challenges as evidenced by the “Latin” model of labor regulation. Piore and Schrank (2008) argue that the Latin model based on rehabilitation rather than sanction is more effective and conducive to reconciling labor standards with competitiveness.

In the literature on labor inspection, a distinction is often made between the Anglo-Saxon approach to enforcement rooted in sanctions and deterrence and the Latin approach (practiced in France, Spain, and Central/Latin American countries) based on conciliation and rehabilitation. The Latin model gives inspectors discretion and flexibility to work out a realistic plan to bring firms into compliance, paying attention to production demands and specific situations (Piore and Schrank, 2008). Besides, inspectors play the role of business consultants by spreading best practices in the industry.

Similarly, Locke, Amengual and Mangla (2009) argue that a traditional “compliance approach” that emphasizes policing and sanction has not induced progress in working conditions. They maintain that a “commitment approach” characterized by joint problem solving and capacity building between buyers and suppliers is more effective at addressing the root causes of poor working conditions in supply chains. Yet other scholars argue for a hybrid approach, combining advisory and punitive roles of labor inspectors (Pires, 2008).

While the problem-solving approach has important advantages, its effectiveness is likely to be compromised under certain circumstances. The Latin model is a state regulatory mechanism entirely funded by the government while the ILO model is a public-private partnership, which is increasingly funded by the garment industry. Monitoring and consulting the very firms that finance their activities may replicate the classic dilemma and conflict of interests facing auditing firms (Seidman, 2008). Moreover, the commitment approach is effective only when buyers and suppliers are willing to invest in their relationships. When neither suppliers nor buyers are motivated, policing and sanction may be necessary to bring suppliers into compliance. Overall, BFC needs to strike a difficult balance between monitoring and advisory roles.

#### *Comparison with other non-state initiatives*

While the above assessment has revealed certain limits of the ILO program, it has important advantages in comparison with other existing private voluntary schemes. The weaknesses of corporate CoC and private monitoring can be summarized as follows: high cost, lack of coordination, selective standards, mixed results, limited reach, lack of worker viewpoint, and parallel systems (Posthuma, 2008). While the Cambodian case shares some of the weaknesses such as limited reach and parallel systems, it fares better than other initiatives in many respects, such as cost-effectiveness, coordination, and capacity building, in addition to independence and credibility mentioned earlier.

ILO BFC is clearly more cost-effective than private monitoring schemes. One sourcing agent remarks that third-party audit is expensive, costing about USD 2000 per audit, and the quality is questionable given its money-driven nature.<sup>46</sup> On the other hand, access to ILO monitoring report per factory per year is currently USD 500. Since all

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<sup>46</sup> Conversation with sourcing agent representative at Buyers Forum. 9 October 2008.

factories are monitored every 6 to 8 months, cost per audit is about USD 250-330. The main difference in cost arises from the fact that ILO monitors are locally based Cambodian nationals while private auditors are often expatriates.

Moreover, the coordinating role of the ILO has been important in bringing different actors together. The ILO has provided a forum for various stakeholders (i.e. the government, the garment industry association, union federations, and international buyers) to collaborate. One buyer remarked that it was unthinkable a few years ago that buyers could collaborate, as they saw each other only as competitors.<sup>47</sup> Indeed, private regulatory schemes often lack an institutional framework to coordinate different actors and responsibilities, compromising their effectiveness (Macdonald, 2007).

In addition, the ILO helped reduce duplication of private audits as some though not all buyers have replaced their own or third-party audits with ILO monitoring. The idea is to use saving from monitoring for training and remediation.<sup>48</sup> Various training and capacity building are offered by ILO BFC, and some buyers burden share the cost of training. This contrasts with purely private schemes where various initiatives co-exist and compete without coordination, leading to duplication in some areas and lack of provision in others, given free rider problems. In short, by setting standards, monitoring industry-wide, coordinating stakeholders, and providing training, the ILO has provided semi-public good to the industry.

## **1.5. Conclusion**

Based on interviews and participant observation, this chapter has evaluated the ILO's innovative scheme to monitor and improve working conditions in Cambodia's garment

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<sup>47</sup> Conversation with buyer representative at Buyers Forum. 9 October 2008.

<sup>48</sup> See Appendix I on supplier survey results for the extent to which buyers have reduced duplication and replaced their audits with ILO monitoring.



sector. The ILO program is unique in that it combines different elements of non-state approaches to improve working conditions: market forces, empowerment, and transparency. Overall, ILO BFC scores high on rigor and perceived impacts on monitored factories, medium on accountability and export performance, and low on coverage, complementarity with state regulation, and sustainability. BFC fares better than other private initiatives in terms of cost-effectiveness, coordination, and capacity building in addition to its independence and credibility. The next generation model should build on the strengths of the Cambodian model while addressing the weaknesses.

The question remains as to how the identified weaknesses, in particular regulatory enclaves and parallel systems can be addressed. The problem of limited coverage may be partially mitigated by promoting worker organization in non-monitored establishments and sectors, possibly with the help of transnational solidarity networks. However, workers are difficult to organize in small subcontractors and illegal workshops. Also, this strategy assumes that freedom of association is recognized and upheld by the government, which is not always the case in developing countries. Another way to regulate the sphere left unregulated by private initiatives is to let government labor inspectors concentrate their efforts on non-covered establishments and sectors. This solution may be effective when limited resources constrain monitoring efforts of the labor inspectorate.

Often times, however, state regulation in developing countries faces additional difficulties. In Cambodia, culture of impunity for those in power is pervasive, undermining the rule of law and crippling effective law enforcement.<sup>49</sup> Corruption runs

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<sup>49</sup> This point has been repeatedly mentioned by many interviewees. Also, see Hall (2000) for field-based accounts of impunity.

rampant not only among government officials and factory managers but also among union leaders. These problems are deeply rooted in politics at the core and thus extremely difficult to rectify.

Parallel systems created to bypass such difficulties are not without problems, either. When buyers enforce labor standards instead of the government, improving working conditions is viewed as corporate social responsibility rather than legal compliance, and factories demand buyers to pay the price of good will. Yet buyers are unwilling to pay a premium for better working conditions; rather, they are keen to obtain lower prices. Buyers therefore end up playing two contradictory roles: enforcing labor standards on the one hand and demanding lower prices and faster delivery on the other, squeezing supplier profits and their capacity to improve working conditions. Another question of buyer-driven regulation concerns sustainability. A similar program in Lesotho spearheaded by the ILO and the IFC is experiencing difficulty as brands are backing off and donors are failing to come through with funding (Seidman, 2009). To the extent that regulation depends on fickle market forces, its long-term viability is uncertain.

The difficulty facing developing countries is therefore a combination of government and market failures. The inherent limits of private regulation are increasingly acknowledged (Vogel, 2005; Graham and Woods, 2006; Kuruvilla and Verma, 2006; Seidman, 2007). Ultimately, only government possesses undisputed legitimacy and potential to enforce labor standards across all sectors in a sustainable manner. Nevertheless, developing country governments are too often incapable of effectively assuming regulatory roles.

Given the lack of a simple solution, spreading the benefits of better labor conditions worldwide requires progress on all fronts. First, non-state initiatives need to better coordinate themselves as well as with state regulation. While ILO BFC has played an important coordinating role to bring together stakeholders in the Cambodian garment industry, it should further coordinate their monitoring efforts with state regulators.

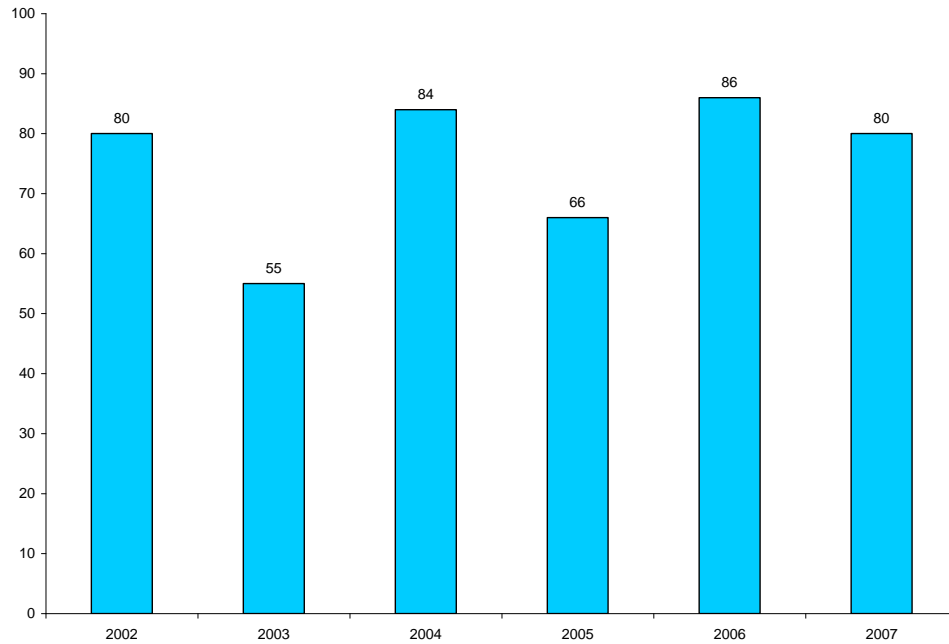
Second, future efforts need to go beyond monitoring. In Cambodia, the ILO had much broader engagement than just monitoring: the ILO helped revise the labor code, supported freedom of association, educated workers about their rights and duties, set up a dispute resolution mechanism, trained union leaders and factory supervisors. Moreover, such extensive ILO involvement was made possible by the political dynamics in the US and its relation with Cambodia, rendering the Cambodian case more unique than universal.

Third, government officials should be given the right incentives to enforce the law. This necessitates a decent wage and much stricter discipline as regards corruption. Effective law enforcement in turn calls for the rule of law. Given that it is a fundamental political issue, technical assistance alone is unlikely to bring about changes. The political class needs to change the prevailing rule of the game and put an end to the culture of impunity. This may be facilitated by internal and external pressures—both governmental and non-governmental—that demand democracy, transparency, and justice.

All in all, through evaluating ILO BFC, this chapter has illustrated the complex and multi-level forces shaping the regulatory dynamics in the Cambodian garment sector. While it was US political pressures that initiated the ILO's extensive

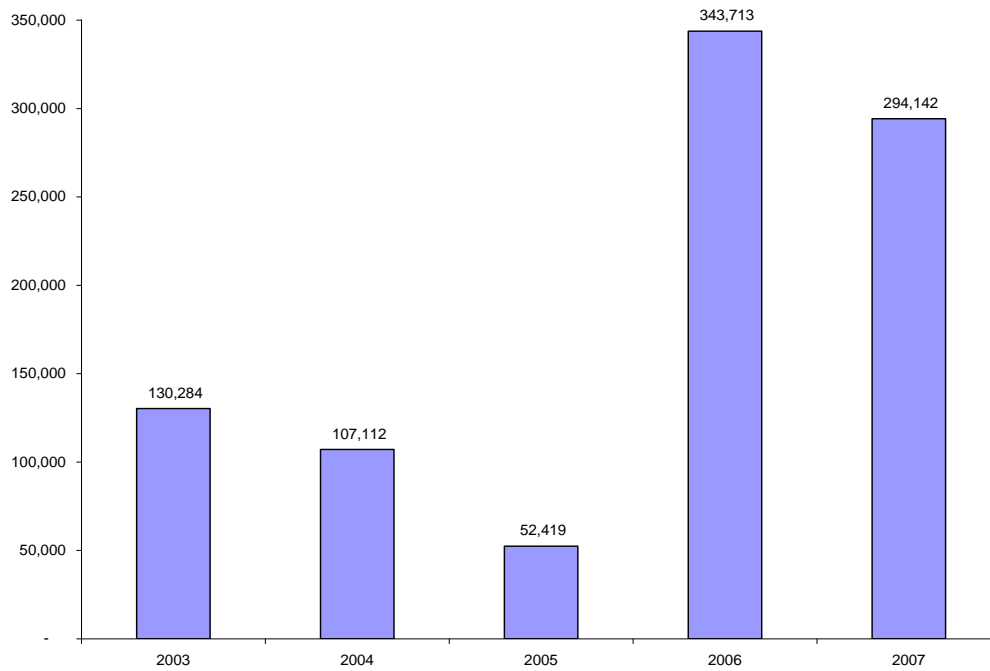
engagement in Cambodia's garment sector, it is currently buyers' needs and demands that are driving ILO BFC. Hence, the remaining chapters focus on the role of buyers in regulating and influencing working conditions in their supplier factories.

Figure 1-1. Number of strikes in the Cambodian garment industry



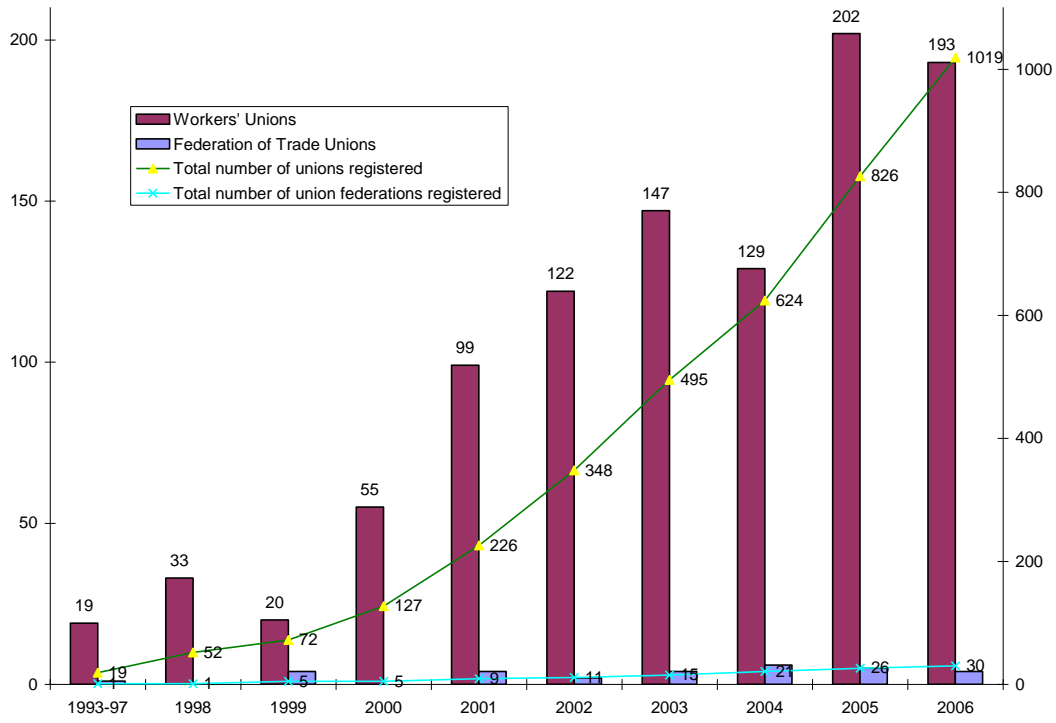
Source: Department of Labor Dispute, Ministry of Labor and Vocational Training

Figure 1-2. Number of lost working days caused by strike



Source : Garment Manufacturers' Association of Cambodia (GMAC)

Figure 1-3. Number of unions and federation registered



Source: Department of Labor Dispute, Ministry of Labor and Vocational Training

## **Chapter 2. The Role of Reputation-Conscious Buyers in Regulating Labor Conditions**

### **2.1. Introduction**

Business has come to play an important role in regulating the sphere traditionally reserved for government, especially in developing countries. On the one hand, the globalization of production and the vertical disintegration of multinational enterprises (MNEs) have contributed to the growing industrial capabilities in the developing world (Gereffi et al., 2005). On the other hand, persistent lack of capacity of developing country governments has created regulatory gaps, and transnational networks of activists have come to demand MNEs to assume responsibilities for regulating labor conditions in their supply chains (Elliott and Freeman, 2003).

In particular, MNEs in labor-intensive sectors such as garment and footwear have been criticized for sourcing from countries where labor is cheap and regulation is weak: taking advantage of so-called ‘sweatshop’ labor and aggravating a ‘race to the bottom.’ The 1990s saw a remarkable growth in anti-sweatshop campaigns, mostly emanating from the United States and Europe. In particular, famous brands such as the Gap, Levi Strauss, and Nike were exposed and blamed for dismal working conditions in their supply chains in developing countries.

As a response to the growing demand for more proactive involvement in regulating working conditions, many MNEs have implemented codes of conduct (CoC) and monitoring procedures while some brands have joined multi-stakeholder initiatives (MSI) to commit to better working conditions in global supply chains (O’Rourke, 2006). The principal motivation of MNEs is to safeguard their reputation as damaging a brand

image incurs a considerable financial loss (Conroy, 2007). To a larger extent, therefore, non-state regulation has become one of the dominant modes of regulating labor conditions in global supply chains.

The rise of non-state regulation of labor standards has provoked heated debates about its effectiveness. While some see CoC and private monitoring as a flexible response to the reality of poor regulation in developing countries (Nadvi and Wältring, 2004), others find fault with private systems of CoC and monitoring, arguing that they exclude workers and lack transparency and credibility. Esbenshade (2004) points out that the system of private monitoring has inherent contradictions: manufacturers control monitoring that is meant to discipline them while workers have no voice in the system that is meant to benefit them. Barrientos et al. (2003) criticize buyer CoC for their narrow scope and bias against labor rights such as freedom of association. Barrientos (2008) also maintains that CoC fail to protect the most vulnerable workers employed by subcontractors. Further, Seidman (2008) argues that even independent monitoring schemes face limitations as monitors are dependent on employers for access and funding.

Moreover, some scholars voice concerns that anti-sweatshop campaigns' focus on brands restricts the regulated realm to export sector for brand products whereas working conditions elsewhere tend to be worse (Elliott and Freeman, 2003). Similarly, Seidman (2008) points out that under the private system of CoC and monitoring, buyers choose the level of standards for their target consumers: US brands targeting students such as the Gap may implement rigorous standards while retailers targeting price-conscious consumers such as Wal-Mart may care less.



This last point raises an important question about the potential and limits of buyer-driven regulation. Do different buyers have different labor standards? Do reputation-conscious buyers regulate suppliers differently from other buyers? Does buyer-driven regulation create pockets of best practices or ratchet up working conditions? These questions remain largely unanswered mainly due to lack of systematic data.

Empirical studies have been largely limited to single case or small N case studies on private/independent monitoring or specific buyers. Even the most comprehensive evaluation of MSI to date, Ethical Trading Initiative (ETI) impact study, covering 11 ETI member companies 23 supplier sites in 5 countries, does not assess impacts quantitatively.<sup>50</sup> Further, the ETI impact study does not compare suppliers of ETI member companies with other suppliers, limiting the types of buyers under examination. Existing studies on buyers tend to be qualitative and limited to branded buyers (Frenkel, 2001; Frenkel and Scott, 2002; Locke and Romis, 2006). Despite exceptions such as Locke et al. (2007) and Jiang (2009) that quantitatively evaluate the impact of buyer-supplier relationships, there is a lack of systematic assessment on whether and how different types of buyers variably affect working conditions in supplier facilities.

The purpose of this chapter, therefore, is two fold: (i) to assess whether buyers with *different degrees of reputation consciousness*—defined in this paper using buyers' MSI membership status—variably influence supplier compliance with labor standards and (ii) to identify the patterns through which buyers regulate working conditions in supplier factories. This chapter seeks to achieve this task through a mix of quantitative and qualitative approaches. Quantitative analysis exploits the unique factory-level data

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<sup>50</sup> ETI impact studies can be accessed via their website: <http://www.ethicaltrade.org/resources/key-eti-resources/eti-impact-assessment-part-1-main-findings>

provided by the International Labour Organization (ILO) program, Better Factories Cambodia (BFC). Qualitative analysis is based on the author's field research conducted in Phnom Penh, Cambodia in the summers of 2007 and 2008.

This chapter focuses on the unique nature of the Cambodian model that combines semi-public monitoring and private enforcement. While the ILO is mandated to monitor and report factory compliance with the Cambodian labor law and international labor standards, the ILO has no enforcement power. The Ministry in charge of labor inspection and remediation suffers from incapacity and corruption, which prevents it from effectively enforcing the labor law. Given the lack of government enforcement, buyers often act as a virtual enforcement authority.

This chapter is organized as follows. The next section discusses deterrence theory that links the motivations of buyers and suppliers with compliance performance. Then, the methods and data will be discussed. The quantitative section shows that factories producing for reputation-conscious buyers have better compliance levels than other factories. The qualitative section demonstrates that reputation-conscious buyers enforce labor standards both *reactively* and *proactively* while suppliers also make proactive efforts despite constraints imposed by purchasing practices. Finally, the chapter concludes by highlighting the potential and limits of buyer-driven regulation and the actions needed to spread the benefits of better working conditions more widely.

## **2.2 Theory and Hypotheses**

Theoretical literature on compliance has traditionally focused on the role of enforcement and deterrence. The literature has been inspired by the economics of crime literature pioneered by Becker (1968) and Stigler (1970), who argued that individuals

and firms rationally weigh the cost and benefit of non-compliance when deciding whether or not to violate a law. This deterrence theory posits that a firm's propensity to comply with regulations is positively related with the probability of detection and expected penalty of violation. In other words, unless detection is probable and punishment is sufficiently severe, firms always have an incentive to evade regulation. This logic has been applied to a number of compliance issues including occupational safety and health (Viscusi, 1979; Bartel and Thomas, 1985) and minimum wage compliance (Ashenfelter and Smith, 1979).

More recently, this theory has been applied to *private* monitoring of minimum wage compliance in the US garment industry (Weil, 2005; Weil and Mallo, 2007). They find that more stringent forms of monitoring by manufacturers are associated with better compliance. Indeed, scholars increasingly recognize that public enforcement is no longer the dominant force driving compliance behavior of firms and that various third-parties are actively shaping regulatory environment (Braithwaite and Drahos, 2000; Black, 2003; Hutter and Jones, 2007). Particularly in the global garment industry, which has seen a wave of anti-sweatshop campaigns and boycotts since the 1990s, societal and media pressures have become the driving force of firms' compliance behavior with regard to labor standards.

While the deterrence theory was initially developed to explain compliance behavior in response to public enforcement, it can be applied to private enforcement as well. Those buyers facing a higher probability of detection and expected penalty are more willing to invest their time and resources in regulating their supply chains than other buyers. Expected penalty is higher for those buyers that derive much of their value from brand image. For major apparel brands such as Adidas, the Gap, and Nike, brand

value accounts for 40 to 50 percent of the companies' market capitalization (Conroy, 2007). Bad publicity arising from negative campaigns seriously damages brand reputation and thus profits. Knowing the vulnerability of brands, activists have deliberately targeted them and often succeeded in modifying corporate behavior (Ibid.). Given the higher probability of detection and expected penalty, buyers who have the most to lose from bad publicity have come to regulate their supply chains more rigorously.

Most buyers enforce CoC in their supply chains through pre-order selection and post-order monitoring. Before placing orders, almost all buyers assess the compliance levels of candidate factories either by internal compliance teams or external auditors. If compliance level is deemed unsatisfactory, compliance teams demand corrective action plans. Only when the factory's compliance reaches an acceptable level, can sourcing teams place orders. In this way, buyers' compliance departments play the role of a gate keeper. After orders are placed, factories are regularly monitored, and once important or persistent non-compliance issues are signaled, buyers ask for corrective action plans. If factories do not rectify the problems within a given time frame, buyers may cancel orders. While most major buyers have CoC that include the national labor law and international core labor standards, the acceptable level of compliance and the degree of actual enforcement are likely to depend on buyers' vulnerability to negative publicity and thus reputation consciousness.

For supplier factories, therefore, the expected cost of labor standard violation varies with the type of buyers they are producing for. Reputation-conscious buyers, facing the higher expected cost of non-enforcement, are more likely to carefully assess their supplier compliance before placing orders and enforce rigorously after placing

orders. Consequently, the cost of non-compliance facing suppliers of reputation-conscious buyers is higher than that of other suppliers, making the former more likely to comply with labor standards than the latter.

The expected cost of non-compliance may also depend on the number of buyers a factory is producing for. From the deterrence perspective, when a factory is being watched by a number of buyers, non-compliance is more likely to be detected and punished, raising the cost of non-compliance. Based on the ETI impact study, Barrientos and Smith (2007:720) point out the importance of “critical mass” of buyers for inducing supplier compliance. Nonetheless, when a factory is producing for only one buyer, the probability of detection may be lower, but the cost of punishment (i.e. eventual cancellation of orders) may be larger.

The cost calculation of suppliers, then, is likely to depend on a combination of the type and number of buyers: when a factory is producing for only one or a small number of very reputation-conscious buyers, given their rigorous enforcement and potentially high cost of punishment, the factory is likely to maintain a relatively high level of compliance. When a factory is producing for only one or a small number of less reputation-conscious buyers, however, it is unlikely to give a sufficient incentive for suppliers to improve compliance performance significantly. In other words, the effect of critical mass is likely to be more important for less reputation-conscious buyers. Given the above discussion, we can form the following hypotheses.

*Hypothesis 1. Factories producing for at least one particularly reputation-conscious buyer will have a higher level of labor standard compliance than factories producing for other types of buyers.*

*Hypothesis II. Factories producing for a larger number of less reputation-conscious buyers will have a higher level of labor standard compliance than factories producing for fewer of these buyers.*

This chapter combines quantitative and qualitative methods as each method can make distinct contributions (Brady and Collier, 2004). The quantitative method helps establish statistical relationships between variables and an outcome and identify *whether and how much* each variable matters for the outcome. The qualitative method can account for the causal mechanisms and processes: *why and how* those variables lead to the outcome. Moreover, *triangulation* of different methods approaching the same problem increases inferential leverage and enhances the validity of hypotheses (Ibid.).

Specifically, the following quantitative section describes variables and estimates regression models to explain variation in compliance performance of Cambodia's garment factories. The purpose here is to evaluate the hypotheses that reputation consciousness of buyers and the number of such buyers sourcing from a factory significantly affect supplier compliance performance. The subsequent qualitative section builds on the quantitative findings and seeks to explain the black box: through which mechanisms buyers regulate supplier compliance.

### **2.3. Quantitative Analysis**

The quantitative section of this paper draws on the wealth of information collected by ILO BFC. ILO monitors conduct un-announced visits of all exporting garment factories every 6 to 8 months. As monitoring covers the entire population of exporting

factories in Cambodia (approximately 300), there is no problem associated with sampling. While the ILO has been monitoring factories since 2001, monitoring and firm characteristic data have been systematically stored only since 2006. Accordingly, the data used for this study cover the period from January 2006 to December 2008 for 344 factories. During this period, ILO monitors visited factories 4 times on average. The data have been pooled to make a panel dataset of 1230 observations.

### ***Dependent Variable***

ILO monitors assess nearly 400 checklist items of labor standards, which are based on the Cambodian labor law and the international labor standards. The monitored standards have been agreed by a tri-partite governing body, comprising of the Cambodian government, employers, and unions in the garment industry. These standards are grouped into the following categories: contracts, wages, hours, leave, welfare, occupational safety and health (OSH), and fundamental rights.

As for monitoring procedures, un-announced visits span an entire day or longer for larger establishments. The process includes on-site inspection, meetings with human resource managers, union leaders, and shop stewards as well as off-site interviews with workers. Copies of pay slips and hour records are collected for verification. ILO monitors assess each checklist item and determine whether a factory complies with a specified standard. When the factory is deemed out of compliance with a certain item, monitors make a standardized suggestion for improvement. Therefore, the presence of a suggestion is equivalent to non-compliance and the absence of a suggestion, compliance.

In general, fewer suggestions or non-compliance items indicate better working conditions.<sup>51</sup>

The average compliance level during the period between 2006 and 2008 is 89 percent, where a score of 100 indicates full compliance. This suggests a very high level of overall compliance in Cambodia's garment industry during this period. Nonetheless, there is large variation in compliance performance, ranging from near-full compliance to over 100 non-compliance items. Figure 2-1 shows the frequency distribution of the number of non-compliance items in the sample. This quantitative section seeks to explain this variation: why do some factories have better labor compliance levels than other factories? The dependent variable, therefore, is the number of non-compliance items found in each monitoring visit.

### ***Independent Variables***

The independent variables are the presence and number of reputation-conscious buyers. This concept is operationalised by buyer membership of multi-stakeholder initiatives (MSI). Since reputation-conscious buyers tend to participate in MSI to show their commitment to better working conditions and safeguard their reputation, it is a reasonable proxy. Following O'Rourke (2006: 899), this thesis defines MSI in labor regulation as a scheme that involves various stakeholders in negotiating labor standards, monitoring compliance with these standards, and establishing mechanisms to encourage firms to comply with these standards. While MSI can take various forms from

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<sup>51</sup> Recently, it is increasingly acknowledged that compliance is a limited measure of actual working conditions given the prevalence of audit fraud such as double-book keeping (Barrientos and Smith, 2007). Moreover, monitoring fundamental rights, including freedom of association, discrimination, child labor, remains a difficult task. Despite these challenges, ILO monitoring results in Cambodia's garment sector are the most comprehensive and reliable industry-wide data available on the general state of working conditions in garment factories.



certification of production facilities to collaboration of buyers, this chapter concentrates on buyer-oriented schemes given our interest in the role of reputation-conscious buyers.

This chapter considers three MSI: Better Factories Cambodia (BFC), the Fair Labor Association (FLA), and the Ethical Trading Initiative (ETI). BFC embodies an MSI approach given its tripartite governance structure. Buyers participating in BFC (hereafter BFC buyers) pay moderate fees to access to ILO monitoring reports with factories' consent. At the end of 2008, there were 37 international buyers participating in BFC, most of which are brands and well-known retailers. The FLA, an American initiative, is the oldest and the best known brand-oriented MSI in labor regulation. It emphasizes transparency, disclosure, and certification (Hughes et al., 2007). Member companies are required to implement the FLA CoC, submit to un-announced monitoring, and to commit to remediation and public reporting. Currently, 26 companies are participating, most of which are well-known apparel and sportswear brands. The ETI, a UK scheme, is geared toward collaboration and learning rather than monitoring and enforcement (Ibid.). The ETI encourages its member companies to implement its base code in their supply chains and require them to submit annual progress report on their code implementation. Currently, 50 companies are participating, most of which are European brands and retailers.

It is important to note the key differences between BFC and the other two MSI, the FLA and the ETI. First, BFC does not certify buyers and does not require buyers to implement certain codes or monitoring/reporting procedures. Second, buyers can fully rely on ILO monitoring and replace their own (or third-party) audits if they choose to, given the ILO's industry-wide monitoring. Third, while membership of the FLA and the ETI involves expensive fees, BFC only asks buyers to pay very reasonable fees to

access to monitoring reports. Overall, BFC is more economical and less burdensome than the FLA and the ETI.

This thesis operationalizes the degree of reputation consciousness by dividing buyers into three groups: buyers that participate in BFC *and* the FLA or the ETI (hereafter MSI buyers); buyers that participate in BFC but *not* in the FLA or the ETI (hereafter BFC-only buyers); and buyers that participate in none of the MSI mentioned. The degree of reputation consciousness is considered high for MSI buyers, given the extra burden involved. Indeed, all the MSI buyers in the sample are branded buyers that have experienced negative publicity. BFC-only buyers are considered less reputation-conscious than the first group. These buyers are mostly large and well-known retailers. The third category of buyers that participates in none of the MSI is mostly smaller generic retailers that consumers hardly hear of and thus least reputation-conscious.

Table 2-1 shows the summary statistics of variables. BFC-only buyers are present in 31 percent of the factories in the sample. The number of BFC-only buyers sourcing from a factory ranges from 0 to 4. As for MSI buyers, 27 percent of the factories in the sample produce for at least one MSI buyer, participating in either the FLA or the ETI in addition to BFC.<sup>52</sup> This leaves 42 percent of factories producing for buyers that join none of the MSI. There appears to be a significant negative association between the number of more or less reputation-conscious buyers in a factory and non-compliance (Figure 2-2 shows the number of all BFC buyers, which is a combination of BFC-only and MSI buyers).

### ***Control Variables***

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<sup>52</sup> The number of MSI buyers sourcing from the same factory is small, and thus this variable is highly correlated with the presence variable (>0.89), which is why it is dropped from regression analysis.

However, buyer variables are unlikely to be the only factors that affect the factory-level compliance performance. Various establishment-level characteristics are clearly related to working conditions, and thus need to be controlled for. First of all, the size of the establishment, as measured by number of employees, can affect the level of compliance. Larger factories have made larger investment, raising their opportunity costs of exit, which, in turn, justifies larger investment to comply with labor standards. In particular, when investment involves large fixed costs, a minimum efficiency scale may be needed. Moreover, given that size increases employee alienation and supervisory costs, larger establishments are more likely to see the benefit of respecting labor standards to raise self-motivation and to minimize the source of disputes and monitoring cost (Bryson et al., 2007). For all these reasons, larger establishments are more likely to be associated with better compliance. The natural logarithm of total number of employees measures the size of the establishment.

Second, the age of the establishment is likely to influence the level of compliance. Factory management may learn the benefit of compliance or the cost of non-compliance over time (age).<sup>53</sup> On the other hand, the age of the establishment may impose physical constraints: older establishments tend to have older facilities and limited space, making it more difficult and costly to comply with certain standards concerning welfare as well as safety and health (Bryson et al., 2007). Given the lack of precise data on this variable, total number of visits by ILO monitors since 2001 is used as a proxy, ranging from 1 to 9.

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<sup>53</sup> Factory management can also learn from training. The ILO provides various training on labor standards and human resource management to factories on a voluntary basis. While it is beyond the scope of this thesis, this avenue may be explored in future work.

Third, unions are likely to affect the factory's working conditions. That unions raise wages and improve worker benefits has been widely researched and acknowledged (Freeman and Medoff, 1984). Moreover, unionized establishments are found to violate fewer safety and health standards (Weil, 2001). In Cambodia, labor unions have grown both in number and in power since the revision of the labor code in 1997. In the sample, the number of unions ranges from 0 to 6, with a mean of 1.3 unions in a factory. Disputes and strikes are a major threat for employers in a time-sensitive business like garment. Since unions are likely to raise the cost of non-compliance through possible disputes and strikes, employers of unionized establishments and especially those with a larger number of unions are more likely to comply with labor standards.

Fourth, the factory's ownership may help explain the variation in labor standard compliance. Foreign-owned firms tend to provide better pay to workers than their domestic counterparts, given the MNEs' advanced technological know-how and management systems (OECD, 2008). In Cambodia, over 90 percent of exporting garment factories is foreign owned while 61 percent is owned by investors from Taiwan, Hong Kong, and China.<sup>54</sup> This study will assess whether a minority of factories under the Western and Cambodian ownership is different from the rest in terms of compliance level.

### ***Model Specifications***

This section tests whether the degree and number of reputation-conscious buyers have a significant effect on supplier labor standard non-compliance. In addition to the variables discussed above, year control dummies for 2006 and 2007 are added to form the following model:

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<sup>54</sup> Figures from Garment Manufacturers' Association of Cambodia (GMAC).

$$\text{Non-compliance}_{it} = \alpha + \beta_1 \cdot \text{presence of MSI buyers}_{it} + \beta_2 \cdot \text{presence of BFC-only buyers}_{it} + \beta_3 \cdot \text{number of BFC-only buyers}_{it} + \beta_4 \cdot \text{establishment size}_{it} + \beta_5 \cdot \text{establishment age}_{it} + \beta_6 \cdot \text{union presence}_{it} + \beta_7 \cdot \text{number of unions}_{it} + \beta_8 \cdot \text{domestic ownership}_{it} + \beta_9 \cdot \text{western ownership}_{it} + \beta_{10} \cdot \text{year 2006}_{it} + \beta_{11} \cdot \text{year 2007}_{it} + \varepsilon_{it}$$

Three types of specifications have been estimated: an Ordinary Least Squares (OLS) estimate using the raw number of non-compliance items (raw OLS), an OLS estimate using the natural logarithm of non-compliance items (semi-log OLS), and a between effects estimate using the natural logarithm of non-compliance items (semi-log between effects). While the raw OLS model allows for the most straight-forward interpretation of coefficients, it suffers from considerable heteroskedasticity, compromising its efficiency. With the semi-log model, heteroskedasticity is significantly reduced.

To address the concern that the OLS assumption of constant intercept across cases and time may be unreasonable, fixed, random, and between effects are considered. Fixed effects regression is often used for panel data to control for omitted variables that differ between cases but are constant over time. It uses time-series information of panel data to measure the expected change in the dependent variable given a unit change in a variable *within* cases. As the fixed effects model is equivalent to introducing dummy variables, which reduces a degree of freedom for each case, this technique is more appropriate for panel data with fewer cases and longer time periods.

In contrast, between effects is used to control for omitted variables that change over time but remain constant between cases. This model uses cross-section information

of panel data to measure the expected change in the dependent variable given a unit change in a variable *across* cases. This is equivalent to taking the mean of each variable for each case across time and estimating a regression with the collapsed dataset of means. The random effects are weighted average of the fixed and between effects, assuming that the unit change in an independent variable leads to the same effect on the time-series and cross-section data. The Hausman test does not justify the use of random effects for the data.

Considering the nature of the data (i.e. panel data with a large number of cases and a small number of time periods) and the question this paper seeks to answer (i.e. why do some factories have better compliance levels than others), between effects model is more appropriate. The between effects model is used as a check to the semi-log OLS, our preferred model given its intuitive results, efficiency, and larger degrees of freedom.

### ***Results***

All three models show a significant negative association between reputation-conscious buyer variables and non-compliance (Table 2-2). In other words, non-compliance is reduced when a factory is producing for reputation-conscious buyers. Specifically, the presence of MSI buyers is consistently significant at the 0.001 level. In terms of coefficients, the presence of MSI buyers reduces non-compliance by 35 percent. In the raw OLS model, this translates to a reduction in non-compliance items by 13 items. This result supports the first hypothesis that factories producing for at least one particularly reputation-conscious buyer have better compliance performance than other factories.

As for BFC-only buyers, the presence of BFC-only buyers is not consistently significant although the number of BFC-only buyers is highly significant across all

models. An additional BFC-only buyer in a factory reduces non-compliance by 11.2 percent, which is equivalent to 2.8 items in the raw OLS model. This indicates that a less reputation-conscious buyer alone does not induce a marked improvement in supplier compliance, but when more of them are sourcing from the same factory, they create a critical mass of pressure to bring about better working conditions. This result supports the second hypothesis about the number of buyers.

Among control variables, the size of the establishment is statistically significant across all three models. Larger factories enjoy economies of scale and tend to have more resources and sophisticated management systems. The age of the establishment is positively associated with non-compliance, suggesting that newer purpose-built factories have better compliance levels. Union presence is positively associated with non-compliance while the number of unions is negatively associated with non-compliance, though both variables are statistically non-significant.<sup>55</sup> Domestic ownership is highly significant and it increases non-compliance while Western ownership reduces non-compliance. This result is consistent with the theory of foreign wage premium as Cambodian-owned factories tend to lack managerial know-how and financial means while the opposite is the case for Western-owned factories. Year dummy controls show that compliance performance has significantly improved in 2008 compared to 2006 and 2007. Product types, which indicate complexity and skill levels, were initially included in the regressions, but none of them were found significant. This is likely to stem from the fact that Cambodia specializes in low-end products.

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<sup>55</sup> This unexpected result may stem from the fact that a number of dubious ‘yellow’ unions have sprung up in Cambodia in recent years, and that corruption runs rampant as corroborated by multiple interviews. Although the type of unions may have made the difference for the outcome, data limitation precludes further investigation. ILO (2006) finds that independent unions are more helpful for workers than government-supported unions.

## 2.4. Qualitative Analysis

While the above quantitative analysis has confirmed the statistically significant relationship between reputation-conscious buyers and supplier compliance, data constraints prevent us from delving into the mechanisms through which buyers regulate their supplier compliance. The strength of case study research lies in in-depth analysis of few cases to shed light on causal processes. While various types of case studies exist, this section represents a “pathway case,” which seeks to demonstrate causal mechanisms building on quantitative analysis (Gerring, 2007: 122).

This section is based on the author’s fieldwork conducted in the summers of 2007 and 2008 in Phnom Penh, Cambodia. The author conducted 61 semi-structured interviews with factory managers, buyer representatives, industry experts, union federation leaders, labor activists, government officials, and international donors. All interviewees remain anonymous as the content includes sensitive issues. While a number of factors influence working conditions, reputation-conscious buyers were frequently mentioned as a key player. Specifically, these buyers steer suppliers both *reactively* and *proactively* while some suppliers make proactive efforts to improve working conditions despite constraints imposed by purchasing practices.

### ***Pressure-driven Enforcement***

Buyers can make a significant impact at the factory level particularly when transnational advocacy networks are mobilized to pressure buyers. Specifically, activists engage in what Keck and Sikkink (1998) call “accountability politics,” where transnational advocacy networks act as a source of countervailing power, hold MNEs to their CoC, and pressure them to adopt more stringent standards. Important networks for anti-sweatshop campaigns are international trade union federations, student



organizations, and other pro-labor NGOs. Such transnational linkages have proved helpful in improving working conditions in a few garment factories in Cambodia as demonstrated by the following two examples.

A union federation leader cited one major case that mobilized a transnational solidarity network to address anti-union discrimination.<sup>56</sup> River Rich factory dismissed 30 union leaders and members after they organized an election to form an independent union in October 2006. Strikes calling for the reinstatement of the union members faced the riot police. As the union belonged to the federation, the Coalition of Cambodian Apparel Workers Democratic Unions (CCAWDU), which was affiliated with the International Textile Garment Leather Workers' Federation (ITGLWF), they asked for assistance. Lack of cooperation from the management led the ITGLWF to pressure the factory's major buyers, Inditex and H&M for action.

In June 2007, the senior representatives from the ITGLWF, Inditex, H&M, and CCAWDU had intensive discussions with the factory's top management, which resulted in a historic agreement that went beyond the reinstatement of fired workers.<sup>57</sup> Since then, River Rich has been enjoying stable and cooperative industrial relations, thanks to this transnational linkage between the union, the international union federation, and the buyers.<sup>58</sup> Since the union has a close connection with the key buyers, the factory management is aware that the union may contact the buyers if any issues arise.

Another illustrative case involves the Worker Rights Consortium (WRC), Adidas, and PCCS garment factory. The WRC is a US NGO that investigates worker complaints and promotes information disclosure in factories producing University branded products.

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<sup>56</sup> Interview with union federation leader, CCAWDU. 10 September, 2007.

<sup>57</sup> The agreement is available from the website of the ITGLWF:  
<http://www.itglwf.org/DisplayDocument.aspx?idarticle=15317&langue=2>

<sup>58</sup> Interview with training expert. 12 September, 2008.

In 2006, the WRC was contacted by workers to investigate the misuse of short-term contracts in the factory.<sup>59</sup> The Cambodian labor law stipulates that fixed duration contracts should be used for temporary positions and that they cannot exceed 2 years. At the factory, some workers were hired under the contract of fixed duration for 2 to 3 months, after which time they were instructed to take a week-off and then come back to work under new fixed term contracts. This practice deprives workers of their right to seniority bonus, maternity and annual leave among other benefits while it undermines employment security from inappropriate dismissal. At the time of WRC investigation in March 2006, around 1000 employees, about 25 percent of workforce, were under the fixed term contracts.<sup>60</sup>

As the initial discussions between the WRC and the management produced no effects, the WRC pressured Adidas, the factory's major buyer, to take action. With the intervention of Adidas, the discussions started to take on a different tone. Adidas issued a warning to the management that unless the factory converted all fixed-term contracts to non-determined ones in one month, it would cancel its orders.<sup>61</sup> Only after this key intervention by Adidas, the management started to change and finally agreed to make drastic changes.<sup>62</sup> The factory agreed to convert the majority of fixed-term contracts into non-determined ones, and this has been respected since.

Despite these successful examples, this transnational tactic of using buyer leverage to bring about positive changes at the factory level has its limitations. The WRC investigator acknowledges that reputation-conscious brands are more prone to pressures

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<sup>59</sup> Interview with WRC investigator. 4 September, 2007.

<sup>60</sup> The WRC investigation report on this case is available from their website: [http://www.workersrights.org/Freports/Update\\_Dec2006.asp#PCCS](http://www.workersrights.org/Freports/Update_Dec2006.asp#PCCS)

<sup>61</sup> Interview with general manager, PCCS Garment. 21 June, 2008.

<sup>62</sup> Interview with WRC investigator. 4 September, 2007.

and therefore more cooperative, but other buyers care less. While this transnational strategy may work for major issues, it cannot deal with smaller day-to-day issues. A union federation leader involved in the River Rich case concurs that it is time-consuming and costly to pursue this tactic.<sup>63</sup> Moreover, those who can exploit transnational linkages are limited to well-connected and English speaking union federations.<sup>64</sup> All in all, mobilization of transnational networks may bring about positive changes in some factories that produce for reputation-conscious buyers, but it is unlikely to address various day-to-day issues in the majority of factories.

Even if such transnational networks cannot be mobilized every time, however, the possibility of such an alliance has changed dynamics. Establishment-level unions have also come to see buyers as a source of leverage and an authority that can enforce the labor law and improve worker welfare. Indeed, more than a few factory managers complain that unions threaten that they will call buyers if management does not cooperate. In fact, not only unions but also government officials sometimes turn to buyers for help. Since government safety and health inspectors lack enforcement power unlike labor inspectors, they contact buyers to ask for remedial action when serious safety and health issues are found in garment factories producing for famous brands.<sup>65</sup>

### ***Buyer-driven Enforcement***

Through repetitive interactions with transnational activist networks over the past decade, some buyers have come to take a proactive approach to regulating working conditions in their suppliers. Bartley (2005) discusses the dynamic interplay between companies and pressure groups, which gradually changes the terms of debate and

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<sup>63</sup> Interview with union federation leader, CCAWU. 10<sup>th</sup> September, 2007.

<sup>64</sup> Interview with union federation leader, FTUWKC. 26 September, 2007.

<sup>65</sup> Interview with official, Department of Occupational Safety and Health. 21 September, 2007.

regulated terrain. Indeed, some buyers have become proactive and increasingly involved in remediation at the factory-level.

Major brands sourcing from Cambodia, the Gap and H&M have local representatives who deal specifically with compliance issues. The Gap takes a pre-emptive approach and tries to stay well-informed of situations in their supplier factories so that they can intervene at an earlier stage. “We don’t want a bad surprise. We don’t want to learn about a problem in our supplier factory in some newspaper. Rather, we try to intervene before the problem gets bigger.”<sup>66</sup> The Gap’s local representative has extensive contacts with union leaders and helps resolve issues on a daily basis. In fact, other buyers without local staff sometimes even ask them to intervene in their supplier factories when problems arise. The Gap is also heavily involved in dispute resolution. They pressure their suppliers to implement both binding and non-binding awards of the Arbitration Council, a tripartite entity set up by the ILO to deal with collective disputes. They enjoy such leverage vis-à-vis their suppliers partly because they tend to be the major buyer for their suppliers, accounting for up to 70 percent of production in some of factories.

The policy of H&M vis-à-vis their supplier compliance is “transparency, cooperation, and openness.”<sup>67</sup> Locally-based compliance staff visit their suppliers 3 to 4 times a year for two different purposes. First, there are visits based on a remediation cycle of 18 to 24 months, consisting of an un-announced visit and three follow-up visits. Then, there are “ordinary visits,” whose purpose is to engage in continuous dialogue and share best practices. This way, H&M compliance staff try to foster an open

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<sup>66</sup> Interview with the Gap representative. 24 June, 2008.

<sup>67</sup> Interview with H&M representative. 16 October, 2008.

relationship with suppliers, which helps to keep them informed of the situation and to contribute to suppliers' continuous improvement. H&M local compliance staff also work closely with unions. When problems arise, they try to play a neutral mediator role between factory management and unions. When collective disputes are settled at the Arbitration Council, H&M enforces binding awards and sometimes also non-binding awards, depending on the nature and context of cases.

Nonetheless, not all buyers are so proactive and willing to invest their time and efforts to understand and solve problems in supplier factories. Multiple interviews have confirmed the difference in buyer approaches. Well-known brands, in particular those with local representatives, are more well-informed of the local situation and readily available to help solve problems on the factory floor. Moreover, these buyers tend to have more direct contact and established relationships with supplier factories, increasing their leverage. In contrast, other lesser known retailers were never mentioned as helpful partners. These generic retailers tend to use sourcing agents, and thus their relationships with supplier factories are much more distant and mediated, diluting their leverage.

### ***Supplier Efforts and Purchasing Practices***

Some factories are also taking a proactive approach. Since most buyers require factories to comply with their CoC and the national law before placing orders, factories learn about the required standards in advance and try to meet them, and some even try to go beyond the minimum standards. One factory manager mentioned that their current buyers do not have issues with their compliance performance, but the factory makes continuous and proactive efforts to improve working conditions to attract more buyers.<sup>68</sup>

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<sup>68</sup> Interview with factory manager. 11 September, 2008.

Given the fickle nature of the industry and the sluggish global economy, factories are keen to diversify risks by producing for different buyers from the US and Europe.

Different buyers have different standards. One factory manager remarks “Nike is much stricter about everything.”<sup>69</sup> Since buyers who require higher standards tend to be famous brands that give higher profit margins, factories trying to attract them need to improve compliance and sometimes go beyond the national labor law. “Buyer CoC often go beyond the legal requirements, so if we comply with CoC, naturally, we go beyond legal compliance.”<sup>70</sup> Nonetheless, many factory managers complain that compliance with buyer CoC is simply a minimum requirement to get orders, and better compliance does not bring more orders. “No compliance, no orders. But better compliance is not rewarded. It just gets you at the start line.”<sup>71</sup>

In fact, purchasing practices of buyers—including reputation-conscious ones—sometimes contradict with the goal of improving working conditions (Oxfam, 2004; CCC, 2009). A factory manager explains that significant fluctuations in orders make it difficult to keep all of their workers during the low seasons.<sup>72</sup> The garment industry is strongly marked by seasonality. In low seasons, some workers remain idle although the factory has to keep paying their wages. While some buyers require suppliers to hire workers on permanent contracts, they do not share the burden of extra labor costs. Consequently, factory management is sandwiched by buyers’ increasing demands and falling profits.

In recent years, intense competition and rising prices have squeezed garment producers’ profits. One factory manager laments as follows: “Three years ago, the price

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<sup>69</sup> Interview with factory manager. 16 September, 2008

<sup>70</sup> Ibid.

<sup>71</sup> Interview with factory manager. 21 June, 2008.

<sup>72</sup> Ibid.

of pant was \$10 a piece and the cost to produce was \$6 a piece. Now, the price stays the same and the cost has gone up to \$8-9 a piece. Buyers don't increase the price because they can go elsewhere if they want to. It's a buyers' market."<sup>73</sup> While brands are also pushing for lower prices, generic retailers are much more aggressive. One factory manager says he does not consider producing for retailers such as Wal-Mart because margins are too narrow to make profits.<sup>74</sup>

### *Summary*

All in all, the gap in compliance performance appears to stem from reputation-conscious buyers' tendency to rigorously regulate supplier compliance performance through pre-order selection and post-order enforcement, both reactively and proactively. Buyers act reactively in cases where transnational advocacy networks are mobilized to pressure them and demand remedial action in supplier factories. Through repetitive interactions, however, some reputation-conscious buyers have learned to be more proactive in addressing compliance issues in their supplier factories. On the other hand, some factories have come to see better compliance as a way of attracting reputation-conscious buyers and actively try to improve working conditions. Nonetheless, better compliance is not rewarded by buyers and some purchasing practices conflict with the goal of improving working conditions.

While engaged buyers tend to be famous brands, this may change as labor practices of large-scale retailers such as Wal-Mart increasingly come under scrutiny (CCC, 2009). If this trend continues and intensifies, these giant retailers may eventually follow reputation-conscious brands and learn to actively engage with suppliers. The

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<sup>73</sup> Interview with factory manager. 14 October, 2008.

<sup>74</sup> Interview with factory manager. 21 June, 2008.

quantitative findings indicate that a larger number of less reputation-conscious buyers sourcing from the same factory are associated with better compliance performance. This suggests potential for a *critical mass* of less reputation-conscious buyers to induce better compliance in supplier factories.

## **2.5. Conclusion**

The role of business in development continues to expand. In particular, business has been taking over some of the regulatory roles traditionally assumed by government. The globalized garment industry provides a striking example of how MNEs have come to regulate labor conditions in their supply chains in developing countries. Despite the scale and significance of this phenomenon, systematic investigation of the impact of buyers on supplier working conditions has been scarce. In particular, the question of whether buyer-driven regulation creates only pockets of best practices or leads to overall improvement remains largely unanswered.

Based on the unique firm-level data and field interviews in Cambodia's garment sector, this chapter has sought to examine whether and how different types and number of buyers affect labor standard compliance of suppliers. The quantitative findings clearly show that factories supplying for at least one *very* reputation-conscious buyer tend to have a better compliance level than other factories. Moreover, as the number of *less* reputation-conscious buyers sourcing from the same factory increases, so does the compliance level. The qualitative section has demonstrated that reputation-conscious buyers enforce labor standards both reactively and proactively, but buyers willing to engage with stakeholders are often branded buyers under public scrutiny.



The findings point to both the opportunities and limits of private sector-driven regulation in the developing world. Contrary to the criticism that global brands are exacerbating a ‘race to the bottom’ and that private regulation is ineffective, this chapter has shown that reputation-conscious buyers exercise an important regulatory role. Nonetheless, the study has revealed compliance gaps among factories supplying for buyers with different degrees of reputation consciousness.

In fact, the gap is not inherently harmful if some factories achieve better standards and the other factories follow in their footsteps. In Cambodia’s exporting garment sector, the general compliance level has significantly improved over the past decade and ‘sweatshop’ conditions are virtually non-existent. This result owes much to the ILO, which has constantly monitored all exporting garment factories, helped resolve collective disputes by setting up a tripartite Arbitration Council, and provided training and raised worker awareness about labor rights.

All these factors, however, make the Cambodian case more unique than universal, which is one of the limitations of this study. The Cambodian case does not reflect purely buyer-driven regulation, but rather a combination of public and private regulatory mechanisms. This implies that working conditions in purely buyer-regulated supply chains are likely to be worse. Another limitation of this research is its exclusive focus on exporting factories although working conditions in subcontractors are reportedly worse.

Nevertheless, important lessons can be learned from examining the Cambodian case. To spread the benefits of better working conditions more widely, each actor has an important role to play. First, activists and the media need to expand the scope of their attention and target not only branded buyers but also non-branded buyers so that the

latter start changing the cost-benefit calculation and become more engaged with suppliers. Second, buyers need to reward suppliers for better compliance and address purchasing practices that conflict with better working conditions. Moreover, buyers should join forces and better coordinate themselves to use the leverage of *critical mass*. Lastly, better coordination and enforcement requires capable government and effective international organizations, which are the ultimate source of sustainable progress in working conditions.

While this chapter has focused on reputation-conscious buyers and how they influence *overall* labor standard compliance in supplier factories, buyers may affect *different categories* of labor standards in a distinct manner, which is examined in the next chapter.

Table 2-1. Descriptive statistics of variables

Variable	Obs	Mean	S.D.	Min.	Max.
Number of Non-compliance items	1230	37.58	19.81	2	137
Log of number of non-compliance items	1230	3.47	0.59	0.69	4.92
Presence of MSI buyers (1=yes, 0=no)	1230	0.27	0.44	0	1
Presence of BFC-only buyers (1=yes, 0=no)	1230	0.31	0.46	0	1
Number of BFC-only buyers	1230	0.71	0.99	0	4
Establishment Size (Log of total number of employees)	1230	6.8	0.78	2.77	8.92
Establishment Age (Total number of ILO monitor visits)	1230	4.34	2.09	1	9
Union Presence (1=yes, 0=no)	1230	0.78	0.41	0	1
Number of Unions	1230	1.36	1.16	0	6
Domestic Ownership (1=yes, 0=no)	1229	0.05	0.23	0	1
Western Ownership (1=yes, 0=no)	1221	0.06	0.24	0	1

Note: "BFC-only buyers" are those buyers participating in ILO Better Factories Cambodia (BFC) but not in other major MSI, namely the Fair Labor Association (FLA) or the Ethical Trading Initiative (ETI). "MSI buyers" are those buyers participating in BFC as well as the FLA or the ETI.

Table 2-2. Regression results of labor standard non-compliance  
(Jan 2006- Dec 2008)

	OLS		Between Effects
	Non-Compliance	Ln (Non-Compliance)	Ln (Non-Compliance)
Presence of MSI buyers (1=yes, 0=no)	-13.254**** (1.46)	-0.346**** (0.04)	-0.451**** (0.08)
Presence of BFC-only buyers (1=yes, 0=no)	-4.594*** (1.56)	-0.048 (0.05)	-0.024 (0.10)
Number of BFC-only buyers	-2.769**** (0.56)	-0.112**** (0.02)	-0.148**** (0.05)
Establishment Size (Log of total number of employees)	-3.775**** (0.87)	-0.127**** (0.02)	-0.082* (0.04)
Establishment Age (Number of ILO monitor visits)	0.551** (0.24)	0.019** (0.01)	0.015 (0.02)
Union Presence (1=yes, 0=no)	0.718 (1.44)	0.026 (0.04)	-0.048 (0.08)
Number of Unions	-0.590 (0.45)	-0.024 (0.02)	-0.010 (0.03)
Domestic Ownership (1=yes, 0=no)	9.754**** (2.79)	0.190**** (0.06)	0.167* (0.10)
Western Ownership (1=yes, 0=no)	-3.538* (1.82)	-0.123* (0.07)	-0.117 (0.10)
Year 2006 (1=yes, 0=no)	14.297**** (1.26)	0.416**** (0.04)	0.702**** (0.11)
Year 2007 (1=yes, 0=no)	2.115** (1.05)	0.081** (0.04)	0.326** (0.12)
Constant	62.416**** (5.53)	4.293**** (0.16)	3.923**** (0.26)
Number of observations	1221	1221	1221
R-squared	0.318	0.302	0.366
F-value	50.82 (11, 1209)	50.52 (11, 1209)	17.40 (11, 322)
Prob>F	0.000	0.000	0.000

Notes: "BFC-only buyers" are those buyers participating in ILO Better Factories Cambodia (BFC) but not participating in other major MSI, namely, the Fair Labor Association (FLA) or the Ethical Trading Initiative (ETI). "MSI buyers" are those buyers participating in both BFC and the FLA or the ETI. \* Statistically significant at the 0.10 level, \*\* at the 0.05 level, \*\*\* at the 0.01 level, \*\*\*\*at the 0.001 level. Standard errors are in the parentheses.

Figure 2-1. Frequency distribution of non-compliance items

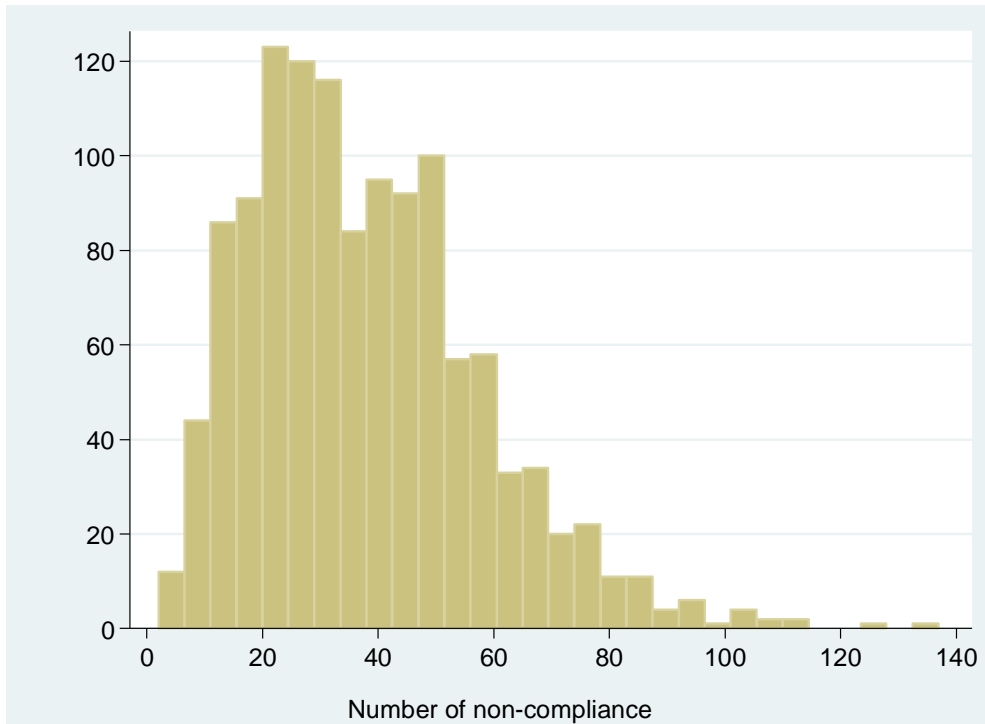
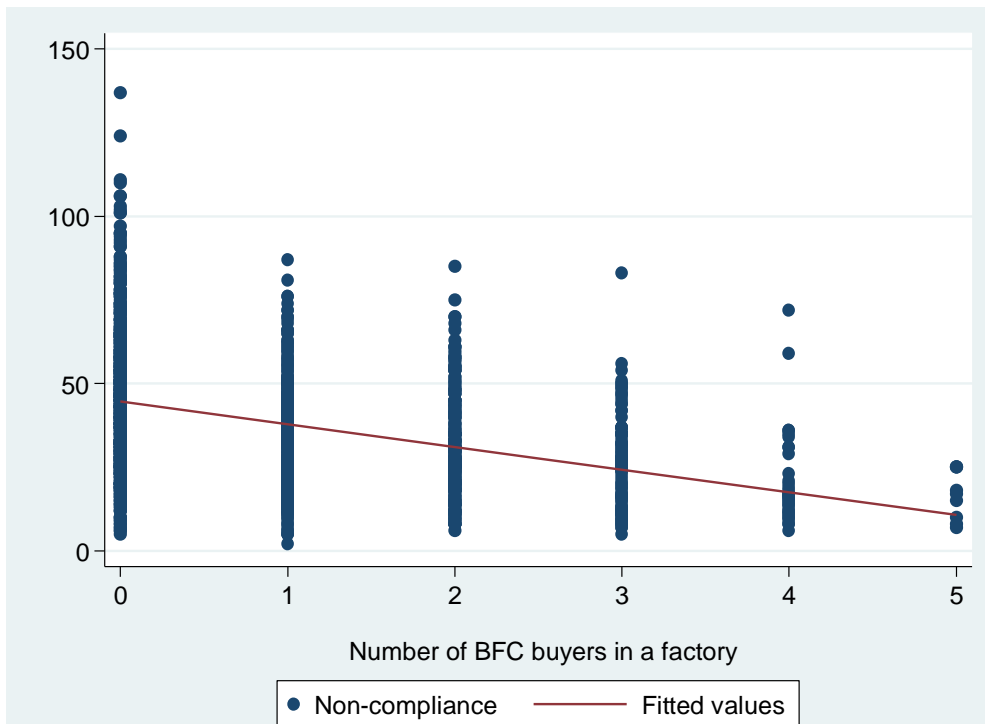


Figure 2-2. Relationship between BFC buyers and non-compliance items



Notes: BFC buyers are those buyers participating in ILO Better Factories Cambodia (BFC).

## **Chapter 3. Issue-specific Determinants of Labor Standard Compliance**

### **3.1. Introduction**

The debate on the effectiveness of non-state labor regulation is heated and on-going. In addition to the criticism that brand-driven schemes only create pockets of best practices, skeptics argue that the scope of buyer influence is severely limited in terms of issue areas: buyers are likely to monitor and implement certain labor standards more rigorously than others. For instance, Seidman (2008) questions whether transnational campaigns targeting buyers really respond to ordinary labor grievances.

Labor struggles have historically been local affairs, as workers demand a voice, calling on governments to protect citizens' rights at work. Transnational campaigns, by contrast, must appeal to outside audiences, and they tend to revolve around issues likely to attract international attention—physical attacks on vulnerable workers, child labor, and other visible example of a serious failure to live up to some broad universal standard of human treatment (Seidman, 2008: 996).

Impact studies on the UK's Ethical Trading Initiative (ETI) suggest that the ETI code had larger impacts on visible and technocratic outcome standards such as health and safety and minimum wage than less visible and more fundamental process rights such as freedom of association (Barrientos and Smith, 2007). Similarly, based on research on garment and coffee industries in Nicaragua, Macdonald (2008) argues that codes of conduct (CoC) and monitoring had limited impacts on less visible and more structural and fundamental issues such as freedom of association, discrimination, and

distributive justice. Other scholars have also found similar patterns (Mamic 2004; Rodriguez-Gravito, 2005). Barrientos and Smith (2007: 717) explain this limited outcome as follows: “underlying this is an inherent tension between commercial actors who prioritize commercial imperatives over compliance with labor codes and social actors who prioritize workers’ rights.”

Despite growing qualitative evidence, the question of whether buyer-driven regulation can improve various areas of labor conditions in supplier facilities has not been quantitatively investigated mainly due to a lack of systematic data. The majority of existing studies are based on interviews and a small number of cases. Building on Chapter 2, this chapter unbundles overall compliance scores and examines the determinants of compliance performance across different categories of labor standards, with a focus on buyer variables. In so doing, this chapter seeks to contribute to the debate on the limits and potential of buyer-driven regulation.

This chapter is organized as follows: the next section discusses the deterrence and behavioral theories that generate different hypotheses, followed by a section on the data and methods. The regression results demonstrate that buyers influence labor standard compliance across issue areas: not only very reputation-conscious buyers but also moderately reputation-conscious ones are significantly and positively associated with better compliance with various categories of labor standards, including freedom of association. The following section discusses original survey results that suggest that some buyers prompt suppliers to go beyond legal compliance, albeit limitation. The chapter concludes by painting a more nuanced picture of buyer-driven regulation.

### 3.2. Theories and Hypothesis

#### *Deterrence Theory of Compliance*

The deterrence theory of compliance is inspired by the economics of crime literature pioneered by Becker (1968) and Stigler (1970). The theory assumes that profit-maximizing firms rationally calculate the cost and benefit of non-compliance and optimally decide to comply with regulation only when the expected cost outweighs the benefit. In other words, unless detection is effective and punishment is sufficiently severe, firms always have an incentive to evade regulation.<sup>75</sup>

The deterrence theory predicts gaps in compliance *across issue categories* given the varying priorities of buyers. Critics argue that buyers tend to enforce standards that are prone to the media's scrutiny and negative publicity (e.g. child labor and miserable working environment) while buyers tend to neglect other issues critical to workers but less relevant to reputation, such as freedom of association and discrimination. Given such uneven attention paid by buyers, the deterrence theory predicts gaps in labor standard compliance across issue categories as suppliers take into account buyer priorities and concentrate their efforts on those high-priority issues.

Moreover, the cost of monitoring and enforcement is likely to affect the level of enforcement. While some issues are visible and easy to fix, such as placing soaps in toilets, other issues are less visible and more difficult to detect and rectify such as discrimination. Lastly, the benefit of non-compliance may also affect the degree of enforcement and compliance. Some of the labor standards such as a limit on overtime can conflict with buyers' business considerations. As buyers are keen to have their

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<sup>75</sup> This view is still dominant in the policy circle. For instance, OECD (2000) makes this assumption.



merchandise delivered on time, they may be more lenient on overtime issues. Hence, the deterrence theory generates the following hypothesis:

*Hypothesis 1: Suppliers of reputation-conscious buyers tend to perform better in labor standard compliance regarding issues that attract media attention, that are visible and easier to fix, and that do not conflict with business interests.*

However, this traditional view of compliance based on rational cost-benefit calculation has been challenged by studies that focus on the behavioral nature of firms. In particular, decision making under risk and uncertainty has systematically deviated from behavior considered as optimal (Shoemaker, 1982).

### ***Behavioral Theory of the Firm***

Behavioral theory of the firm developed by Cyert and March (1963) recognizes bounded rationality in decision making unlike the deterrence theory. Rationally bounded actors intend to be rational, but they are constrained by the lack of information and capacity for calculation (Simon 1952). The behavioral theory posits that the firm seeks to solve particular problems as they arise rather than optimize, addresses multiple issues sequentially rather than simultaneously, tries to avoid uncertainty by focusing on the short-run and by negotiating an environment, and adapts goals to the changing environment (Cyert and March, 1963).

In the socio-legal literature, the concept of deterrence is classified into explicit and implicit deterrence (Thornton, Gunningham and Kagan, 2005a,b). Explicit deterrence refers to rational responses based on careful calculation of the likelihood of being detected and punished, whereas implicit deterrence refers to actions based on the sense

that the mere existence of regulatory actions entails risk of punishment. The deterrence theory discussed above corresponds to explicit deterrence while the behavioral theory closely resembles implicit deterrence, where firms are vaguely aware of the risk of detection and punishment and imperfectly incorporate the risk in their decisions. Based on a survey of firms regarding environmental actions, Thornton et al. (2005a) found that company managers were not attentive to or knowledgeable about the frequency and the magnitude of penalties imposed on other companies. Rather, simply being aware of the existence of regulatory enforcement acted as an implicit deterrence, prompting firms to review their practices and take further actions.

In the global garment industry, given the uncertainty and risk that the media and solidarity campaigns may target any substandard conditions and generate negative publicity, reputation-conscious buyers are likely to pay attention to labor conditions in general rather than to limit their attention to child labor issues. Especially for branded buyers deriving significant values from their image, the cost of any mistake is high, reinforcing their tendency to avoid risk and address issues beyond immediate concerns.

In the empirical studies of OSH inspection, evidence is also more supportive of the behavioral theory than the expected utility theory of deterrence. Scholz and Gray (1990) found that firms respond to two dimensions of expected utility (probability of detection and amount of penalty) differently: firms respond disproportionately to changes in probability than to changes in the average amount of penalty. This finding is consistent with the behavioral view that firms solve problems as they arise rather than to optimize simultaneously. Further, Mendeloff and Gray (2005) demonstrate that OSH inspection reduces injuries including the types of injuries not covered by inspection, suggesting that inspection spurs managerial attention to a wider set of issues rather than

a subset of monitored issues. Such tendency may also apply to buyers: child labor and sweatshop allegations in the past prompt buyers to pay attention to other issues that could potentially cause problems in the future.

Another important aspect of the behavioral theory is the understanding that the firm decisions are taken by collections of individuals with diverse interests (Argote and Greve, 2007). In contrast to the deterrence theory that assumes monolithic and rational actors maximizing benefits, Cyert and March (1963) introduced the concept of organizational coalition and conflict. Specifically, firms tend to deal with a complex set of interrelated problems by dividing them into a number of simple problems and assign them to different subunits, creating a latent conflict of goals among subunits. For buyers, this conflict can be seen in sourcing and compliance departments with different goals, interests, and identities: the former is driven by price, quality and delivery whereas the latter is primarily concerned with compliance with labor and environmental standards. While sourcing departments tend to overpower compliance departments, buyers are far from monolithic and can be contradictory in terms of what they demand from suppliers. All in all, the behavioral theory applied to labor standard compliance generates the following hypothesis.

*Hypothesis II: Suppliers of reputation-conscious buyers tend to perform better in labor standard compliance across issues and beyond those issues that attract the media attention, that are visible and easier to fix, and that do not conflict with business interests.*

### 3.3. Data and Methods

This chapter exploits the monitoring and firm characteristics data provided by ILO BFC. ILO monitors visit exporting garment factories un-announced every 6-8 months and collect monitoring and other data. The data cover the period from January 2006 to December 2008 for 344 garment factories in Cambodia, making a panel dataset of 1230 observations. ILO monitors assess nearly 400 checklist items of labor standards, which are grouped into the following categories: contracts, wages, hours, leave, welfare, occupational safety and health (OSH), and fundamental rights.

#### *Descriptive Statistics*

Table 3-1 presents the summary statistics of compliance measures for 2006-08. The average compliance ratio during the period between 2006 and 2008 is 89 percent, where a score of 100 indicates full compliance. Despite this very high level of overall compliance, full compliance is rare; in fact not a single factory is fully compliant with OSH standards. Although the average compliance ratio for fundamental rights is extremely high (99.5 percent), this category is not directly comparable with others as one violation of fundamental rights (e.g. freedom of association) has much more serious implications than one violation of a minor OSH issue (e.g. provision of adjustable back chairs). There is no weighing of labor standards and each item is given equal weight. Given that monitored standards under OSH account for nearly one third of total monitored items, overall performance is disproportionately influenced by performance vis-à-vis OSH. Compliance performance with different labor standards is positively correlated (Table 3-2).

Figure 3-1 shows the industry *average* number of non-compliance items between 2006 and 2008. The number of non-compliance items has consistently declined across

issue categories, suggesting overall improvement. Figure 3-2 shows the industry *total* number of non-compliance items regarding fundamental rights across sub-components between 2006 and 2008. The category of fundamental rights is composed of sexual discrimination, sexual harassment, freedom of association, anti-union discrimination, forced labor, child labor, and strike.<sup>76</sup> The most frequent violation concerns sexual discrimination, notably dismissal of pregnant women, followed by freedom of association.

Over the three year period, in all issues except sexual discrimination, the incidence of non-compliance has been significantly reduced. In 2006, the incidence ratio (i.e. the probability of detecting at least one violation of fundamental rights for each monitoring visit) was quite high at 40 percent, which was nearly halved in 2008 to 22 percent. Overall, descriptive statistics show that compliance has improved across different issue categories, beyond those visible and easy to fix issues like child labor and OSH. To understand what is driving this progress, the next section operationalizes variables for regression analysis.

### ***Dependent Variables***

The number of non-compliance items reported for each issue category measures the level of working conditions in a factory. Given that monitored standards for hours and leave are few and that they measure similar issues (i.e. the number of hours/days worked), they are combined together to form one category, hours-leave. Similarly, welfare is joined with OSH to form OSH-welfare, as welfare has only few monitored standards and the majority of them are closely related to OSH (e.g. drinking water and

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<sup>76</sup> Admittedly, it is difficult to accurately monitor violation of fundamental rights especially sensitive issues like sexual harassment. Although sexual harassment is reportedly non-existent, a joint study by the ILO and the World Bank finds that it is quite common (ILO, 2006).

toilets). The dependent variables, therefore, are the number of non-compliance items regarding contract, wage, hours-leave, and OSH-welfare.

Fundamental rights need to be treated separately since violation of fundamental rights occurs only rarely, but one incidence of non-compliance has serious implications. Hence, non-compliance of fundamental rights is measured by a binary variable (whether or not violation occurred) rather than a continuous variable (how many violations occurred). The monitored standards under fundamental rights are grouped into (i) sexual discrimination and harassment, (ii) child labor, and (iii) freedom of association (FOA).<sup>77</sup>

### ***Independent Variables***

Independent variables are the presence and number of reputation-conscious buyers. Following Chapter 2, this chapter operationalizes the concept of reputation consciousness of a buyer by looking at whether or not a buyer participates in multi-stakeholder initiatives (MSI).<sup>78</sup> Since reputation-conscious buyers tend to participate in MSI to show their commitment to better working conditions and safeguard their reputation, it is a reasonable proxy. While MSI can take various forms from certification of production facilities, compliant-based investigation, to collaboration of buyers, this study focuses on the Fair Labor Association (FLA) and the Ethical Trading Initiative (ETI), given their prominence and buyer-oriented nature, as well as Better Factories Cambodia (BFC), a local ILO-managed scheme in Cambodia's garment sector.<sup>79</sup>

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<sup>77</sup> The FOA variable is composed of interference with FOA, anti-union discrimination, and mistreatment of workers engaged in strikes.

<sup>78</sup> Following O'Rourke (2006: 899), this thesis defines MSI in labor regulation as a scheme that involves various stakeholders in negotiating labor standards, monitoring compliance with these standards, and establishing mechanisms to encourage firms to comply with these standards.

<sup>79</sup> It is important to note the key differences between BFC and the other two MSI, the FLA and the ETI. First, BFC does not certify buyers and nor does it require buyers to implement certain codes or monitoring/reporting procedures. Second, buyers can fully rely on ILO monitoring and replace their own (or third-party) audits if they choose to, given the ILO's industry-wide monitoring. Third, while membership of the FLA and the ETI involves expensive fees, BFC only asks buyers to pay very

As in Chapter 2, the degree of reputation consciousness is operationalised by classifying buyers into three groups: buyers that participate in BFC *and* the FLA or the ETI (hereafter MSI buyers); buyers that participate in BFC but *not* in the FLA or the ETI (hereafter BFC-only buyers); and buyers that participate in none of the MSI mentioned. The degree of reputation consciousness is considered high for MSI buyers, given the extra burden involved. Indeed, all the MSI buyers in the sample are branded buyers that have experienced negative publicity. BFC-only buyers are considered *less* reputation-conscious than the first group. These buyers are mostly large and well-known retailers. The third category of buyers that participates in none of the MSI is mostly smaller generic retailers that consumers seldom hear of and thus *least* reputation-conscious.

Since various establishment-level characteristics are clearly related to working conditions, the following firm characteristics are considered as in Chapter 2: the size of the establishment as measured by the natural logarithm of total number of employees, the age of the establishment proxied by the total number of visits by ILO monitors since 2001, presence and number of unions, and factory ownership (domestic and western).<sup>80</sup>

### ***Model Specification***

The determinants of non-compliance vis-à-vis issue categories other than fundamental rights, namely contract, wage, hours-leave, OSH-welfare, are estimated with pooled semi-log OLS models respectively as shown below [1]. As for non-compliance regarding fundamental rights, pooled logit models have been estimated for sexual discrimination, child labor, and FOA respectively as follows [2]:

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reasonable fees to access to monitoring reports. Overall, BFC is more economical and less burdensome than the FLA or the ETI.

<sup>80</sup> Refer to Chapter 2 for the detailed explanation of the control variables

$$\text{Ln}(\text{Non-compliance})_{it} = \alpha + \beta \cdot \text{Buyer}_{it} + \gamma \cdot Z_{it} + \varepsilon_{it} \quad [1]$$

$$\text{Pr}(\text{Non-compliance})_{it} = \alpha + \beta \cdot \text{Buyer}_{it} + \gamma \cdot Z_{it} + \varepsilon_{it} \quad [2]$$

where  $\alpha$  indicates the intercept term,  $\text{Buyer}_{it}$  is a vector of variables concerning reputation-conscious buyers,  $Z_{it}$  is a vector of firm characteristics and year controls, and  $\varepsilon_{it}$  denotes the error term. Fixed effects techniques are not employed since fixed effects estimation for panel data with small T and large N is known to generate biased and inconsistent coefficients for dummy variables, which is known as incidental parameters problem (Baltagi, 2008). To take into account the presence of repeated firm observations, standard errors are estimated with firm-clustering so that observations are not treated as independent within each cluster.

### 3.4. Results

Reputation-conscious buyer variables turn out to be highly significant and negatively associated with non-compliance across all issue categories (Table 3-3). The presence of MSI buyers is consistently significant at the 0.001 level. Having at least one MSI buyer in a factory reduces the number of non-compliance items by 43 percent for hours-leave, followed by 39 percent for OSH-welfare, 34 percent for wage, and 30 percent for contract. BFC-only buyers—less reputation-conscious than MSI buyers—are also highly significant. For wage and OSH-welfare issues, having an additional BFC-only buyer in a factory reduces non-compliance items by 14 percent. As for contract and



hours-leave, the presence of BFC-only buyers reduces non-compliance items by 20 and 28 percent respectively.

The size of establishment is the most statistically significant control variable for contract, wage, and OSH-welfare, but not for hours-leave. The size is consistently negatively associated with non-compliance as larger factories enjoy economies of scale and tend to possess resources and sophisticated management systems. The age of establishment is positively associated with non-compliance and significant for OSH-welfare, suggesting that older facilities face physical constraints. The presence and number of unions are not statistically significant except for hours-leave: having an additional union in a factory reduces non-compliance regarding hours-leave by 6 percent. Domestic ownership is significant and positively associated with non-compliance for wage and hours-leave while Western ownership is negatively associated with non-compliance. This result is consistent with the theory of foreign wage premium as Cambodian-owned factories tend to lack managerial know-how and financial means. Year controls for 2006 and 2007 are significant and positive, suggesting that compliance performance significantly improved in 2008.

Table 3-4 presents the logit model results for non-compliance with fundamental rights, which reveals a more complex picture. Buyer variables are significantly and negatively associated with the probability of violating FOA issues. In other words, when a factory is producing for at least one MSI *or* BFC-only buyer, the probability of violating FOA issues is significantly lower, suggesting that both types of buyers pay attention to issues related FOA. The result also suggests significant compliance gaps between suppliers of MSI *or* BFC-only buyers and suppliers of the least reputation-conscious buyers. In contrast, buyer variables have no significant effects on the

probability of sexual discrimination, suggesting that none of the buyers (including reputation-conscious ones) pay significant attention to this issue. As for child labor, buyer variables are slightly significant and negatively associated with the probability of violation, but statistical significance is much lower than for FOA. This may indicate that even the least reputation-conscious buyers are somewhat careful about child labor issues and therefore the gaps arising from buyer types are narrower than for other issues.

In terms of the control variables, the size of establishment is highly significant and *positively* related to the probability of violating FOA-related standards, which contrasts with the earlier findings for other issue categories. While larger establishments may be better at complying with standards that require important investments and thus economies of scale, larger workplaces tend to alienate workers and increase their resistance to management (Hodson, 2001). This helps explain why larger establishments perform better for issues concerning OSH-welfare, contract, wage, but worse for FOA-related issues. Union variables are generally not significant. Domestic ownership is significant and positively associated with non-compliance vis-à-vis FOA issues, contradicting the argument that factory owners sharing the same nationality as workers tend to respect and treat them better.

In sum, not only very but also moderately reputation-conscious buyers are significantly and positively associated with suppliers' labor standard compliance across various issue categories including FOA, albeit lack of significant association with sexual discrimination. Hence, the findings are more supportive of the behavioral theory than the deterrence theory.

### **3.5. Discussion on Beyond Compliance**

In addition to the critique that buyers regulate only visible and easy to fix issues, there is criticism that buyer-driven schemes do little to promote distributive justice, notably living wage (Macdonald, 2008). In other words, critics argue that buyers may encourage supplier compliance but they are unlikely to bring about “beyond compliance.” This section briefly analyzes original survey results and discusses whether buyers motivate suppliers to go beyond compliance especially with regard to pay.

According to the literature on environmental regulation, “overcompliance” by firms is motivated by “social license” pressures from activists and communities, firms’ sensitivity to bad publicity and management style (Gunningham, Thornton and Kagan, 2003, 2005b). At the same time, economic pressures impose limits on investments required to go beyond compliance (Ibid.). In labor regulation, similar logic is likely to be at work although beyond compliance in labor regulation also includes providing better pay than the legally mandated one, which many firms use to enlist worker efforts.

The supplier survey was conducted between June and October 2008 in Phnom Penh, Cambodia, and the survey targeted general managers of exporting garment factories. A total of 51 factory managers responded to the survey out of approximately 300 of Cambodia’s export garment factories. The survey collection procedure, sample representatively, and complete answers are detailed in Appendix I. This section focuses on the questions concerning whether factories provide working conditions that exceed legal requirements and whether buyers encouraged or required them to do so.

65 percent of the factories responded that they provide conditions that are better than the legal requirements, not counting production bonus (Question 31). In terms of the areas in which factories go beyond legal compliance (Question 32), bonus tops at 45

percent, followed by allowance (39 percent), base salary (27 percent), and welfare (27 percent). Thus, factories tend to provide pecuniary incentives that exceed the legally mandated requirements.

When asked whether buyers required or encouraged the factories to go beyond legal compliance (Question 33), only 6 percent responded “required” and 42 percent responded “encouraged,” while 52 percent of the factories denied buyer influence on their decisions to go beyond compliance. For those factories that were required or encouraged by buyers, welfare and OSH were the principal areas that buyers asked for progress beyond legal compliance (Question 34). This is primarily because buyer CoC are often more detailed and stricter about welfare and OSH issues than the national labor law. In contrast, buyers rarely demand improvement in pecuniary conditions beyond legal compliance because they also seek lower prices as pointed out by several factory managers.

Statistical analysis of associations between buyer types and beyond compliance variables reveals an interesting picture. Based on Pearson’s Chi Square test, factories producing for at least one MSI buyer are much more likely to provide conditions that exceed the legal requirements ( $p=0.004$ ). When moderately reputation-conscious buyers (BFC-only buyers) are included, the significance of association is somewhat reduced ( $p=0.041$ ). Similarly, the factories that were encouraged or required by buyers to go beyond compliance are disproportionately producing for at least one MSI buyer ( $p=0.001$ ). The significance of association remains important even when BFC-only buyers are included ( $p=0.006$ ).

Overall, the above analysis shows that some buyers do encourage suppliers to go beyond legal compliance, but the issue areas tend to be limited to welfare and OSH.

This suggests the limits of buyers in improving pecuniary conditions of workers beyond compliance with the minimum wage.<sup>81</sup> Moreover, those buyers that encourage or require suppliers to go beyond compliance are disproportionately reputation-conscious buyers.

### **3.6. Conclusion**

This chapter has sought to answer the question of whether buyers help improve various categories of labor conditions in supplier facilities. Drawing on the factory-level data from Cambodia's garment industry, this chapter has shown that some buyers positively influence supplier compliance *across various issue categories*. Not only *very* reputation-conscious buyers but also *less* reputation-conscious buyers are significantly and positively associated with better compliance performance regarding contract, wage, leave and hours, OSH and welfare, and freedom of association in supplier factories, albeit lack of significant association with sexual discrimination.

In terms of theories, the findings are more supportive of the behavioral theory based on bounded rationality than the deterrence theory assuming perfect rationality. Although negative publicity concerning supply chains tends to focus on child labor and sweatshop conditions, reputation-conscious buyers, vaguely aware and fearful of potential risk, have been paying increased attention to issues that go beyond those visible and easy to fix issues. If the behavioral theory indeed better explains buyers' regulatory and suppliers' compliance behavior, critics' concern that only the media-sensitive issues can be regulated may be too pessimistic. Nevertheless, the *least* reputation-conscious buyers seem to behave in line with the deterrence theory: knowing

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<sup>81</sup> The survey result indicates that productivity concerns and labor market dynamics play a prominent role in raising workers' pay.

their relative immunity from negative publicity, they let their suppliers systematically under-perform their peers across all issue categories.

Indeed, the findings point to the growing gaps between increasingly regulated supply chains controlled by reputation-conscious buyers on the one hand and still sparsely regulated supply chains of the *least* reputation-conscious buyers on the other. While reputation-conscious buyers are increasingly committed to regulating various labor conditions including freedom of association, some buyers remain muted and do not participate in any initiatives aimed at improving working conditions. In this sense, therefore, the results paint a more nuanced picture of buyer-driven regulation than one-sided criticism or acclaim that tends to fuel the debate.

The last section briefly discussed survey results on whether buyers induce their suppliers to provide conditions that exceed legal requirements. The survey results show that some buyers do encourage suppliers to go beyond legal compliance, but the issue areas of their influence are often limited to welfare and OSH. Moreover, those buyers that encourage or require suppliers to go beyond compliance are disproportionately reputation-conscious buyers. This, together with the gaps identified in the regression analysis suggest the need to complement buyer-driven regulation, if a greater number of workers were to benefit from better working conditions.

While this chapter has contributed to the empirical debate on buyer-driven regulation and to the theoretical debate concerning compliance behavior of firms, some limitations remain. There is endogeneity in the buyer variables given that buyers influence supplier compliance through pre-order selection and post-order monitoring. Thus, some may argue that the statistical association identified in this study simply captures matching process of better-performing suppliers and reputation-conscious

buyers and that nothing really changed. As demonstrated in the qualitative section of Chapter 2, however, reputation-conscious buyers regulate their suppliers more rigorously than other buyers, and knowing this, suppliers keen to attract reputation-conscious buyers improve working conditions *before* trying to obtain orders. General progress in compliance in recent years also attests to the dynamic nature of buyer behavior: buyers including less reputation-conscious ones are becoming increasingly demanding in terms of labor and environmental standards.

Nonetheless, the underlying characteristics of different buyers and the channels through which buyers influence their suppliers remain a black box. While this thesis has so far assumed that buyers affect supplier compliance only through enforcement, there may be other mechanisms through which buyers influence their suppliers such as relationship and learning. These are the issues investigated in the next chapter.

Table 3-1. Summary of compliance measures

Compliance measures	Contract	Wage	Hours	Leave	Welfare	OSH	Fund Rights	Total
Number of monitored standards	43	69	22	33	24	98	52	341
Number of non-compliance items	4.2	4.6	3.2	4.0	3.9	17.3	0.3	37.6
Average compliance ratio	90.3	93.3	85.1	87.9	83.8	82.3	99.5	89.0
Standard Deviation	7.1	6.2	9.6	10.5	10.2	9.1	1.3	19.8
% of factories in full compliance	7.0	7.8	4.2	13.3	6.4	0.0	80.0	0.0

Table 3-2. Correlations among labor standard compliance across issue categories

	Contract	Wage	Hours	Leave	Welfare	OSH
Contract	1.00					
Wage	0.58	1.00				
Hours	0.51	0.57	1.00			
Leave	0.59	0.57	0.50	1.00		
Welfare	0.51	0.49	0.43	0.53	1.00	
OSH	0.59	0.54	0.48	0.57	0.66	1.00



Table 3-3. Determinants of labor standard non-compliance across issue categories  
(2006-08)

	Ln (Total)		Ln (Contract)		Ln (Wage)		Ln (Hours-Leave)		Ln (OSH-Welfare)	
Presence of MSI buyers	-0.346**** (0.06)	-0.317**** (0.05)	-0.292**** (0.08)	-0.304**** (0.08)	-0.376**** (0.09)	-0.337**** (0.08)	-0.328**** (0.09)	-0.428**** (0.07)	-0.368**** (0.07)	-0.385**** (0.06)
Presence of BFC-only buyers	-0.048 (0.08)	-	-0.148 (0.09)	-0.202*** (0.07)	-0.082 (0.10)	-	-0.138 (0.10)	-0.277**** (0.07)	0.040 (0.08)	-
Number of BFC-only buyers	-0.112**** (0.03)	-0.124**** (0.02)	-0.031 (0.04)	-	-0.118*** (0.04)	-0.143**** (0.03)	-0.065 (0.04)	-	-0.154**** (0.03)	-0.144**** (0.02)
Establishment size	-0.127**** (0.03)	-0.131**** (0.03)	-0.182**** (0.04)	-0.193**** (0.04)	-0.159*** (0.05)	-0.161**** (0.05)	-0.069 (0.05)	-	-0.144**** (0.04)	-0.147**** (0.04)
Establishment age	0.019 (0.01)	-	0.015 (0.02)	-	0.008 (0.02)	-	-0.008 (0.01)	-	0.029** (0.01)	0.029** (0.01)
Presence of unions	0.026 (0.06)	-	0.049 (0.08)	-	-0.024 (0.09)	-	0.005 (0.08)	-	0.045 (0.06)	-
Number of unions	-0.024 (0.02)	-	-0.027 (0.03)	-	0.002 (0.03)	-	-0.049* (0.03)	-0.061*** (0.02)	-0.014 (0.03)	-
Domestic ownership	0.190* (0.10)	0.201** (0.10)	0.153 (0.12)	-	0.349** (0.16)	0.353** (0.16)	0.285** (0.12)	0.304*** (0.12)	0.133 (0.09)	-
Western ownership	-0.123 (0.13)	-	-0.133 (0.11)	-	-0.027 (0.15)	-	-0.010 (0.12)	-	-0.139 (0.12)	-
Year effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Constant	4.293**** (0.23)	4.381**** (0.23)	2.377**** (0.27)	2.530**** (0.25)	2.321**** (0.32)	2.356**** (0.32)	2.192**** (0.29)	1.810**** (0.06)	3.787**** (0.25)	3.826**** (0.25)
Number of observations	1221	1229	1221	1230	1221	1229	1221	1229	1221	1230
R-squared	0.30	0.30	0.18	0.17	0.20	0.19	0.21	0.20	0.30	0.29
F-value	33.11 (11, 343)	55.80 (6, 343)	18.18 (11, 343)	45.42 (4, 347)	22.88 (11, 343)	27.44 (5, 346)	28.31 (11, 343)	49.44 (6, 346)	23.41 (11, 343)	40.40 (6, 347)
Prob>F	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000

Note: \* Statistically significant at the 0.10 level, \*\* at the 0.05 level, \*\*\* at the 0.01 level, \*\*\*\* at the 0.001 level.  
Standard errors in the parentheses are adjusted to firm-clustering.

Table 3-4. Determinants of labor standard non-compliance for fundamental rights  
(2006-08)

	Total	FOA	Sexual Discrimination	Child Labor
Presence of MSI buyers	-0.440 (0.30)	-1.082*** (0.35)	0.094 (0.42)	-0.875* (0.51)
Presence of BFC-only buyers	-0.669** (0.32)	-0.918** (0.39)	-0.563 (0.49)	0.107 (0.55)
Number of BFC-only buyers	0.126 (0.15)	0.198 (0.17)	0.118 (0.20)	-0.747* (0.39)
Establishment size	0.330* (0.17)	0.712**** (0.22)	-0.062 (0.21)	0.198 (0.26)
Establishment age	-0.065 (0.06)	-0.155* (0.08)	0.047 (0.07)	-0.073 (0.10)
Presence of unions	-0.073 (0.32)	-0.159 (0.41)	-0.287 (0.45)	0.155 (0.47)
Number of unions	-0.059 (0.12)	0.080 (0.14)	-0.031 (0.17)	-0.442* (0.25)
Domestic ownership	0.954*** (0.37)	1.159*** (0.44)	0.508 (0.54)	0.432 (0.54)
Western ownership	-0.080 (0.32)	0.176 (0.41)	-0.402 (0.56)	-1.107 (1.00)
Year effects	Yes	Yes	Yes	Yes
Constant	-3.090**** (0.78)	-6.348**** (0.26)	-1.494 (1.25)	-4.661*** (1.71)
Number of observations	1221	1221	1221	1221
Pseudo R-squared	0.05	0.07	0.03	0.14
Wald chi square	54.95	53.88	38.69	58.45
Prob>Wald chi square	0.000	0.000	0.000	0.000

Note: \* Statistically significant at the 0.10 level, \*\* at the 0.05 level, \*\*\* at the 0.01 level, \*\*\*\*at the 0.001 level. Standard errors in the parentheses are adjusted to firm-clustering.

Figure 3-1. Industry average of non-compliance items across issue categories

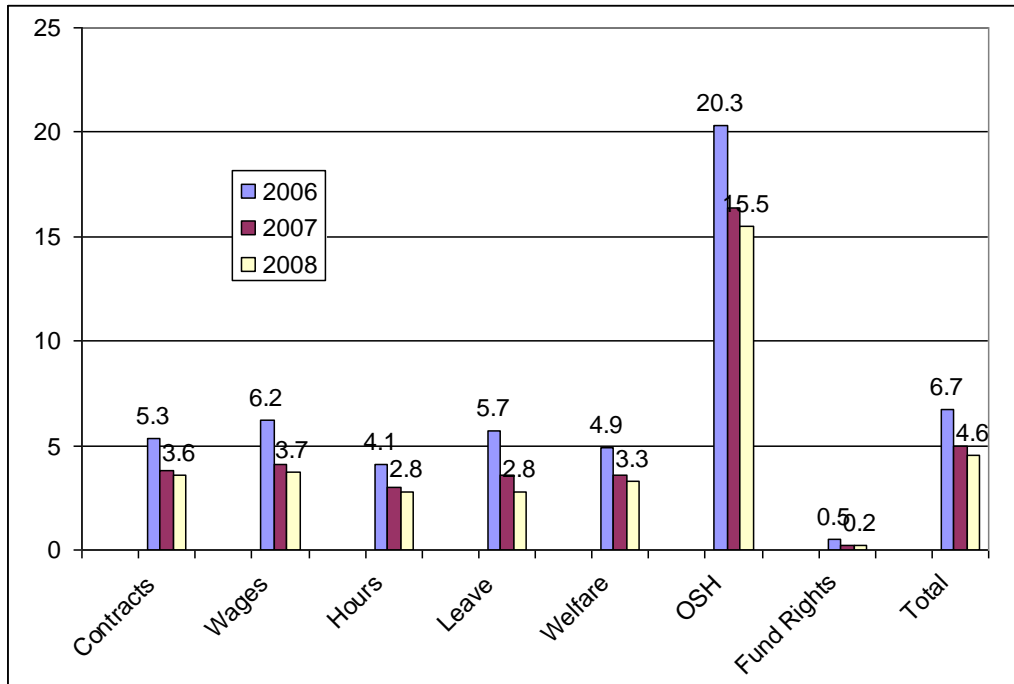
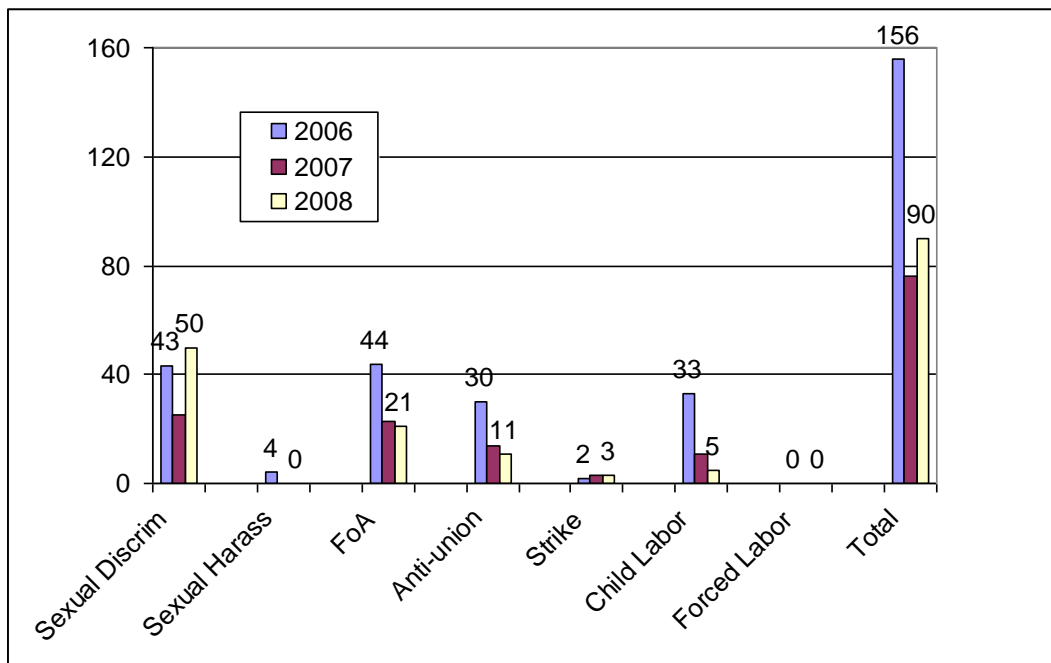


Figure 3-2 Industry total of non-compliance items for fundamental rights



## Chapter 4. Channels of Buyer Influence

### 4.1. Introduction

While the rise of non-state regulation of labor standards has provoked a heated debate about its desirability and effectiveness, the question of what determines working conditions in supplier establishments and how buyers influence them remains poorly understood. Recognizing this gap, Locke, Kochan, Romis and Qin (2007) call for a more comprehensive approach to understanding and addressing the root causes of poor working conditions. This chapter contributes to reframing the debate by shedding light on buyer-supplier relationships that influence supplier compliance-performance.

The existing studies of buyer influence on suppliers' working conditions are predominantly case studies of branded buyers. Frenkel (2001) studies two global athletic footwear brands and their contractor factories in China and describes how brands shape employment relations in their suppliers. Through a matched-pair case study, Frenkel and Scott (2002) examine two otherwise similar Adidas suppliers and explain the difference in working conditions by their relationships with Adidas: one enjoyed a collaborative relationship while the other was kept at arm's length. They conclude that a close and collaborative relationship with Adidas has encouraged value-sharing, learning, and innovation, contributing to better working conditions. In a similar case study of Nike and its suppliers, Locke and Romis (2006) reach a similar conclusion. Though insightful, these case studies examine only a handful of suppliers.

Addressing this weakness, Locke, Qin and Brause (2007) quantitatively assess the determinants of supplier compliance-performance using Nike's compliance data covering 830 suppliers in 51 countries. They find that factories designated as Nike's "strategic partners" and those frequently visited by Nike's staff (both compliance and production) have higher

compliance scores. Although they see this as evidence that close supplier-buyer relationships foster trust and encourage knowledge sharing, positively influencing working conditions, they assume rather than demonstrate such a channel of buyer influence. Besides, their exclusive focus on one global brand precludes generalization.

Jiang (2009) has found a statistically significant link between the nature of buyer-supplier relationships and supplier compliance with CoC, based on survey data from China's garment industry. Jiang shows that buyer-supplier relationships characterized by open and two-way dialogue are positively related to supplier compliance with CoC. The article, however, does not differentiate the types of buyers, which are likely to affect supplier compliance-performance. Moreover, it does not consider other channels of buyer influence such as deterrence and learning.

While the preceding chapters showed that factories supplying for reputation-conscious buyers have better labor standard compliance than other factories, data limitations prevented them from delving into the black box of buyer influence: through which channels buyers influence their supplier compliance-performance. At this time, original survey data collected in the Cambodian garment sector enable the author to address this question.

The purpose of this chapter, therefore, is two fold: (i) to examine different channels of buyer influence with regard to supplier compliance-performance and (ii) to assess whether reputation-conscious buyers affect those channels differently. The chapter proceeds as follows. The next section discusses hypotheses derived from the deterrence theory, transaction cost economics, and relational exchange theory. The subsequent section presents the data and methods, followed by estimation results, which show that market-based relationships between buyers and suppliers are systematically associated with poor compliance performance. The chapter then concludes with overall observations and practical implications.

## **4.2. Theories and Hypotheses**

This section discusses the theories that link buyer variables and supplier compliance-performance. Three potential channels of buyer influence are examined: deterrence, relationship, and learning. Each of the three channels generates three hypotheses: a) the channel is directly linked to supplier compliance-performance, b) the channel mediates the effect of reputation-conscious buyers on supplier compliance-performance, and c) the channel interacts with reputation-conscious buyers and influences supplier compliance-performance.

### ***Deterrence Theory***

In economic and legal studies, the traditional view of compliance behavior emphasized deterrence, assuming that rational and profit maximizing firms decide to comply with regulation only when the expected cost of non-compliance exceeds the expected benefit (Becker, 1968; Stigler, 1970). This theory posits that a firm's propensity to comply with regulations is positively related to the probability of detection and the expected penalty of violation.

Regarding reputation-conscious buyers, the deterrence theory would predict that those buyers facing a higher probability of detection and expected penalties for poor working conditions in their supply chains are more likely to rigorously regulate their suppliers than other buyers. Some buyers, predominantly global brands, have been repeatedly exposed by the media and criticized by labor activists. Moreover, the expected penalty is higher for those buyers that derive much of their value from their brand image, which could be easily damaged by sweatshop allegations (Conroy, 2007).

### **Detection Hypotheses**

According to the deterrence theory, suppliers who are rigorously monitored and credibly sanctioned by buyers are likely to expect a higher cost of non-compliance, leading

them to reduce non-compliance. The probability of detection is higher when buyers' compliance staff visits supplier establishments frequently.

*Hypothesis I-a. The frequency of visits by buyers' compliance staff is negatively related to supplier non-compliance.*

Reputation-conscious buyers may affect their supplier compliance-performance through factory visits in two ways. First, the frequency of visits may be different. Given the higher stakes, reputation-conscious buyers may visit their suppliers more often than other buyers, which may explain why reputation-conscious buyers are associated with better supplier compliance-performance.

*Hypothesis I-b. The effect of reputation-conscious buyers on supplier non-compliance is mediated by the frequency of visits.*

Alternatively, the frequency of visits by reputation-conscious buyers may not be different, but the impact of their visits may be different from other buyers if the 'quality' of their visits is superior. In this case, it is not the frequency of compliance visits per se, but the interaction of visit frequency and reputation-conscious buyers that influences supplier compliance-performance.

*Hypothesis I-c. The negative association between the frequency of visits and non-compliance is more pronounced in the presence of reputation-conscious buyers.*

#### Warning Hypotheses

The other element in the deterrence theory is the expected penalty of non-compliance. For suppliers, a potential penalty for non-compliance is a cancellation of orders. When a buyer and a supplier sign a contract, it normally includes a clause that obliges suppliers to abide by the buyer's CoC. Although it occurs only rarely, buyers have the right to terminate the contract in the event of non-compliance. Hence, buyers who want to rigorously enforce their CoC are likely to communicate the negative consequence of non-compliance (i.e. cancellation of orders) by warning their suppliers implicitly or explicitly. In turn, suppliers who receive such warnings are likely to take compliance issues more seriously.

*Hypothesis II-a. Warnings by buyers about the negative consequence of non-compliance are negatively related to supplier non-compliance.*

As discussed above, reputation-conscious buyers with higher stakes in regulating labor conditions in their supply chains may influence their suppliers through warnings in two ways. First, they may be more likely to issue warnings than other buyers, which may help reduce non-compliance.

*Hypothesis II-b. The effect of reputation-conscious buyers on supplier non-compliance is mediated by warnings.*

Alternatively, it may not be whether or not a warning has been issued, but rather *who issues the warning* that makes a difference for supplier compliance-performance. When a reputation-conscious buyer issues a warning, it may be taken more seriously by suppliers, given the higher stakes involved.



*Hypothesis II-c. The negative association between warnings and supplier non-compliance is more pronounced in the presence of reputation-conscious buyers.*

### ***Transaction Cost Economics (TCE)***

The management literature on supplier behavior has focused on opportunism and the nature of buyer-supplier relationships. The literature principally draws on transaction cost economics (TCE) and relational exchange theory (RET), which have been integrated in many studies investigating buyer-supplier relationships and their impacts (Heide and John, 1992; Morgan and Hunt, 1994; Jiang, 2009).

The TCE approach is based on the behavioral assumptions of *bounded rationality* and *opportunism* (Williamson, 1985). Unlike the deterrence theory that assumes perfectly rational actors, TCE (and more broadly new institutional economics) assumes that individuals are constrained by limited capacity to gather and process information, hence bounded rationality (Simon, 1952). Opportunism refers to lack of honesty in transaction, which can be *active*, such as lying, stealing, and cheating or *passive*, including subtle forms of deceit such as withholding of information (Williamson, 1985). More broadly, behaviors that are inconsistent with an agreed contract or principle are considered opportunistic (Wathne and Heide, 2000). From the TCE perspective, therefore, non-compliance with agreed CoC can be viewed as suppliers' opportunistic behavior vis-à-vis buyers.

According to Williamson's logic, the degree of opportunism largely depends on *asset specificity*, or non-transferable investment in one's partner. When a buyer invests time and resources in its supplier, this investment cannot be redeployed elsewhere, and vice versa. A higher degree of asset specificity required in transaction, then, raises switching costs and induces commitment and reduces opportunism from the party that made such investment. The early TCE literature emphasized vertical integration, or *hierarchy*, as a solution to

opportunism given its superior capacity to monitor and align incentives than *market* (Williamson, 1975). Nonetheless, over the past decades, new organizational forms that are neither market nor hierarchy, or *hybrids*, have become more dominant (Williamson, 1991). Under the hybrid form of governance, the cost of replacing a partner is more expensive than market and thus parties work together to restrain opportunism (Joshi and Stump, 1999). Opportunism is often controlled through “learning by monitoring” characterized by collaboration and information exchanges (Helper, MacDuffie, and Sabel, 2000).

### ***Relational Exchange Theory (RET)***

A legal theorist Macneil (1980)’s concept of *relational contract*, in which social relations shaped by prevailing norms and values are embedded in contracts, has been extensively applied to buyer-supplier relationships. Unlike the TCE approach that sees each transaction as a unit of analysis, the RET views the relationship based on the transactions as a unit of analysis (Vandaele, Rangarajan, Gemmel, and Lievens, 2007). While the RET does not reject the existence of opportunism, it rejects the assumption of universal opportunism (Hawkins, Wittman, and Beyerlein, 2008). Parties to relational exchange depend on relational norms such as trust and commitment, broadly defined as the mutual expectations that exchange partners will act in mutually beneficial ways. Hence, opportunistic behavior in relational exchange is controlled through mutual and self-regulation rather than threats or incentives (Gundlach, Achrol, and Mentzer, 1995).

Given their relative strengths, most scholars combine the TCE and RET to explain buyer-supplier relationships and related performance. For instance, Sako (1992) distinguishes two types of contracting relationships: *arm’s-length* versus *obligational contractual relations*. Arm’s-length contracting is a transaction-based relationship where tasks, duties, and conditions are spelled out in explicit contracts. Obligation contracting, on the other hand, is a trust-based relationship characterized by a high level of interdependence, risk sharing, and

long term horizons. Each type of relationship involves a trade-off. While buyers pursuing the arm's-length strategy may be able to obtain the lowest price by playing one supplier off against another, they have more difficulty in inducing commitment and controlling opportunism. In contrast, parties to the obligational contracting can reduce uncertainty and opportunism through developing trust and frequent communication, but they are locked in the relationship.

Empirical support for the importance of buyer-supplier relationships in influencing supplier compliance-performance is growing. A handful of case studies have shown that close and collaborative relationships between brands and suppliers encourage learning and value-sharing, contributing to better working conditions (Frenkel, 2001; Frenkel and Scott, 2002; Locke and Romis, 2006). Further, Locke, Amengual and Mangla (2009) argue that a traditional "compliance approach" based on policing and sanction has not induced progress in working conditions. Rather, they contend that a "commitment approach" characterized by joint problem solving and capacity building between buyers and suppliers is more effective at addressing the root causes of poor working conditions in supply chains. In line with their argument, Jiang (2009) shows through regression analysis that norm-based relationships characterized by open, two-way dialogue and joint problem solving are positively associated with supplier compliance with CoC.

#### Long-term Relationship Hypotheses

From the TCE perspective, long-term relationships tend to justify idiosyncratic investment because parties have long enough horizons to reap the benefits of their investment. Also, repetitive interactions provide opportunities to reward good behavior and punish opportunism. From the RET viewpoint, the duration of relationships helps foster trust and align firms expectations, reducing opportunistic behavior. Empirically, long-term relationships are found to increase commitment and reduce opportunism in inter-firm

relationships (Joshi and Stump, 1999). Hence, longer duration of the relationship, especially with the most important buyer, is likely to reduce suppliers' opportunism and non-compliance.

*Hypothesis III-a. The duration of the relationship with a supplier's most important buyer is negatively related to supplier non-compliance.*

Reputation-conscious buyers seek to ensure that their supply chains are constantly up to a high standard in terms of quality and compliance, which requires a higher degree of asset specificity. Accordingly, reputation-conscious buyers are likely to prefer a long-term relationship to foster trust and induce cooperation. This tendency may explain why suppliers of reputation-conscious buyers are associated with better compliance-performance.

*Hypothesis II-b. The effect of reputation-conscious buyers on supplier non-compliance is mediated by the duration of the relationship with a supplier's most important buyer.*

While a long-term relationship may be necessary to induce better compliance, it may not be sufficient if it is conditioned upon the type of buyers: reputation-conscious buyers are more likely to make idiosyncratic investment in their suppliers than other buyers. In other words, the duration of the relationship may significantly affect supplier compliance *only* when it is *with a reputation-conscious buyer*.

*Hypothesis III-c. The negative association between the duration of the relationship and supplier non-compliance is more pronounced in the presence of reputation-conscious buyers.*

### Market-based Relationship Hypotheses

According to the TCE, market-based and thus arm's-length relationships are preferred when the degree of asset specificity required in transactions is low: it is more efficient to use the market to manage standardized transactions than to make idiosyncratic investment in their partners. While efficiency may be attained in a market-based relationship, controlling opportunism is more difficult given the lower switching costs despite safeguards such as threats and incentives. From the RET perspective, lack of relational norms in a market-based relationship precludes fostering commitment and trust. In sum, both the TCE and RET predict a higher degree of opportunism under market-based relationships.

In the global garment industry, at least three types of buyer-supplier relationships exist. The first type goes through sourcing agents who match buyers with factories around the world, searching for the best combination of price, quality, and delivery demanded by buyers. Agents function as a "one-stop shop" or a supply chain manager, and the relationship between a buyer and a supplier factory is a contract-based one-off relationship (Play Fair, 2008). The second type goes through vendors, which are MNEs with multiple production facilities. Vendors tend to have long and established relationships with buyers and distribute orders to their subsidiaries around the globe as well as to sub-contractors. The third type is a direct relationship between a buyer and a factory, which could occur when a factory or its head office enjoys a long and established relationship with its buyer. In sum, the first type represents a market-based relationship, which is likely to be associated with worse compliance-performance than the other relationships.

*Hypothesis IV-a. Market-based relationships through agents are positively related to supplier non-compliance.*

On the other hand, reputation-conscious buyers demanding about quality and compliance standards are likely to avoid market-based relationships that do not encourage suppliers to commit to continuous improvement. Reputation-conscious buyers may be associated with better supplier compliance-performance precisely because they avoid such relationships.

*Hypothesis IV-b.* The effect of reputation-conscious buyers on supplier non-compliance is mediated by the absence of market-based relationships.

Alternatively, even when transacting through agents, reputation-conscious buyers may still make idiosyncratic investment and induce supplier efforts in a way that other buyers do not. In this case, the negative effect of market-based relationships is mitigated by the presence of reputation-conscious buyers.

*Hypothesis IV-c.* The positive association between market-based relationships and supplier non-compliance is less pronounced in the presence of reputation-conscious buyers.

#### Learning Hypotheses

The nature of buyer-supplier relationships also affects the degree of learning, which is likely to influence working conditions in supplier establishments. Technical assistance and knowledge spillovers from buyers signal buyers' credible commitment to the relationship, which then helps foster trust between buyers and suppliers (Sako and Helper, 1998; Bönnte, 2008). Although providing learning opportunities does not necessarily reduce supplier opportunism, it may help suppliers to improve production processes and work organization, which may in turn improve working conditions.

Case studies have found substantial scope for learning between buyers and suppliers that helps improve working conditions. In a matched-pair case study, Locke and Romis (2006) illustrate how a collaborative relationship between Nike and its supplier encouraged upgrading of a production system and work organization, leading to higher wage levels and shorter work hours. Specifically, the supplier that adopted a lean-production system with the help of Nike benefited from greater worker participation and higher productivity. Hence, it can be hypothesized that the more learning opportunities buyers provide, the better the supplier compliance-performance.

*Hypothesis V-a. Learning opportunities provided by buyers are negatively related to supplier non-compliance.*

Nonetheless, not all buyers provide similar learning opportunities. As the case studies of global brands corroborate, brands tend to provide more extensive training and assistance to upgrade their supplier production systems and to improve quality control than other buyers. Such asset specific investment is justified by high quality and compliance standards sought by reputation-conscious buyers. Therefore, reputation-conscious buyers may provide more learning opportunities than others, helping reduce supplier non-compliance.

*Hypothesis V-b. The effect of reputation-conscious buyers on supplier non-compliance is mediated by learning opportunities.*

Alternatively, it may be the ‘quality’ of learning rather than the quantity of learning that affects supplier compliance-performance. Reputation-conscious buyers may provide ‘better’ learning opportunities than other buyers, given the higher standards required.

*Hypothesis V-c. The negative association between learning opportunities and supplier non-compliance is more pronounced in the presence of reputation-conscious buyers.*

### **4.3. Data and Methods**

This study exploits monitoring and firm characteristics data collected by ILO BFC. ILO monitors conduct un-announced visits of all the exporting garment factories every 6 to 8 months on average. ILO monitoring covers the entire population of exporting factories in Cambodia (approximately 300) and the data are systematically available since 2006. Nevertheless, ILO BFC does not collect detailed information on buyer-supplier relationships, which is critical to testing the above hypotheses. For this reason, the author conducted a survey of supplier factories in the Cambodian garment industry in the latter half of 2008. Consequently, the size of the survey determines the size of the sample.

#### ***Survey Data Collection***

The survey was conducted between June and October 2008 in Phnom Penh, Cambodia, and the survey targeted general managers of exporting garment factories. A total of 51 factory managers responded to the survey out of approximately 300 of Cambodia's export garment factories.<sup>82</sup> While it covers only 17 percent of the industry population, the actual response rate is likely to be higher as explained below. Survey questions have been tested with industry experts and then piloted in four factories. Given that factory managers are predominantly Chinese speakers, the questionnaire and cover letter were written in both English and Chinese.

The survey collection employed a multi-pronged approach to increase responses given limited time and resources. First, ILO monitors distributed and collected questionnaires

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<sup>82</sup> In fact, as one survey respondent was responsible for four branches, the actual survey size is 54. While the survey response is identical for the four branches, their factory characteristics and compliance data vary.



during their routine factory visits. Second, the author accompanied ILO monitors and conducted face-to-face interviews with factory managers during factory visits. Third, the author sent emails to factory managers asking to complete the questionnaire on-line. The three survey vehicles were used equally: monitors collected 16 responses, the author interviewed 17 factory managers, and the web-based survey collected 18 responses.

The major issue in a survey is a problem of non-response, which introduces bias and distorts the representativity of a sample (Buckingham and Saunders, 2004). For this reason, Hansen and Hurwitz (2004) propose combining interviews and mail questionnaires to optimize the response rate given resource constraints. Indeed, interviews helped alleviate non-response problems pervasive in self-completed survey collection. When managers were present, which was almost always the case, the interview approach attained a 100 percent response rate (i.e. all managers agreed to be interviewed), while the response rate for the web-based approach reached only 15.5 percent.<sup>83</sup> As ILO monitoring schedule is random (i.e. not affected by the level of compliance or any other explanatory variables), interviewing during factory visits reduces potential bias in the sample. Thanks to the multi-pronged survey collection approach, the sample profile is broadly in line with the population profile as shown in Table 4-1, although larger factories and better performers are slightly over-represented. Complete survey questions and answers are detailed in Appendix I.

### ***Dependent Variable***

ILO monitors assess nearly 400 checklist items of labor standards, which are based on the Cambodian labor law and the international labor standards. The checklist items are grouped into the following categories: contracts, wages, hours, leave, welfare, occupational

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<sup>83</sup> A link to the web-based questionnaire was sent by email to 147 managers, of which 31 returned as delivery failures, and of which 18 responded (i.e. the response rate of 15.5 percent). Given the fast turnover of managers in the industry and lack of internet use in some factories, the likelihood of ‘deliberate refusal’ is likely to be less than what the figure indicates. The response rate for collection through monitors is not available as the number of questionnaires distributed by monitors is not known. The response rate for the monitor channel is likely to be higher than the web-based one, but much lower than that of interviews.

safety and health (OSH), and fundamental rights. Un-announced visits span an entire day or longer for larger establishments, and the process includes an on-site inspection, meetings with human resource managers, union leaders, and shop stewards as well as off-site interviews with workers. When a factory is deemed out of compliance with a certain item, ILO monitors make a standardized suggestion for improvement. Therefore, the presence of a suggestion is equivalent to non-compliance and the absence of a suggestion, compliance. In general, a smaller number of suggestions or non-compliance items indicates better working conditions.

The industry-average compliance level in 2008 was 90 percent (where a score of 100 indicates full compliance), suggesting a very high level of overall compliance in the Cambodian garment industry. As in Chapter 3, the items under OSH and welfare are grouped together to form one category, ‘OSH-welfare’ while the items under hours and leave are combined as ‘hours-leave.’ In fact, giving equal weight to each checklist item leads to over-representation of OSH-welfare, as together they account for 35.7 % of the total checklist items. To rectify this over-representation, the weight of each item under OSH-welfare has been reduced to half, leading to a better balance of issue categories in the composite: contract (15.4%), wage (24.6%), hours-leave (19.7 %), OSH-welfare (21.5 %), and fundamental rights (18.6%).<sup>84</sup>

### ***Independent Variables***

Independent variables can be loosely organized under the categories articulated in the hypothesis section: deterrence, buyer-supplier relationships, and learning. Table 4-2 shows the survey responses regarding the channels of buyer influence.

#### **Deterrence**

One of the measures of deterrence is the frequency of visits by buyers’ compliance staff. As shown in Table 4-2, there is large variation: 60 percent of factories receive up to 5

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<sup>84</sup> The result based on the un-weighted composite is not substantially different from the output using the weighed composite, but the latter is more robust.

compliance visits per year while 22 percent receive 15 times or more. The frequency of visits is coded from 1 to 6 as an interval measure. The other measure of deterrence is a dummy variable of whether or not buyers have warned implicitly or explicitly about the consequence of non-compliance (i.e. cancellation of orders). 46 percent of the managers acknowledge having received implicit or explicit warnings.<sup>85</sup>

There is a potential issue of endogeneity with the deterrence variables if buyers tend to visit problematic factories and issue warnings disproportionately to these factories. While endogeneity may be controlled by using instrumental variables or first-differencing variables, lack of appropriate instruments and temporal gaps between dependent and independent variables precludes using these techniques. Nonetheless, potential endogeneity may be less problematic considering that buyers' compliance visits have multiple purposes unlike ILO monitoring. Locke, Qin, and Brause (2007:18) mention that Nike concentrates its resources on high-risk factories *and* suppliers with which they want to develop more long-term relationships.

Similarly, the author's interviews with buyer local representatives find that they visit their suppliers not just to enforce their CoC, but to develop open and close relationships. Moreover, the problem of endogeneity for warnings may be less severe since the author's interviews have found that supplier perception of warnings varies considerably. Some managers considered accepting buyer CoC as equivalent to an implicit warning, given the clause stipulating that violation of CoC may lead to termination of contracts. Other managers, however, interpreted warnings as specific buyer remarks addressing particular compliance problems.

### Buyer-supplier relationships

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<sup>85</sup> Nonetheless, only 10 percent of them responded that non-compliance has actually led to a cancellation of orders. This is because most suppliers rectify problems within a given time frame as demanded by buyers. Only when the problem is severe and recurrent do buyers terminate contracts.

The nature of the buyer-supplier relationships is measured by the duration of the relationship with a supplier's most important buyer and the mode of communication with buyers. The duration varies from 0-2 years (14 percent) to 10 years or more (16 percent), while the majority falls between 3 and 6 years (54 percent). The duration of the relationship is coded from 1 to 6 as an interval measure. The mode of communication with buyers is divided quite equally: directly with buyers (43 percent), through vendors (37 percent), and through agents (31 percent). The measure of a market-based relationship is a dummy variable of whether or not a supplier communicates through agents.

### Learning

According to the surveyed managers, buyers share technical knowledge often (33 percent) or sometimes (53 percent). The kind of knowledge commonly shared is quality control (95 percent), followed by work place skills (51 percent), and production system (40 percent). 26 percent of the surveyed factories had buyers involved in determining their production systems. Buyers encourage training often (30 percent) or sometimes (50 percent). In general, there appears to be knowledge sharing between buyers and suppliers. From these questionnaire responses, three dummy variables have been created to measure learning opportunities: whether or not buyers often share technical knowledge, whether or not buyers have been involved in determining production system, and whether or not buyers often encourage training.

### Reputation-conscious buyers

The last independent variable is a reputation-conscious buyer, which may be mediated by the other independent variables or interact with them to influence compliance performance. Following the preceding chapters, this chapter operationalizes the concept of a reputation-conscious buyer by looking at whether or not a buyer participates in multi-stakeholder

initiatives (MSI).<sup>86</sup> Since reputation-conscious buyers tend to participate in MSI to show their commitment to better working conditions and safeguard their reputation, it is a reasonable proxy. This study focuses on the Fair Labor Association (FLA) and the Ethical Trading Initiative (ETI), given their prominence and buyer-oriented nature.<sup>87</sup> Hence, a dummy variable of a buyer participating in the FLA or the ETI (hereafter, MSI buyers) is used as a measure of a reputation-conscious buyer.

### *Control Variables*

Firm characteristics found to be significant in Chapter 2 and 3 are controlled for: the size of the establishment as measured by the natural logarithm of total number of employees and the age of the establishment proxied by the total number of visits by ILO monitors since 2001. In addition, firms' capacity and network are considered as follows.

Firms may need to have a certain level of financial capacity to improve compliance performance (Winter and May, 2001). As the direct measure of financial capacity was difficult to obtain, the survey asked whether the factory provides Free-on-Board (FOB) services or Cut, Make and Trim (CMT) only. FOB is a full-package service, responsible for purchase of fabric and accessories, production, and transport until loading merchandises onto the export carrier. CMT literally refers to the production process only. The distinction between the two types of services is important because sourcing of fabric and financing import and export costs require substantial resources and managerial know-how unlike CMT (USAID 2007). Hence, a dummy variable for FOB is used as a measure of financial capacity.

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<sup>86</sup> Following O'Rourke (2006: 899), this thesis defines MSI in labor regulation as a scheme that involves various stakeholders in negotiating labor standards, monitoring compliance with these standards, and establishing mechanisms to encourage firms to comply with these standards.

<sup>87</sup> The Fair Labor Association (FLA), an American initiative, is the oldest and the best known brand-oriented MSI in labor regulation. Member companies are required to implement the FLA code of conduct, submit to un-announced monitoring by accredited auditors, and to commit to remediation and public reporting. Currently, 26 companies are participating, most of which are well-known apparel and sportswear brands as well as university affiliates. The Ethical Trading Initiative (ETI), a UK scheme, is geared toward learning and self-reporting rather than monitoring. The ETI encourages its member companies to implement its base code in their supply chains and require them to submit annual progress report on their code implementation. If progress is deemed unsatisfactory, members may be asked to resign. Currently, 50 companies are participating, most of which are large European brands and retailers.

Financial and managerial capacity of factory can also be affected by firm network including parent companies and other branches, as they can provide access to capital, managerial know-how and best practices (Erickson and Jacoby, 2003). Independent firms deprived of such access are likely to have lower capacity than networked firms. The questionnaire asked whether the factory is independent, subsidiary of a group and/or one of multiple branches in Cambodia. Thus, the dummy variable of independent firm is used to measure the absence of firm network.

Table 4-3 reports the descriptive statistics and inter-correlations of all the variables under investigation. A cursory examination shows statistically significant relationships between supplier non-compliance and agent, MSI-buyer, and factory size variables, which will be further evaluated using multi-variate regressions.

### ***Model Specification***

Given the small sample size, simultaneously incorporating all the independent and control variables as well as interaction terms depletes degrees of freedom. To circumvent this problem, regression analysis is conducted in two steps. First, baseline OLS regressions are run for each category of independent variables (i.e. deterrence, relationship, and learning), including MSI buyer and its interaction terms. Second, an OLS regression is run with those significant predictors identified in the baseline regressions, together with control variables.

The baseline regression for deterrence:

$$\text{Non-compliance} = \alpha + \beta_1 \cdot \text{visit frequency} + \beta_2 \cdot \text{warning} + \beta_3 \cdot \text{MSI buyer} + \beta_4 \cdot \text{frequency} \cdot \text{MSI buyer} + \beta_5 \cdot \text{warning} \cdot \text{MSI buyer} + \varepsilon$$

The baseline regression for relationship:

$$\text{Non-compliance} = \alpha + \beta_1 \cdot \text{duration} + \beta_2 \cdot \text{agents} + \beta_3 \cdot \text{MSI buyer} + \beta_4 \cdot \text{duration} \cdot \text{MSI buyer} + \beta_5 \cdot \text{agents} \cdot \text{MSI buyer} + \varepsilon$$

The baseline regression for learning:

$$\text{Non-compliance} = \alpha + \beta_1 \cdot \text{knowledge sharing} + \beta_2 \cdot \text{production system} + \beta_3 \cdot \text{encourage training} + \beta_4 \cdot \text{MSI buyer} + \beta_5 \cdot \text{knowledge} \cdot \text{MSI buyer} + \beta_6 \cdot \text{system} \cdot \text{MSI buyer} + \beta_7 \cdot \text{training} \cdot \text{MSI buyer} + \varepsilon$$

The main regression with added control variables:

$$\text{Non-compliance} = \alpha + \beta_1 \cdot \text{significant deterrence variable} + \beta_2 \cdot \text{significant relationship variable} + \beta_3 \cdot \text{significant learning variable} + \beta_4 \cdot \text{MSI buyer} + \beta_5 \cdot \text{factory size} + \beta_6 \cdot \text{factory age} + \beta_7 \cdot \text{FOB} + \beta_8 \cdot \text{independent} + \varepsilon$$

#### **4.4. Results**

##### ***Baseline Regressions***

Table 4-4 shows the result for the deterrence model. Neither visit frequency nor warning is significantly associated with non-compliance although they both have negative signs as expected. The presence of MSI buyers is statistically significant in Model 1 and it reduces non-compliance by 7 items ( $p < 0.05$ ). This suggests that reputation-conscious buyers influence supplier compliance through a channel other than deterrence. When interaction terms are introduced in Model 2, none reaches statistical significance. Visit frequency by non-MSI buyers is negatively associated with non-compliance, and in the presence of MSI buyers, this negative effect is reinforced. Warnings by non-MSI buyers are negatively associated with non-compliance although this negative effect is reduced when MSI buyers are present. In sum, even though the direction of effects is broadly in line with the stated

hypotheses, none of the deterrence hypotheses are statistically significant in the estimation results.

Table 4-5 shows the relationship model results, in which transaction through agents increases non-compliance by 5.7 items ( $P < 0.05$ ) in Model 3. The presence of MSI buyers is equally significant though in the opposite direction, reducing non-compliance by 5.6 items. The duration of relationship is not significant and positively associated with non-compliance. Once the variable is interacted with MSI-buyer, however, it gains significance and reduces non-compliance as shown in Model 4.<sup>88</sup> In contrast, the duration of the relationship with a non-MSI buyer is not significant and positively related to non-compliance. This suggests that the duration of relationship helps reduce non-compliance only when the most important buyer is an MSI buyer, rejecting the general hypothesis of long-term relationships and confirming the interaction hypothesis with reputation-conscious buyers.

In Model 4, variable “Agents” measures the effect of agents in the absence of MSI buyers, and it is highly significant, increasing the number of non-compliance by 9.8 items ( $p < 0.01$ ). This is because the agent effect for an MSI buyer has been separated by adding an interaction variable (Agents\*MSI buyer), which is non-significant and increases non-compliance by only 1.4 items.<sup>89</sup> It is interesting to note that the significance of MSI buyer is lost once the interaction terms are included. The findings generally support the market-based relationship hypothesis that transaction through agents is associated with a higher level of non-compliance. The effect of reputation-conscious buyers is partially mediated by the agent

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<sup>88</sup> The coefficient of the interaction term (duration\*MSI buyer) measures the difference in the slopes for MSI and non-MSI buyers while the coefficient of “Duration of relationship” measures the slope for non-MSI buyers. Therefore, the effect of an extra year of relationship (i.e. 2 years in this case) with an MSI buyer on non-compliance is the sum of coefficients for non-MSI and MSI buyers:  $0.72 - 1.51 = -0.79$ .

<sup>89</sup> The coefficient of the interaction term (agents\*MSI buyer) measures the difference in the slopes for MSI and non-MSI buyers while the coefficient of “Agents” measures the slope for non-MSI buyers. Therefore, the coefficient for the use of agents in the presence of MSI buyers is the sum of coefficients for non-MSI and MSI buyers:  $9.75 - 8.36 = 1.39$ .



variable, but it also appears to interact with agents, implying the particularities of reputation-conscious buyers.

In the learning model in Table 4-6, none of the independent variables except MSI buyer are significantly associated with non-compliance. Buyers' knowledge sharing and involvement in determining production systems have expected negative signs while encouraging training has a positive sign, possibly due to a relatively high correlation with MSI buyer (i.e. 0.53). Running separate regressions for each independent variable renders none of them significant. None of the interaction terms are significant, suggesting that reputation-conscious buyers do not condition the effect of learning variables on non-compliance. Overall, the learning hypotheses are not supported by the estimation results.

#### ***Main Regressions with Added Controls***

Table 4-7 reports the results of main OLS regressions with the variables found significant in the baseline regressions (i.e. relationship and reputation-conscious buyer variables) and control variables. Model 7 includes all the variables, while Model 8 displays only the significant variables without interaction terms, which is more parsimonious. It shows that about one-quarter of the variation in non-compliance is explained by only two variables: transaction through agents and the size of the factory.

The most consistent and significant predictor of non-compliance turns out to be the agent variable. Model 7 shows the conditional effect of agents: transacting through agents when MSI buyers are not present increases non-compliance by 10 items ( $p < 0.01$ ). Model 8 shows the general effect of agents: when a supplier transacts through agents, regardless of the presence of MSI buyers, non-compliance increases by 6.5 items ( $p < 0.05$ ). The duration of the relationship with an MSI buyer is negatively related with non-compliance and slightly significant ( $p < 0.1$ ), suggesting that MSI buyers may be qualitatively different from other buyers in their approach to buyer-supplier relationships.

As for control variables, factory size is the only significant one. Larger factories tend to have fewer non-compliance items as expected (e.g. a one percent increase in the number of employees reduces non-compliance by 4.3 items). The significance of MSI buyers is lost once agents and factory size are included. Other firm characteristics such as age, FOB, independence are not significant.

### ***Interpretation of Results***

The above findings lend support to the relationship hypotheses that the nature of buyer-supplier relationships importantly affects supplier compliance-performance. Specifically, market-based transactions through sourcing agents are consistently associated with poorer compliance performance across different specifications. This negative agent effect is augmented in the absence of reputation-conscious buyers. The significant effect of MSI buyers is likely to be mediated through their preference for close and established relationships with suppliers as very few MSI buyers use agents (only 3 out of 49 suppliers in the sample produce for at least one MSI buyer and use agents).

On the other hand, the duration of the relationship is found to reduce non-compliance only with an MSI buyer. This conditional effect also attests to the particularity of MSI buyers. While a long-term relationship may be a necessary condition for fostering trust and developing collaboration, it is unlikely to be a sufficient one, which explains the variable's lack of significance in the main regression. With a better measure, the collaboration hypothesis is likely to be supported.<sup>90</sup> In sum, it is likely that the absence of agents and the presence of collaboration underlie the negative and significant association between reputation-conscious buyers and supplier non-compliance found in the preceding chapters.

Particularities of reputation-conscious buyers are corroborated by the buyer survey, completed by 13 major buyers in Cambodia's garment sector (Appendix II). First, MSI

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<sup>90</sup> Jiang (2009) succeeded in showing the statistical link between such norm-based relationships and compliance while he failed to show a significant link between market-based relationships and compliance.

buyers tend to communicate directly with factories while other buyers tend to transact through vendors and sourcing agents. Second, MSI buyers often account for a large share of the production capacity of their suppliers whereas other buyers do not. This gives more leverage to MSI buyers vis-à-vis their suppliers. Third, MSI buyers have a tendency to emphasize continuous improvement while other buyers often turn to ‘zero tolerance’ and ‘three strikes’ policies. These rigid procedures are likely to prompt suppliers to hide problems rather than to be open about them. Overall, reputation-conscious buyers are indeed qualitatively different from other buyers in terms of managing relationships with suppliers.

Although the learning hypotheses are not supported by the evidence, this channel should be further explored with a larger sample and different measures of learning. As the type of relationship is likely to affect the degree of learning between buyers and suppliers, a structural model may be used. On the other hand, there is little evidence to support the deterrence hypotheses, which may suggest that a policing approach through intensive monitoring and credible threats may not be the most effective strategy to improve supplier compliance. Nevertheless, the measures of deterrence may suffer from endogeneity, and therefore, the result is more tentative than conclusive.

Based on these findings, Figure 4-1 depicts a model of buyer influence on supplier compliance-performance. Given the need to maintain high standards, which require a higher degree of asset specificity, reputation-conscious buyers tend to opt for direct relationships with vendors and factories. These buyers often form collaborative relationships and invest their time and resources in suppliers, encouraging supplier commitment. In contrast, other buyers, especially cost-conscious buyers specializing in more standardized products prefer market-based transactions through agents for efficiency reasons. However, market-based transactions encourage neither buyers nor suppliers to make asset-specific investment as they have shorter time horizons. Consequently, suppliers in market-based relationships tend to

under-perform their peers enjoying collaborative relationships in terms of labor standard compliance. Supplier compliance is also affected by the size of the factory; larger factories tend to have better compliance levels than smaller ones, given their economies of scale and higher opportunity/monitoring costs.

#### **4.5. Conclusion**

While much has been studied and debated about CoC and monitoring procedures, how buyers influence working conditions in their supply chains remains poorly understood. In particular, a quantitative investigation into different channels of buyer influence has been lacking. This chapter has attempted to fill the gap by examining different channels (i.e. deterrence, relationship, and learning) through which buyers influence supplier compliance-performance. This chapter has also sought to assess how reputation-conscious buyers may affect those channels differently. To accomplish these tasks, this chapter exploited the monitoring and firm characteristic data provided by ILO BFC as well as the original survey data collected by the author.

This chapter has shown that the main channel linking buyers and supplier compliance-performance is the nature of their relationships. Suppliers engaged in market-based transactions through agents systematically under-perform suppliers who do not depend on agents. In other words, market-based relationships are associated with poor compliance performance. While deterrence and learning variables generally show expected signs, they do not reach statistical significance.

The findings have important practical and theoretical implications. The results indicate that market-based relationships through agents may be part of the problem rather than a solution from the viewpoint of improving working conditions. Market-based relationships characterized by short-term horizons motivate neither buyers nor suppliers to invest their time and resources to understand the root causes of poor working conditions and to commit to

continuous improvement. Rather, market-based relationships prompt suppliers to try to pass compliance audits with minimum efforts. Moreover, the non-significance of the deterrence variables suggests that a policing approach based on intensive monitoring and credible threats may not be the best way to bring about progress in supplier compliance. These, together, point to the limit of arm's-length, compliance-oriented relationships, which could breed mistrust and dishonesty.

Conversely, the findings signal the need to develop collaborative relationships marked by open dialogue, trust, and commitment, which helps foster an environment supportive of continuous improvement. Close and open relationships with buyers enable suppliers to discuss problems and find solutions rather than to hide them from buyers. To improve supplier working conditions, therefore, buyers need to place more importance on the quality of their relationships with suppliers—openness, trust, mutual commitment—and not just on the traditional concerns of price, quality and delivery of goods. These points are echoed by other scholars (Locke and Romis, 2006; Locke et al., 2007; Jiang, 2009; Locke et al., 2009).

Such collaborative relationships may well underlie the significant and positive effect of reputation-conscious buyers on supplier compliance-performance. Given the high degree of asset specificity required, reputation-conscious buyers tend to avoid market-based relationships and to form collaborative relationships with their suppliers. In fact, the duration of the relationship has a positive effect on compliance performance only when it is with a reputation-conscious buyer. In contrast, more cost-conscious buyers retailing highly standardized products tend to prefer market-based relationships that do not require asset specific investment. This suggests that attracting reputation-conscious buyers could bring important benefits not only in terms of upgrading products and processes but also in terms of forming collaborative relationships and improving working conditions.

Nevertheless, it is important to acknowledge the negative effects buyers—including reputation-conscious ones—can have on working conditions in supply chains. In fact, purchasing practices of buyers sometimes contradict with the goal of improving working conditions (CCC, 2009; Oxfam, 2004). In recent years, intense competition and rising prices have squeezed garment producer profits, making it difficult to invest in better working conditions or raise wages. On the other hand, buyers are increasingly demanding quicker delivery, which disrupts work schedules and increases overtime. Moreover, significant fluctuations in orders leave workers idle during low seasons, making it costly for factories. These buying practices have negative consequences on suppliers' capacity to improve working conditions, and thus need to be addressed.

This chapter has several limitations. First, the sample size is small although the sample is broadly representative of the population. Second, the deterrence variables potentially suffer from endogeneity, which needs to be better controlled in the future work. Third, while interactions and mediation between reputation-conscious buyers and other independent variables have been considered, relationships among independent variables have not been taken into account, which may require simultaneous equation modeling. Considering these limitations, this chapter does not claim to have offered exhaustive hypothesis testing. Rather, it has provided support to the existing studies and some additional insights into buyer influence on their supplier compliance-performance. Future research could address these points and expand upon the inner-workings of the relationship channel.

Table 4-1. Population and sample profiles

	Non-compliance		Factory Size		Factory Age		Presence of MSI buyer	
	Population	Sample	Population	Sample	Population	Sample	Population	Sample
Observation	300	52	300	53	300	54	300	52
Mean	20.0	17.8	1197.5	1420.3	5.4	5.9	0.4	0.4
S.D.	12.4	9.7	1056.7	1086.6	2.3	2.4	0.7	0.5

Table 4-2. Responses to the questionnaire on the channels of buyer influence

	Percent	Valid	Missing
<u>Deterrence</u>			
How many times does buyers' compliance staff visit your factory per year?		50	1
0-2 times	30		
3-5 times	30		
6-8 times	14		
9-11 times	2		
12-14 times	2		
15 times or more	22		
Your buyers have warned explicitly or implicitly about the risk of non-compliance leading to a cancellation of orders	46	50	1
<u>Relationship</u>			
For how many years have you produced for your most important buyer?		50	1
0-2 years	14		
3-4 years	28		
5-6 years	26		
7-8 years	10		
9-10 years	6		
10 years or more	16		
Do you communicate directly with buyers or through vendors or agents?		51	0
Mostly directly with buyers	43		
Mostly through vendors	37		
Mostly through agents	31		
<u>Learning</u>			
Your buyers share technical knowledge		51	0
Yes, often times	33		
Yes, sometimes	53		
No, not really	14		
Your buyers have been involved in determining the production system	26	51	0
Your buyers encourage training for workers/supervisors/managers		50	1
Yes, often times	30		
Yes, sometimes	50		
No, not really	20		

Table 4-3. Correlation matrix of dependent, independent, and control variables

Variable	Mean	S.D.	1	2	3	4	5	6	7	8	9	10	11	12
1 Non-compliance	17.80	9.67												
2 Visit frequency	1.62	1.16	-0.18											
3 Warning	0.45	0.50	-0.02	-0.04										
4 Duration	3.07	1.60	0.08	-0.31**	0.07									
5 Agents	0.31	0.46	0.39***	0.00	0.02	-0.01								
6 Share knowledge	0.32	0.47	-0.14	0.01	0.35**	-0.03	0.08							
7 Production system	0.25	0.44	-0.24	0.05	0.11	-0.04	-0.09	0.29**						
8 Encourage training	0.30	0.43	-0.20	0.07	-0.08	-0.02	-0.12	0.14	0.05					
9 MSI buyer	0.44	0.50	-0.36***	0.26	-0.23	-0.04	-0.34**	0.04	0.06	0.53***				
10 Factory size	7.01	0.70	-0.38***	0.14	0.08	0.02	-0.22	0.31**	0.14	0.40***	0.61***			
11 Factory age	5.94	2.40	-0.01	0.10	-0.18	0.21	-0.16	-0.19	0.04	-0.13	0.17	0.18		
12 FOB	0.82	0.40	-0.17	0.01	0.05	0.14	-0.21	0.12	-0.29**	0.24	0.31**	0.25	0.05	
13 Independent	0.20	0.40	0.21	-0.01	-0.05	-0.14	0.32**	0.09	0.17	-0.04	-0.20	-0.23	-0.15	-0.39***

Note: \*\* p< 0.05, \*\*\* p<0.01



Table 4-4. Deterrence model results

Variable	Model 1		Model 2	
Visit frequency	-0.91	(1.15)	-1.07	(1.72)
Warning	-2.41	(2.67)	-3.13	(3.56)
MSI buyer	-7.01**	(2.78)	-5.07	(5.45)
Visit frequency*MSI buyer			-1.47	(2.40)
Warning*MSI buyer			0.95	(5.69)
Constant	23.45****	(2.75)	22.74****	(3.27)
Observation	50		50	
R-squared	0.16		0.16	
F-value	2.84**		1.73	

Note: \* p< 0.10, \*\* p< 0.05, \*\*\* p<0.01, \*\*\*\* p<0.001.  
Standard errors are in the parentheses.

Table 4-5. Relationship model results

Variable	Model 3		Model 4	
Duration of relationship	0.41	(0.76)	0.72	(0.81)
Agents	5.71**	(2.82)	9.75***	(3.01)
MSI buyer	-5.56**	(2.63)	1.08	(2.98)
Duration*MSI buyer			-1.51*	(0.79)
Agents*MSI buyer			-8.36	(5.64)
Constant	17.44****	(3.21)	13.72****	(3.07)
Observation	51		49	
R-squared	0.22		0.36	
F-value	4.57***		4.87***	

Note: \* p< 0.10, \*\* p< 0.05, \*\*\* p<0.01, \*\*\*\* p<0.001.  
Standard errors are in the parentheses.

Table 4-6. Learning model results

Variable	Model 5		Model 6	
Share knowledge	-1.65	(2.96)	-3.81	(4.56)
Production system	-4.51	(3.20)	-3.76	(4.82)
Encourage training	0.19	(3.25)	3.19	(6.00)
MSI buyer	-6.44**	(3.05)	-6.09	(4.25)
Knowledge*MSI buyer			3.58	(6.20)
System*MSI buyer			-1.20	(6.66)
Training*MSI buyer			-4.72	(7.25)
Constant	22.17****	(1.97)	22.27****	(2.18)
Observation	51		51	
R-squared	0.18		0.19	
F-value	2.55*		1.47	

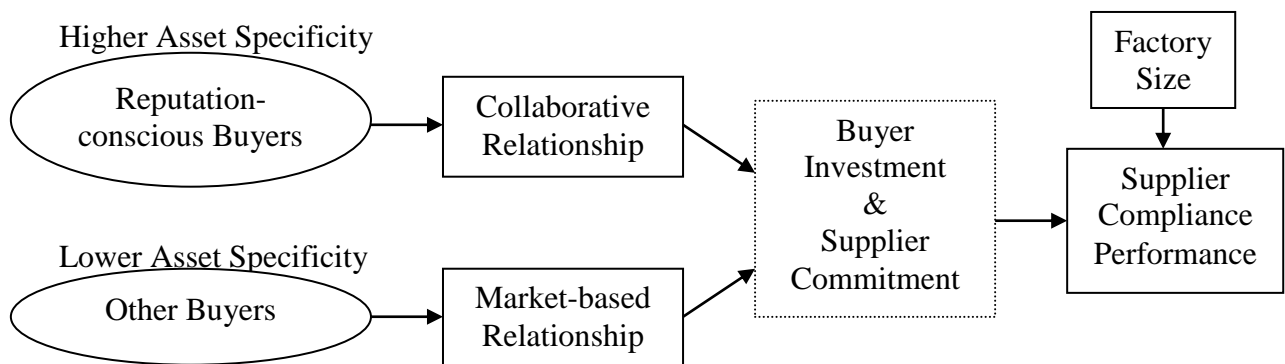
Note: \* p< 0.10, \*\* p< 0.05, \*\*\* p<0.01, \*\*\*\* p<0.001.  
Standard errors are in the parentheses.

Table 4-7. Main regression results with significant variables and added controls

Variable	Model 7		Model 8	
Duration of relationship	0.52	(0.83)		
Agents	10.09***	(3.24)	6.54**	(2.66)
MSI buyer	3.32	(3.31)		
Duration*MSI buyer	-1.33*	(0.79)		
Agents*MSI buyer	-7.92	(5.73)		
Factory size	-4.37**	(2.16)	-4.28**	(1.80)
Factory age	0.73	(0.55)		
FOB	0.34	(3.14)		
Independent	-1.28	(3.23)		
Constant	39.34**	(14.96)	45.85*****	(12.94)
Observation	49		52	
R-squared	0.44		0.24	
F-value	3.43***		7.74***	

Note: \* p< 0.10, \*\* p< 0.05, \*\*\* p<0.01, \*\*\*\*\* p<0.001.  
Standard errors are in the parentheses.

Figure 4-1. Model of buyer influence on supplier compliance-performance



## Overall Conclusion

This dissertation consists of four inter-linked chapters on labor standard compliance in Cambodia's garment sector, starting from an overall picture and narrowing down to the central theme. Chapter 1 provides a contextual overview of the Cambodian garment sector and assessment of the ILO monitoring program. Chapter 2 and 3 focus on the role of buyers and show that reputation-conscious buyers regulate their suppliers differently from other buyers. Then Chapter 4 examines the channels through which buyers influence their supplier compliance-performance. As a whole, this PhD thesis has made significant contributions to empirical and theoretical knowledge with important policy and managerial implications.

In terms of empirical contributions, Chapter 1 constitutes the latest and the most comprehensive evaluation of the ILO monitoring program, Better Factories Cambodia (BFC), which is considered to be one of the most promising models of labor regulation. While BFC has overcome some of the weaknesses of private monitoring in terms of rigor, cost effectiveness, coordination, as well as credibility, BFC runs in parallel to the state institutions and enforcement depends on buyers. Further, the scheme's viability remains to be tested.

Moreover, this dissertation contributes to the debate on the effectiveness of non-state labor regulation. Although critics claim that buyer-driven regulation inevitably leads to limited coverage in terms of establishments and issue areas, lack of systematic data has precluded quantitative treatment of the subject. Chapter 2 and 3 provide strong evidence that *very* reputation-conscious buyers are increasingly regulating labor conditions in their supply chains across various issue areas including fundamental rights.

Even *less* reputation-conscious retailers such as Wal-Mart and Target are found to pay attention to a variety of labor conditions in their supplier factories. On the other hand, significant compliance gaps have been identified between suppliers of reputation-conscious buyers and suppliers of the *least* reputation-conscious buyers, with the former systematically outperforming the latter. The findings thus contribute to a better and more nuanced understanding of the potential and limits of buyer-driven regulation.

Further, the dissertation sheds light on the different channels through which buyers influence working conditions in their supplier facilities. Chapter 4 tests various hypotheses on deterrence, relationship, and learning and finds that it is the nature of buyer-supplier relationships (market-based versus established) rather than deterrence *per se* that significantly affects supplier compliance-performance. The findings provide support for the work of Richard Locke and his collaborators, who argue that “commitment-oriented approach” is more effective than the “compliance-focused model” for addressing the root causes of poor working conditions.

This thesis has also made methodological contributions to the field of reputation and labor regulation. First, I have come up with a new way of operationalizing reputation consciousness by categorizing buyers according to their membership status of multi-stakeholder initiatives (MSI). Studies of firm reputation have traditionally relied on Fortune magazine’s ranking of World’s Most Admired Companies. However, this ranking does not directly measure the extent to which companies are sensitive to negative publicity and thus willing to invest in improving labor conditions in their supply chains. MSI membership status is a better measure since companies join MSI mainly to manage reputation risk as confirmed by the buyer survey.

Another methodological contribution to the field is the use of mixed methods, which was enabled by the diverse data collected in Cambodia's garment sector. On the one hand, the existing studies of working conditions in supply chains are predominantly qualitative studies based on a single or few cases. However rich and insightful, these accounts are not amenable to generalization. On the other hand, a few emerging quantitative studies on the subject tend to leave out the context and assume away causal mechanisms. This dissertation has sought to demonstrate the utility of combining qualitative and quantitative methods in arriving at parsimonious conclusions while taking into account causal processes and contextual factors, thereby enriching our knowledge.

This dissertation makes significant theoretical contributions as well. I have taken an evolutionary and eclectic approach to theorizing in order to demonstrate the utility and limits of different theories. The rational expected utility framework in Chapter 2 was useful for explaining why reputation-conscious buyers would behave differently from other buyers and why that affects supplier compliance-performance. Nonetheless, Chapter 3 has shown the limits of the rational deterrence theory in explaining the comprehensive response by reputation-conscious buyers, which was better explained by the behavioral theory. Chapter 4 has provided support for the relationship hypotheses consistent with the transaction cost economics and relational exchange theory rather than the deterrence theory.

In so doing, the thesis has provided a theoretical bridge for the disparate literature on labor conditions in global supply chains. On the one hand, there is critical literature by sociologists and development scholars assuming that firms are solely motivated by

incentives and threats in line with the rational deterrence theory.<sup>91</sup> On the other hand, there is management literature that views buyers as a partner in problem-solving through collaboration and learning.<sup>92</sup> Such divergent perspectives arise from the fact that the former camp studies all types of buyers including unscrupulous ones while the latter camp focuses on branded buyers who are conscious of their reputation and thus more responsible. This thesis has sought to reconcile the two perspectives and shown that while the *least* reputation-conscious buyers behave in line with the rational deterrence theory, reputation-conscious buyers act in a manner more consistent with the behavioral theory. Moreover, the thesis has explained the divergent behavior in terms of the varying degrees of asset specificity required by different types of buyers.

This finding has important policy and managerial implications as it suggests that different strategies may be needed for different types of buyers. For buyers with higher stakes in their reputation, it makes sense to foster long-term and collaborative relationships with their suppliers to improve labor conditions in their supply chains. For these buyers, therefore, a “commitment-oriented approach” is a better solution than a “compliance-focused approach” as argued by Locke et al. (2009). Nevertheless, it is unrealistic to expect the *least* reputation-conscious buyers to take a commitment-oriented approach to supply chain management. These buyers tend to favor market-based relationships given the lower degrees of asset specificity required. Further, they are unknown to consumers and thus less vulnerable to negative publicity. In the absence of ‘moral’ market forces, suppliers producing for these buyers need to be regulated by another regulatory mechanism, namely the state.

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<sup>91</sup> Major authors in this camp include Stephanie Barrientos, Jill Esbenshade, and Gay Seidman.

<sup>92</sup> Major authors in this camp include Stephan Frenkel and Richard Locke and his collaborators.

This leads us to the discussion on the next generation model of labor regulation. While state regulation in many developing countries is far from effective, non-state regulatory schemes including ILO BFC are limited by their coverage. To avoid “regulatory enclaves” and fill regulatory gaps, public and private initiatives should be better coordinated to make use of their relative strengths as Posthuma (2008) argues. Since non-state initiatives focus on exporting consumer goods sector, public enforcement should concentrate on other sectors and subcontractors. In the long-run, however, public and private regulatory efforts need to converge and government needs to take center stage.

This dissertation has the following limitations. The scope of inquiry is limited to the exporting garment sector in Cambodia, which means that non-exporting garment factories, other sectors, and other countries are not considered. Despite the anecdotal evidence that working conditions in subcontractors and other sectors are worse, it was not possible to obtain systematic data to make a comparison. Besides, the Cambodian case is more unique than universal given its bilateral trade agreement with the US, susceptibility to pressures from the US, and extensive involvement of the ILO at institutional and program levels. Another limitation concerns the nature of the data. While the ILO has conducted factory-level monitoring since 2001, systematic data are available only from 2006, limiting the time-series element of the data. In addition, the sample size of the surveys is smaller than originally envisaged due to resource constraints.

Future work should address these concerns and further explore the determinants of working conditions in global supply chains and uncover the black box of buyer influence. Specifically, the following questions seem worth exploring. Which is good



for working conditions in supplier facilities, more buyer leverage or less? There seem to be conflicting interpretations about how buyer leverage influences suppliers. While buyer leverage may help enforce labor standards in some cases, lack of supplier leverage may squeeze profits and worsen working conditions. Identifying scope conditions would be helpful. Another promising question relates to the difference between the determinants of compliance and those of ‘beyond compliance.’ The survey results indicate that different forces are at work: buyers may encourage compliance, but they are unlikely to motivate suppliers to go beyond compliance in most issue areas. It would be worthwhile to further investigate this issue.

As a whole, this PhD thesis has made an original contribution to the literature on labor regulation in global supply chains and buyer-supplier relationships. The unique and systematic factory-level data from the Cambodian garment sector enabled me to ask questions that were not previously possible and to answer them in a comprehensive manner. Novel findings have challenged popular notions and improved our empirical and theoretical knowledge about the potential and limits of buyer-driven labor regulation. Furthermore, the dissertation has suggested practical solutions for tackling poor working conditions in global supply chains: a commitment approach for reputation-conscious buyers and coordination of public and private regulatory framework.

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## Appendix I. Supplier Survey in the Cambodian Garment Sector

### Survey Data Collection

The supplier survey was conducted between June and October 2008 in Phnom Penh, Cambodia, and the survey targeted general managers of exporting garment factories. Survey questions were developed, tested with industry experts and then piloted in four factories by the author. Given that factory managers are predominantly Chinese speakers, the questionnaire and the cover letter were written in both English and Chinese.

The survey collection employed a multi-pronged approach to increase responses given limited time and resources. First, ILO monitors distributed and collected questionnaires during their routine factory visits. Second, the author accompanied ILO monitors and conducted face-to-face interviews with factory managers during factory visits. Third, the author sent emails to factory managers asking to complete the questionnaire on-line. The three survey vehicles were used equally: monitors collected 16 responses, the author interviewed 17 factory managers, and the web-based survey collected 18 responses. In total, 51 factory managers responded to the survey out of approximately 300 of Cambodia's exporting garment factories. Although it covers only 17 percent of the industry population, the actual response rate is higher as explained below.

The major issue in survey is a problem of non-response, which introduces bias and distorts the representativity of a sample. Interview-based survey collection helped alleviate non-response problems pervasive in self-completed survey collection. When managers were present, which was almost always the case, the interview approach attained a 100 percent response rate (i.e. all managers agreed to be interviewed), while the response rate for the web-based approach reached only 15.5 percent.<sup>93</sup> As ILO monitoring schedule is random (i.e. not affected by the level of compliance or any other explanatory variables), interviewing during factory visits reduces potential bias in the sample. Thanks to the multi-pronged survey collection approach, the sample profile is broadly in line with the population profile as shown in the table below, although larger factories and better performers are slightly over-represented.

	Non-compliance Items		Factory Size		Factory Age		Presence of MSI buyer	
	Population	Sample	Population	Sample	Population	Sample	Population	Sample
Ob	300	52	300	53	300	54	300	52
Mean	20.0	17.8	1197.5	1420.3	5.4	5.9	0.4	0.4
S.D.	12.4	9.7	1056.7	1086.6	2.3	2.4	0.7	0.5

<sup>93</sup> A link to the web-based questionnaire was sent by email to 147 managers, of which 31 returned as delivery failures, and of which 18 responded (i.e. the response rate of 15.5 percent). Given the fast turnover of managers in the industry and lack of internet use in some factories, the likelihood of 'deliberate refusal' is likely to be less than what the figure indicates. The response rate for collection through monitors is not available as the number of questionnaires distributed by monitors is not known. The response rate for the monitor channel is likely to be higher than the web-based one, but much lower than that of interviews.

## Survey Results and Analysis

### I. General factory characteristics.

This section asks about factory characteristics that are not in the ILO BFC database. Nonetheless, firm size has turned out to be the only consistently significant determinant of labor standard compliance.

*Question 1. What is the name of your factory? (All 51 answered)*

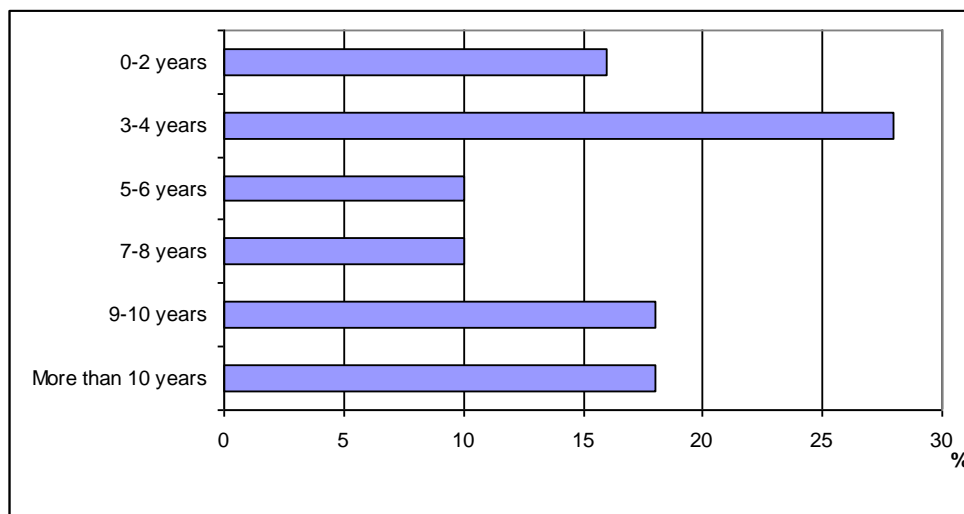
This question was asked in order to match the survey results with ILO monitoring data. Confidentiality was assured.

*Question 2. What is your position?*

	Response	
	Percent	Count
<b>General Manager</b>	<b>52</b>	<b>22</b>
Administrative Manager	14	6
Compliance Manager	12	5
Other	21	9
Answered		42
Skipped		9

While the questionnaire targeted general managers, other managers with sufficient knowledge on buyers and compliance were allowed to respond in the absence of general managers.

*Question 3. How many years has your factory been in operation? (50 out of 51 answered)*



The number of years in operation averages at 5.9 years, which broadly corresponds to the population average of 5.4 years. The age of the establishment can denote the degree of learning and physical constraints of the establishment.

*Question 4. Is your factory part of a larger firm network? (Multiple answers possible)*

	Response	
	Percent	Count
<b>Subsidiary of a group</b>	<b>75</b>	<b>38</b>
One of multiple branches in Cambodia	29	15
Independent	20	10
Answered		51
Skipped		0

Three quarters of the factories surveyed are subsidiaries of a group while 20 percent are independent. In Cambodia's garment sector, subsidiaries are foreign-owned while independent establishments are predominantly domestically-owned. The presence or absence of firm network can affect the factory's financial and managerial capacity.

*Question 5. If it is a subsidiary, does your parent company have a long and established relationship with one or more of your buyers?*

	Response	
	Percent	Count
<b>Yes</b>	<b>78</b>	<b>40</b>
No	0	0
Not Applicable	22	11
Answered		51
Skipped		0

All subsidiaries responded that their parent companies have long and established relationships with buyers

*Question 6. Which service(s) does your factory provide? (Multiple answers possible)*

	Response	
	Percent	Count
<b>Free on Board (FOB)</b>	<b>80</b>	<b>41</b>
Cut, Make, Trim (CMT)	20	10
Subcontracting	2	1
Answered		51
Skipped		0

80 percent of the surveyed factories provide FOB services while the rest provides CMT only. FOB requires more substantial financial capacity and managerial know-how than CMT. While only one factory admitted practice of sub-contracting, it is likely to be much more widespread.

II. Skill levels of workers and complexity of products

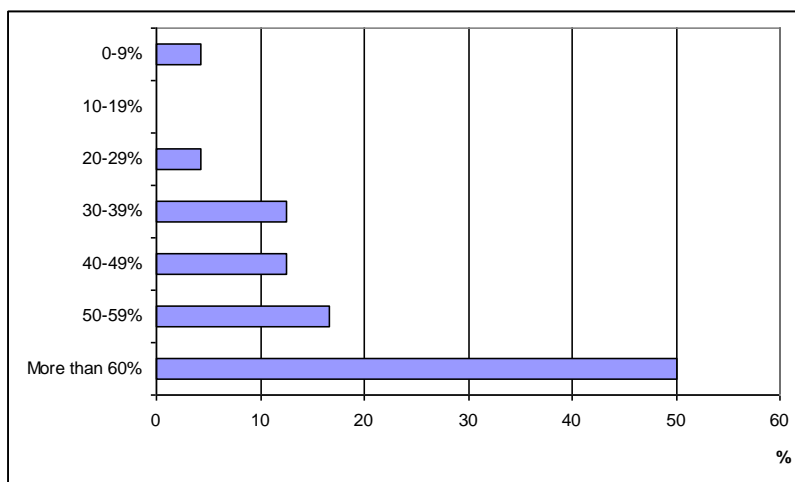
Workers’ skill levels are known to affect working conditions, in particular wage levels, as high-skill workers are paid more for their higher marginal product of labor. Given the lack of individual-level data, this section tried to ascertain the average skill level of workers in the factory. Nevertheless, none of the following measures of skills are significantly related to labor standard compliance. This may stem from the fact that Cambodia’s garment sector generally produces cheap and simple products using low-skilled labor.

*Question 7. Which production system does your factory use?*

	Response	
	Percent	Count
One-piece-flow, Lean system	45	22
<b>Bundle system</b>	<b>51</b>	<b>25</b>
Other	4	2
Answered		49
Skipped		2

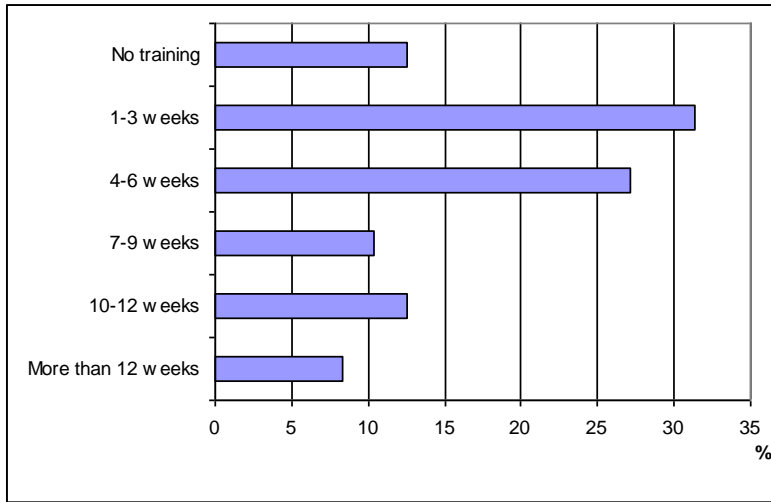
Factories using the bundle system slightly outnumber those using the one-piece-flow/lean system in the survey. The one-piece-flow/lean system generally requires higher levels of skills and coordination than the bundle system given the need to carefully balance the skill levels of workers in the same line.

*Question 8. What is the percentage of multi-skilled workers in your factory? (24 answered)*



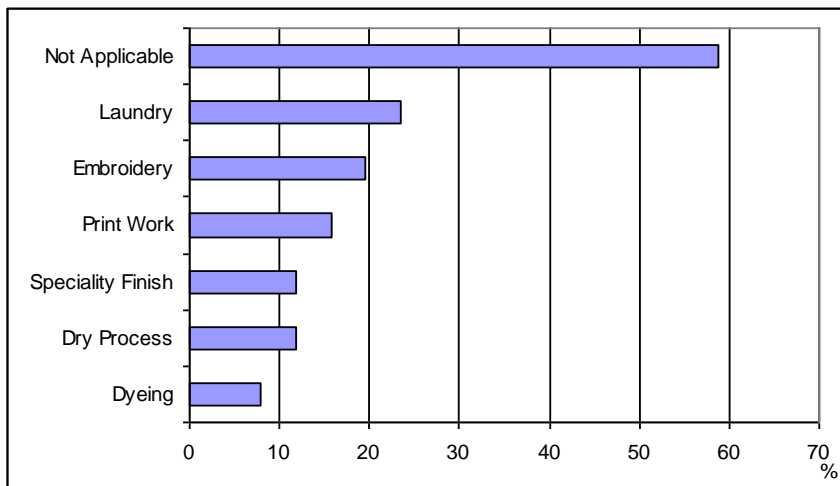
In an attempt to measure skill levels, the question on multi-skilled workers was added later, which is why it has only 24 responses. The majority of workers are multi-skilled in half of the factories responded.

*Question 9. Normally, how long is the training your factory provides to workers in sewing section to improve their skills? (48 answered)*



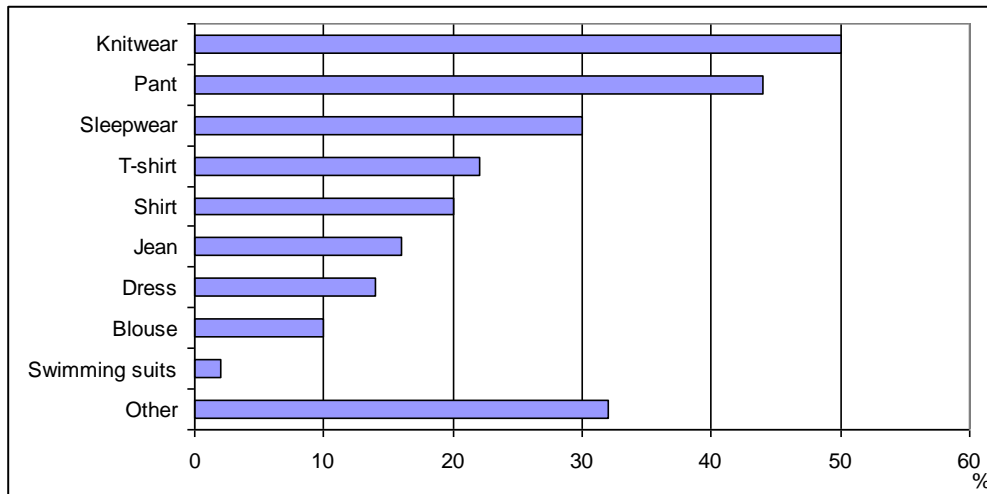
While factories provide about one month of training on average, workers' training needs vary greatly depending on their experience. For instance, some factories recruit only skilled workers and give no training. Therefore, this question is unlikely to adequately measure skill levels of workers.

*Question 10. Does your factory undertake one or more of the following processes in-house? (Multiple answers possible)*



41 percent of the surveyed factories handle processing in-house, which adds complexity and value to products.

Question 11. What products does your factory produce? (Multiple answers possible)

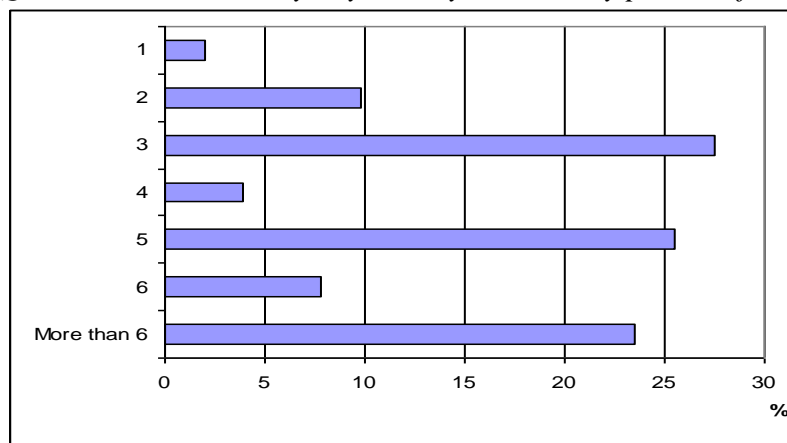


Some products involve a large number of processes and thus are more complex than others. For instance, T-shirt, sleepwear, and men’s pants generally involve fewer processes than jeans, dresses, blouses, and swimming suits. Nonetheless, product complexity depends also on styles, making it difficult to generalize. The most commonly produced product in the Cambodian garment sector is knitwear.

### III. Relationships with buyers

This section seeks to learn about the type of buyers and the nature of buyer-supplier relationships, which is the focus of this dissertation. Chapter 4 has shown that the mode of communication rather than the duration of relationship has an important implication for suppliers’ labor standard compliance. Specifically, suppliers that communicate with buyers indirectly through sourcing agents are systematically associated with worse performance.

Question 12. How many buyers do you normally produce for?



The surveyed factories produce for multiple buyers, most commonly 3 to 5, although 24 % of them produce for more than 6 buyers.

*Question 13. Please list three of your most important buyers (50 out of 51 answered)*

This question was necessary to match suppliers with buyers. Buyer names were asked with assurance of confidentiality.

*Question 14. How many years have you produced for your major buyers?*

	0-2 years	3-4 years	5-6 years	7-8 years	9-10 years	More than 10 years	Count
Buyer 1	14%	<b>28%</b>	26%	10%	6%	16%	50
Buyer 2	<b>30%</b>	21%	28%	10%	2%	9%	47
Buyer 3	<b>33%</b>	23%	23%	9%	2%	9%	43

The duration of relationship is an important measure of buyer-supplier relationship. For the most important buyer (Buyer 1), it ranges from 0-2 years (14 percent) to 10 years or more (16 percent) while the majority falls between 3 to 6 years (54 percent). The duration of relationship with the second and third buyers is shorter than that with the most important buyer.

*Question 15. Do you communicate directly with your buyers or through vendors or agents?*

	Response	
	Percent	Count
<b>Mostly directly with buyers</b>	<b>43</b>	<b>22</b>
Mostly through vendors	37	19
Mostly through agents	31	16
Answered		51
Skipped		0

The mode of communication denotes the distance between buyers and suppliers. While 43 percent of the factories said they communicate directly with buyers, it does not suggest that they discuss all issues directly with buyers. Business issues (i.e. price, quantity, delivery) tend to be settled between buyers and suppliers' headquarters (if they are subsidiaries or branches) while compliance and quality issues are often directly communicated with buyers. 37 percent of the factories transact through vendors and 31 percent through sourcing agents.

*Question 16. How many times do buyers visit your factory per year (all combined)?*

	0-2 times	3-5 times	6-8 times	9-11 times	12-14 times	15 times or more	Count
Quality & Sourcing	<b>30%</b>	<b>30%</b>	14%	2%	2%	22%	50
Compliance	<b>74%</b>	10%	12%	0%	0%	4%	50



Buyers' compliance staff or agents normally audit factories prior to placing orders and then follow-up when problems are signaled. Buyers' quality staff or agents visit supplier facilities much more frequently. Often, they come to inspect before shipping, and a few visit monthly or even weekly.

IV. ILO reporting and duplication

The following questions were asked to find out about the extent to which buyers use ILO reports and whether or not buyers have reduced duplication of audits and replaced it with remediation as promised.

*Question 17. Have any of your buyers reduced or eliminated their own audits and started relying only on ILO reports?*

	Elimination	Reduction	No Change	Not Applicable	Count
Buyer 1	4%	22%	22%	<b>52%</b>	46
Buyer 2	4%	16%	31%	<b>49%</b>	45
Buyer 3	13%	23%	20%	<b>45%</b>	40

Approximately half of the surveyed factories deem their buyers are not using ILO monitoring reports. This is broadly consistent with the extent of buyer participation in the ILO program. Nearly half of BFC participating buyers have reduced or eliminated their own audits, but the other half has not changed their practices, as perceived by suppliers.

*Question 18. If yes to above, what have the buyers replaced their own audits with?*

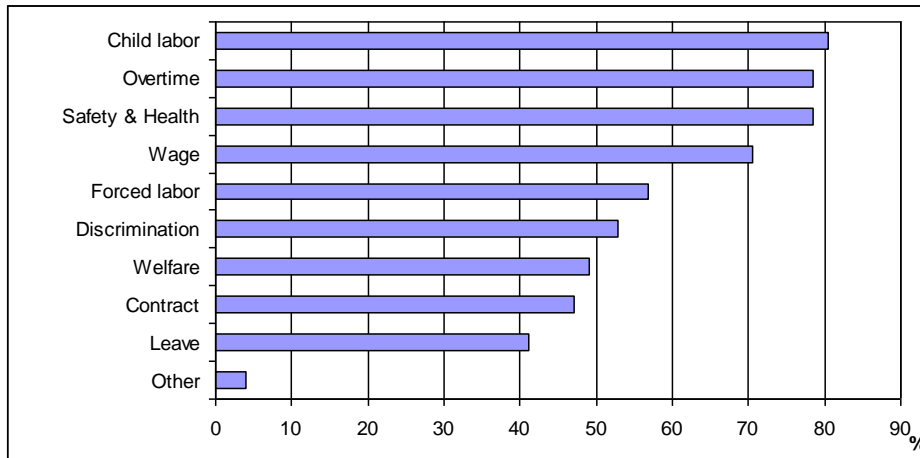
	Response	
	Percent	Count
<b>Focus on remediation &amp; follow-up</b>	<b>68</b>	<b>13</b>
No replacement	16	3
Other	16	3
Answered		19
Skipped		8

Where buyers have reduced or eliminated own audits, it has been replaced by remediation and follow-up in the majority of cases.

V. Compliance issues

This section tries to find out which issues buyers are particularly concerned about and whether they issue warnings and eventually cancel orders to regulate their supplier behavior.

*Q19. Please indicate the compliance issues that your buyers are particularly concerned about. Multiple answers possible. (All 51 answered)*



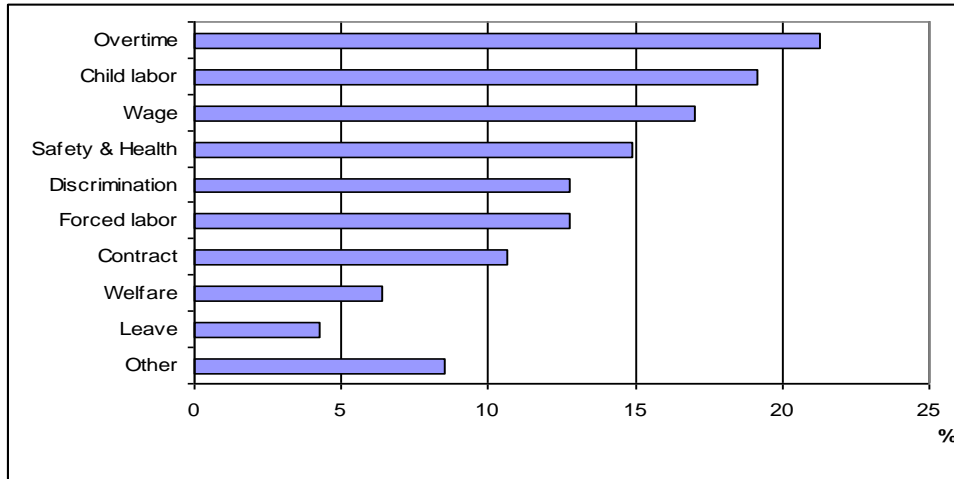
Buyers are perceived to be particularly concerned about child labor, overtime, safety & health, and wage. Some factories noted that buyers are equally attentive to the issues covered by their codes of conduct (CoC).

*Question 20. Has there been an implicit or explicit warning by your buyers about the risk of non-compliance leading to a cancellation of orders?*

	Response	
	Percent	Count
Yes	46	23
<b>No</b>	<b>54</b>	<b>27</b>
Answered	50	
Skipped	1	

Nearly half of suppliers surveyed have received implicit or explicit warnings by their buyers. Some factory managers felt that signing a contract, which stipulates that violation of CoC leads to termination, is an implicit warning while others perceived differently.

Question 21. If yes, regarding which issues? (Multiple answers possible)  
(20 out of 24 answered)



Consistent with the previous responses, buyers tend to issue warnings with regard to overtime, child labor, and wage.

Question 22. Has non-compliance ever led to a cancellation of order?

	Response	
	Percent	Count
Yes	10	5
<b>No</b>	<b>90</b>	<b>46</b>
Answered		51
Skipped		0

Nevertheless, warnings rarely lead to a cancellation of orders because suppliers normally rectify non-compliance in accordance with buyer demands.

## VI. Learning

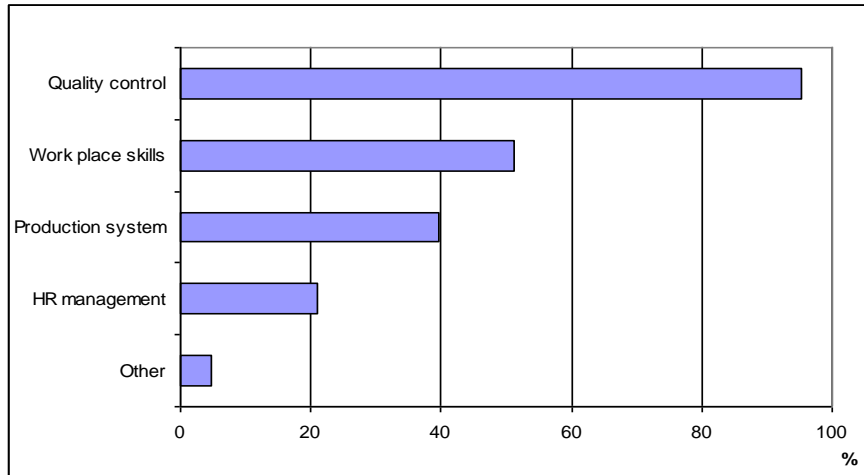
This section tries to assess the degree to which learning occurs between buyers and suppliers. While Chapter 4 did not find a statistically significant association between the following learning measures and compliance performance, different learning measures may yield different results.

Question 23. Do your buyers share technical knowledge?

	Response	
	Percent	Count
Yes, often times	33	17
<b>Yes, sometimes</b>	<b>53</b>	<b>27</b>
No, not really	14	7
Answered		51
Skipped		0

Most buyers share technical knowledge either often (53 percent) or sometimes (33 percent).

*Question 24. If yes, what kind of knowledge do your buyers share? Multiple answers possible. (43 out of 44 applicable answered)*



Buyers share knowledge about quality control more than any other technical knowledge.

*Question 25. Have your buyers been involved in determining the production system?*

	Response	
	Percent	Count
Yes	26	13
<b>No</b>	<b>75</b>	<b>38</b>
Answered		51
Skipped		0

About one quarter of buyers help determine the production system used in supplier establishments.

*Question 26. Do your buyers encourage training for workers/supervisors/managers?*

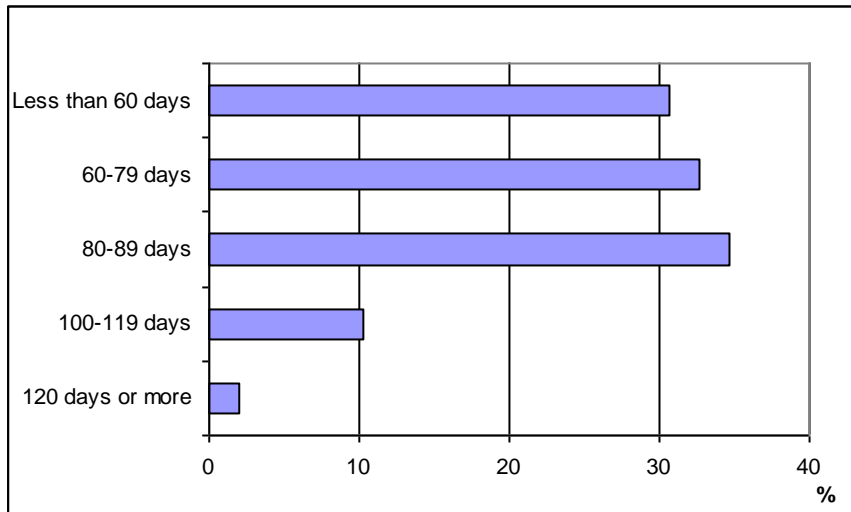
	Response	
	Percent	Count
Yes, often times	30	15
<b>Yes, sometimes</b>	<b>50</b>	<b>25</b>
No, not really	20	10
Answered		50
Skipped		1

Most buyers encourage training either often (30 percent) or sometimes (50 percent). It would have been interesting to ask whether buyers provide training or share the cost of training to measure the extent to which buyers are willing to invest in supplier learning.

## VII. Purchasing Practices

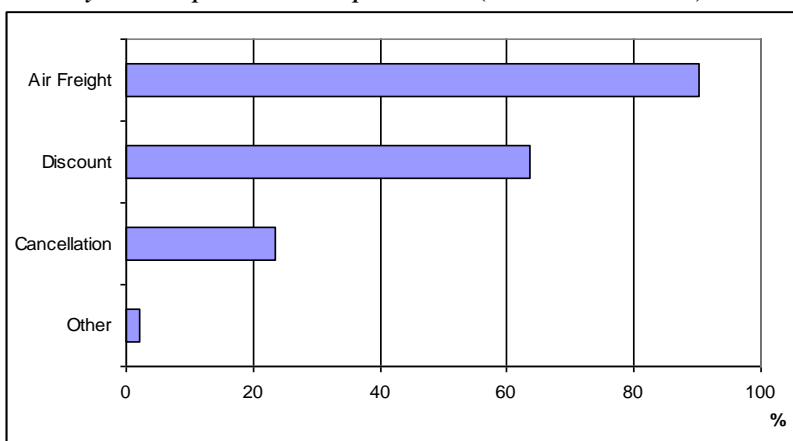
Some purchasing practices such as shorter lead time, low margins, and inability to negotiate are deemed to negatively contribute to working conditions. While the following measures did not have statistically significant association with compliance performance, other measures may yield different answers.

*Question 27. What is the typical lead time (from an order to shipping) demanded by your major buyers? (49 out of 51 answered)*



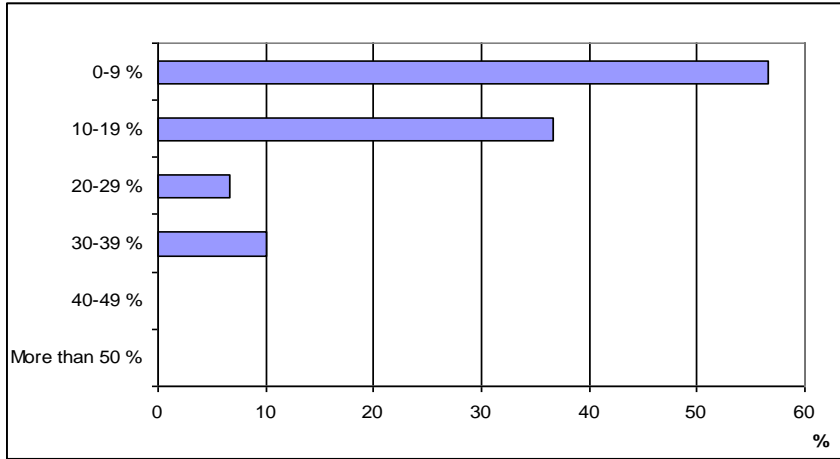
Buyers demand increasingly shorter lead time to catch up with the shorter fashion cycles. Although Cambodia tends to produce less trend sensitive products given the time to market, lead time of less than 60 days is uncommon (31 percent). The average lead time is 60-79 days.

*Question 28. What kind of penalty do your major buyers demand in case of delay in delivery? Multiple answers possible. (All 51 answered)*



In case of delay, 90 percent of buyers demand shipping by air freight, whose costs virtually wipe out factory profits. When the delay is important and/or market demand is weak, buyers demand discount (63 percent) and possibly cancellation (24 percent), to the detriment of factories.

*Question 29. In case of discount, which level of discount do your major buyers normally demand? (30 out of 32 applicable answered)*



When buyers demand discount, it is mostly less than 20 percent: 0-9 percent (57 percent) or 10-19 percent (37 percent). There was also a case where one day of delay equals one percent of discount.

*Question 30. If a buyer requires a last minute change in design or a delivery date, can you negotiate the price?*

	Response	
	Percent	Count
Yes, often times	14	5
<b>Yes, sometimes</b>	<b>54</b>	<b>20</b>
No, not really	32	12
Answered		37
Skipped		3

About 80 percent of the surveyed factories have experienced such buyer demands, and most of them can negotiate the price sometimes (54 percent) or often times (14 percent). There was also a case where the price is fixed, but the delivery date can be postponed in case of last minute changes.

VIII. Working conditions beyond legal requirements

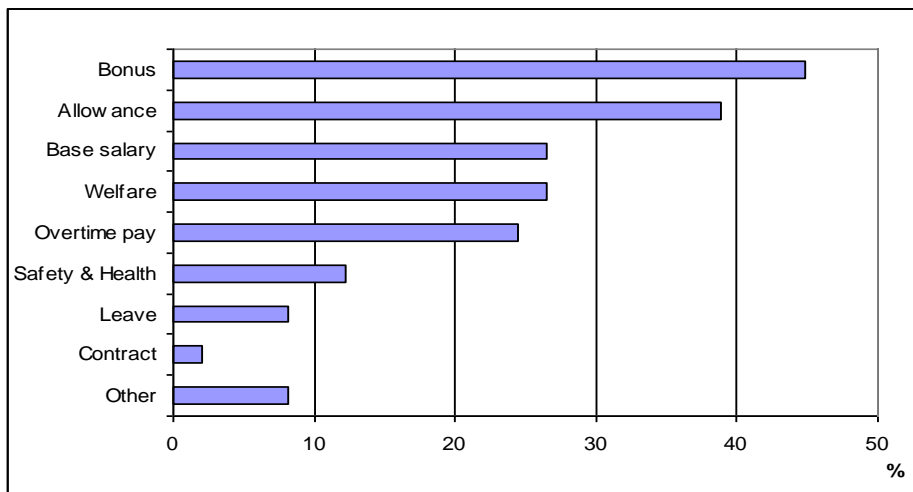
This section seeks to understand the extent to which and the areas in which factories provide working conditions that exceed the legal requirements and how buyers may influence them. The data from this section is analyzed in the last part of Chapter 3, which shows that some buyers encourage suppliers to go beyond compliance, but they tend to be reputation-conscious buyers and the issues center around OSH and welfare.

*Question 31. Does your factory provide working conditions that go beyond what is mandated by the labor law (other than production bonus)?*

	Response	
	Percent	Count
<b>Yes</b>	<b>65</b>	<b>32</b>
No	31	15
Answered		49
Skipped		3

65 percent of the surveyed factories responded that they provide working conditions that exceed the national legal requirements.

*Question 32. If yes, in which areas does your factory go beyond the legal requirements other than production bonus? Multiple answers possible. (All 32 applicable answered)*



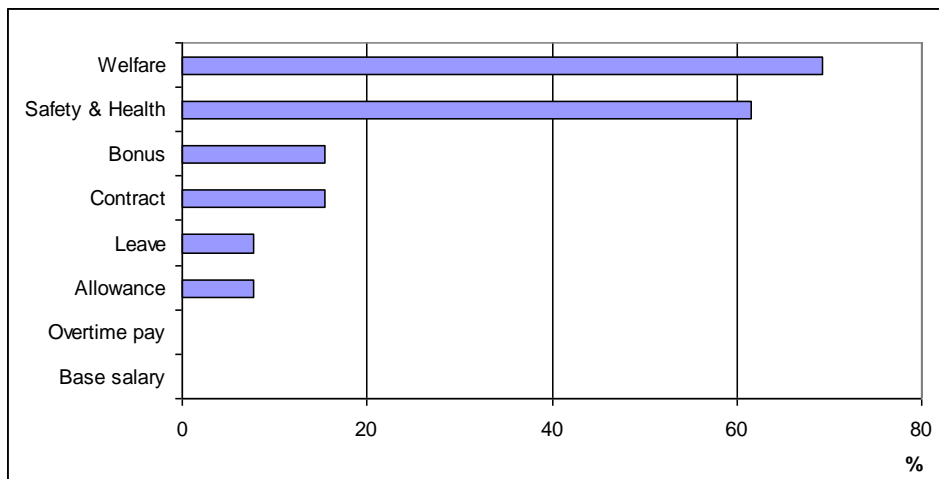
Factories tend to provide pecuniary incentives that exceed the mandated requirements as regards bonus, allowance, base salary and overtime pay. As exceptional cases, some factories even organize birthday parties and provide literacy classes for workers.

*Question 33. Have your buyers required or encouraged your factory to provide working conditions that go beyond the national legal requirements?*

	Response	
	Percent	Count
Required	6	3
Encouraged	42	20
<b>No, not really</b>	<b>52</b>	<b>25</b>
Answered		48
Skipped		3

Buyers may encourage going beyond legal compliance (42 percent) but rarely require it (6 percent). One factory manager noted that buyers always want suppliers to comply with certain standards (i.e. the labor law, CoC) but they do not ask for beyond compliance because they also want lower prices.

*Question 34. If your buyer required or encouraged to go beyond the legal requirements, in which areas? Multiple answers possible. (13 answered out of 26 applicable answered)*



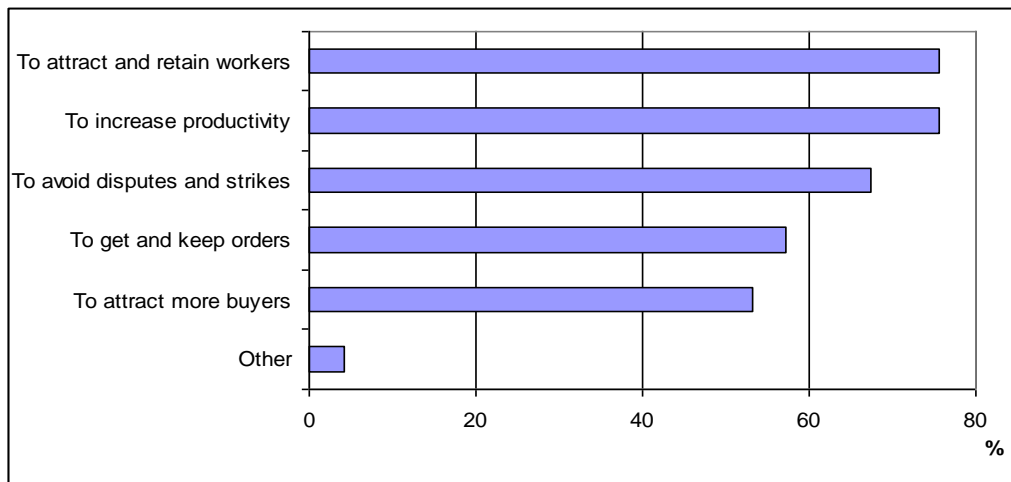
When buyers encourage or require suppliers to go beyond legal compliance, it is mainly with regard to welfare and safety & health because buyer CoC are often more detailed and stricter about these issues than the national labor law. In contrast, buyers rarely encourage or require an improvement in pecuniary conditions (i.e. base salary, overtime pay).



### IX. Motivations and Buyer Influence

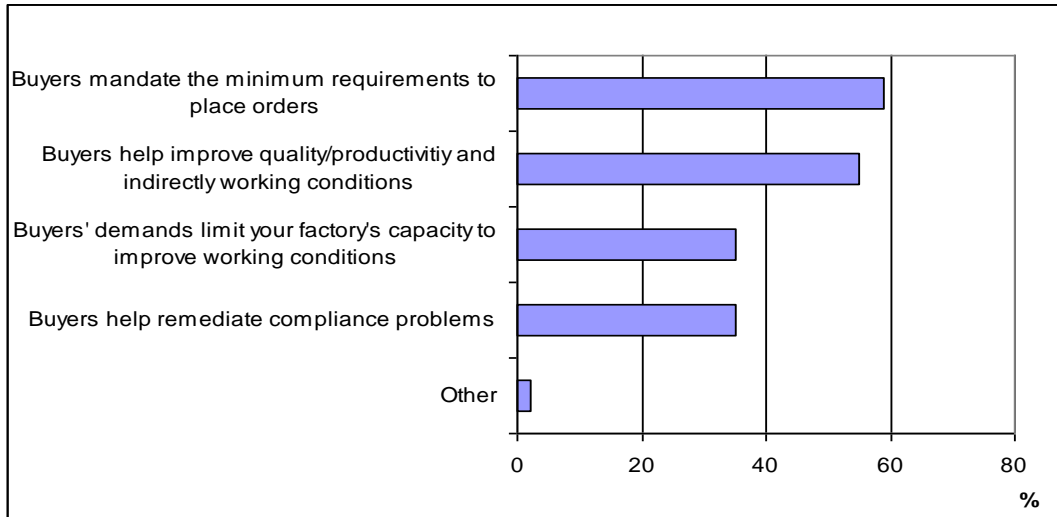
This section asks what motivates factory management to improve working conditions and how buyers influence that decision.

*Q35. What are the main motivations for your factory to improve working conditions? Multiple answers possible. (49 out of 51 answered)*



The most commonly cited reasons to improve working conditions are to attract/retain workers and to increase productivity (76 percent), followed by avoiding disputes and strikes (67 percent). While managers understand that improving conditions help attract buyers (53 percent) and keep orders (57 percent), labor market conditions and efficiency enhancing effects of better working conditions figure more prominently. Considering that this question was asked just after ‘beyond compliance’ questions, respondents are likely to have associated ‘improve working conditions’ with ‘beyond compliance.’ In this sense, the result is likely to show the motivations behind improving conditions beyond compliance.

*Question 36. How do your buyers influence your factory's working conditions?  
Multiple answers possible. (49 out of 51 answered)*



Buyers are often perceived as demanding the minimum requirements to place orders (59 percent). While more than half factory managers acknowledge that buyers help improve quality/productivity (55 percent), one-third of them think that buyer demands (e.g. lower prices, faster delivery) limit their ability to improve working conditions (35 percent).

### Summary

Buyer influence on supplier working conditions is complex and both positive and negative. On the positive front, buyers require suppliers to comply with the labor law and CoC, setting and enforcing the minimum standards. While buyers may encourage or require improvement in welfare or OSH beyond the legal requirements, they rarely push for further progress in workers' pecuniary conditions. Factories appear to be principally motivated by labor market conditions and efficiency effects when they improve working conditions. This suggests that buyers can set the floor but cannot raise the ceiling for most issues. Buyers can also help improve supplier working conditions through technical assistance to ameliorate quality and productivity. Nevertheless, purchasing practices that require shorter lead time and lower profit margins constrain supplier factories capacity to improve working conditions.

## Appendix II. Buyer Survey in the Cambodian Garment Sector

### Survey Data Collection

The purpose of the buyer survey is two-fold. First is to understand buyer-supplier relationships from the viewpoint of buyers. Asking both buyers and suppliers similar questions helps construct a more complete picture. Second, the buyer survey enables us to understand the characteristics and behavior of different types of buyers. While this thesis makes an important distinction between reputation-conscious and other buyers, the difference is not fully understood. This buyer survey serves to fill the gap.

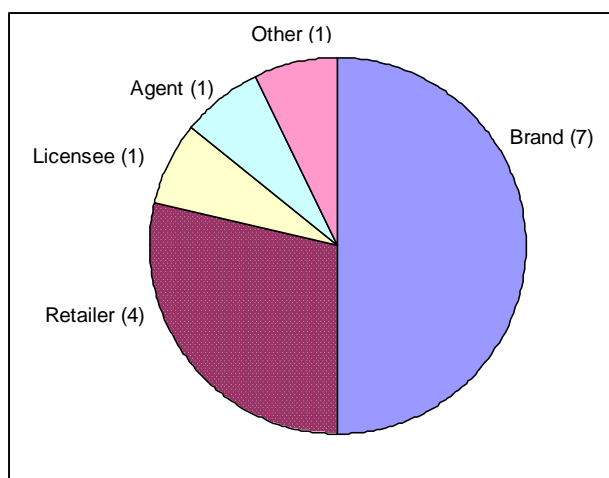
The buyer survey was conducted on 9-10 October 2008 in Phnom Penh, Cambodia during the Buyers Forum, a bi-annual event hosted by the International Finance Corporation (IFC). At the Buyers Forum, major buyer representatives gather to exchange views with other buyers and stakeholders and to build consensus regarding the future of the ILO program. With assistance of ILO BFC, the author distributed questionnaires to 16 participating buyer representatives, of which 12 returned completed forms during the forum. Subsequently, the author contacted 15 other buyers who did not participate in the forum, of which 2 completed the questionnaire on-line. In total, 14 responses were collected, of which 9 BFC participating buyers, 4 non-BFC buyers, and 1 sourcing agent. These 13 buyers account for 45 percent of Cambodia's garment export value in 2006.<sup>94</sup>

### Survey Results and Analysis

#### I. Buyer Characteristics.

*Question 1. What is the name of your company?* (All 14 answered)  
Anonymity of company names was assured.

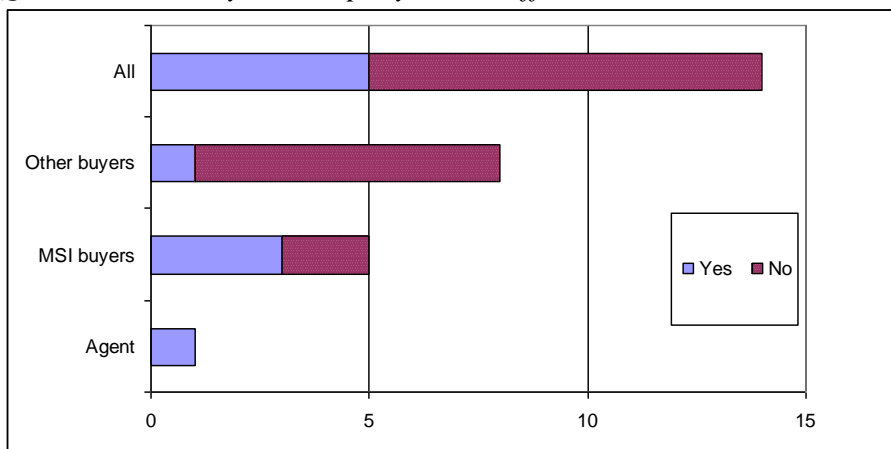
*Question 2. Please classify your company.* (All 14 answered)



<sup>94</sup> The author's calculation based on the export figures from the Ministry of Commerce.

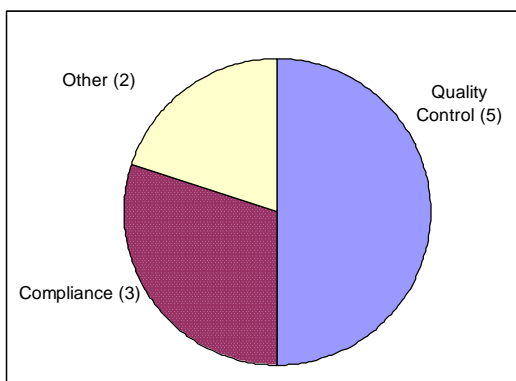
Of 14 companies answered, 7 classify themselves as brand, 4 retailers, 1 licensee, 1 sourcing agent and 1 combining multiple roles. 5 out of 7 branded buyers belong to either the Ethical Training Initiative or the Fair Labor Association, meaning that they are “MSI (Multi-Stakeholder Initiative) buyers” and thus “reputation-conscious” according to the author’s operationalization in the thesis. One respondent was a representative of a major sourcing agent, which functions as a one-stop shop or a supply chain manager that matches factories and buyers. To understand the differences between reputation-conscious buyers, other buyers, and agents, the following survey responses are disaggregated into these three categories next to the total count.

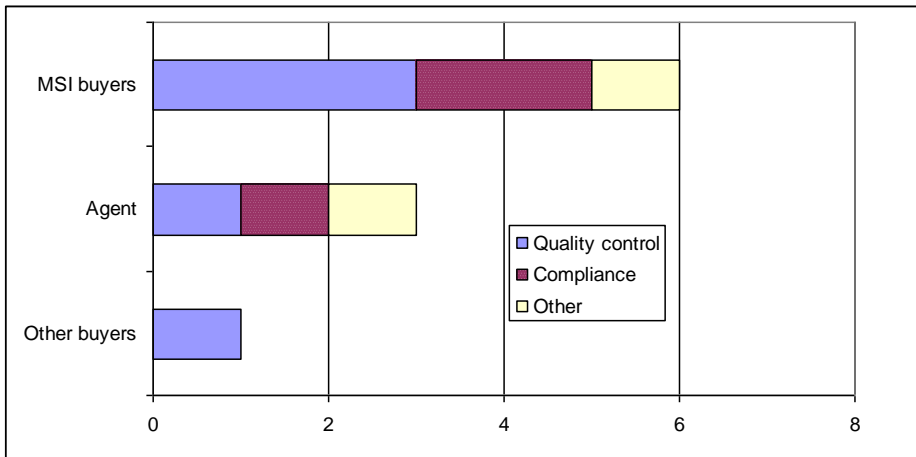
*Question 3. Does your company have staff based in Cambodia?*



5 out of 14 companies have local staff, of which 3 are MSI buyers, 1 other buyer, and 1 agent. It is worth noting that MSI buyers tend to have more local staff than other buyers.

*Question 4. If yes to above, what are they in charge of? Multiple answers possible*

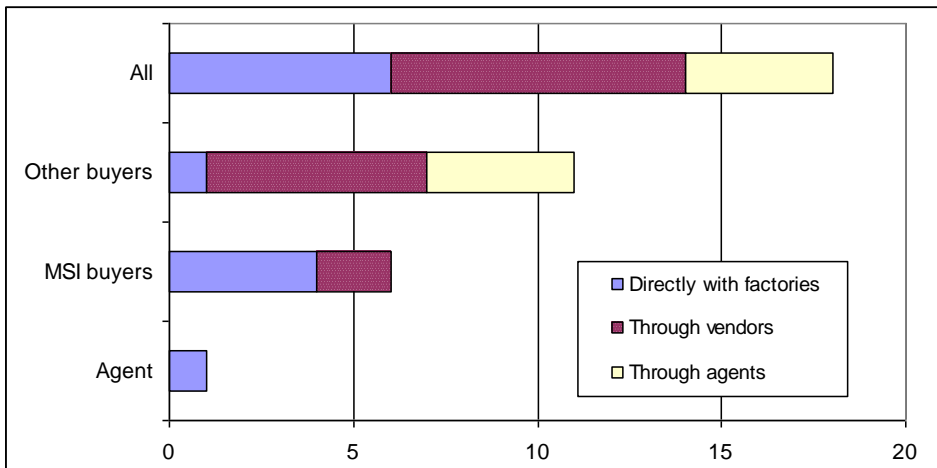




Among 5 companies with staff in Cambodia, all of them have local staff in charge of quality control, while 3 have compliance staff. 2 other responses are 1 shipping and 1 sourcing. 2 MSI buyers have local compliance staff while other buyers do not (in fact, none of the other buyers sourcing from Cambodia have local compliance staff). Also, the agent has local staff in all categories (including sourcing).

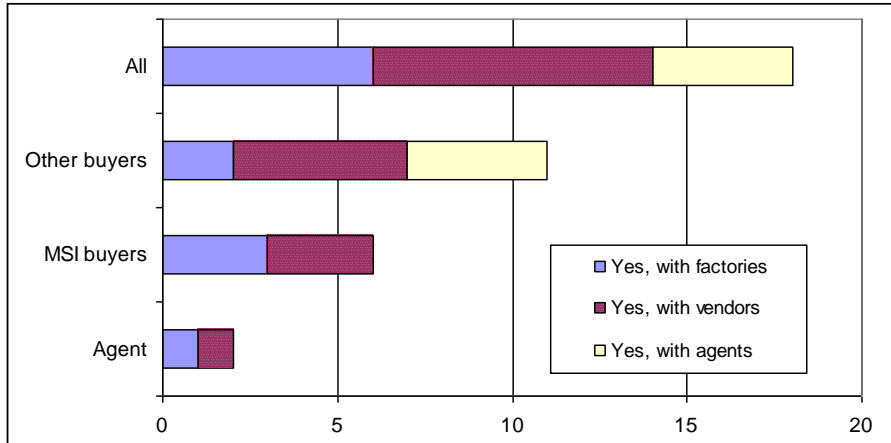
## II. Buyer-Supplier Relationship

*Question 5. Does your company communicate directory with factories in Cambodia or through vendors or agents? Multiple answers possible. (All 14 answered)*



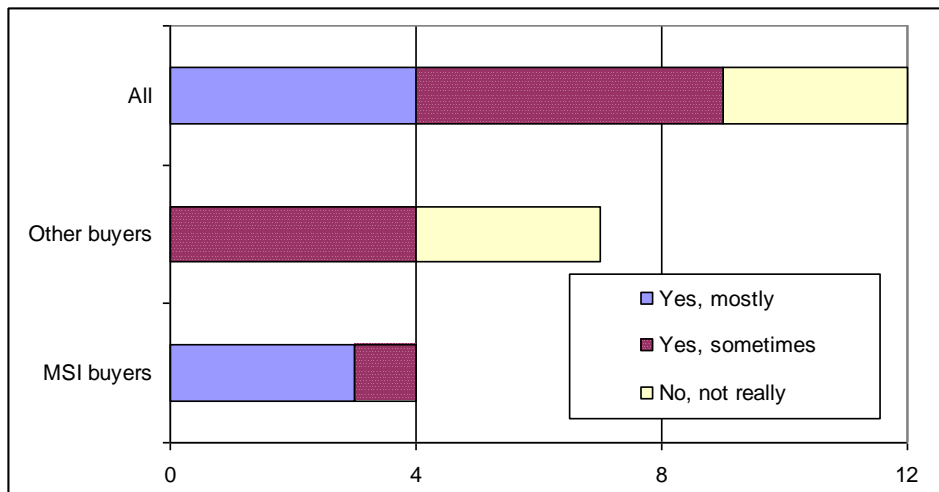
The mode of communication appears to vary with the type of buyers. 4 out of 5 MSI buyers mostly directly deal with factories while only 1 out of 8 other buyers do. Moreover, none of the MSI buyers transact through agents while other buyers do. This is consistent with the Chapter 4's findings that reputation-conscious buyers tend to avoid market-based relationships through agents and prefer direct relationships with factories. Agents deal directly with factories (and buyers) given their role as a supply chain manager.

*Question 6. Does your company tend to have long and established relations with your suppliers? Multiple answers possible*



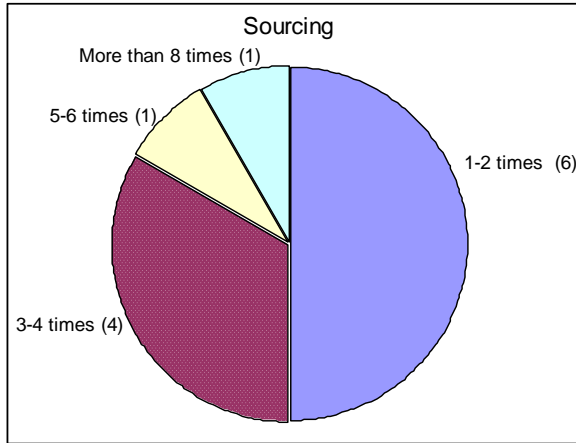
9 out of 14 companies have long and established relations with vendors. While MSI buyers equally have established relations with factories, other buyers tend to form established relationships with vendors and agents.

*Question 7. Does your company account for a large share (i.e. more than half) of the production capacity of supplier factories? (12 out of 14 answered)*

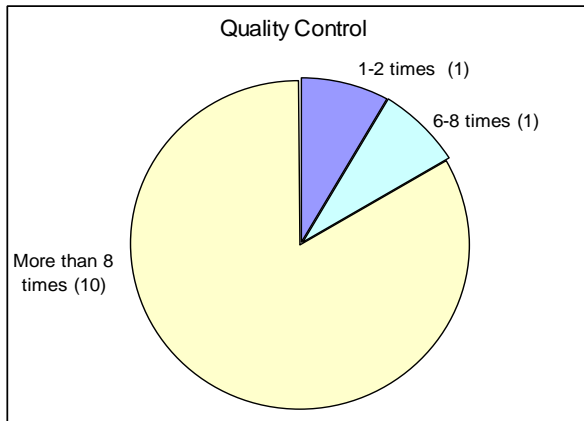


9 out of 14 companies answered account for a large share of suppliers' production capacity sometimes or mostly. While 3 out of 4 MSI buyers take up an important share most of the time, none of other buyers do.

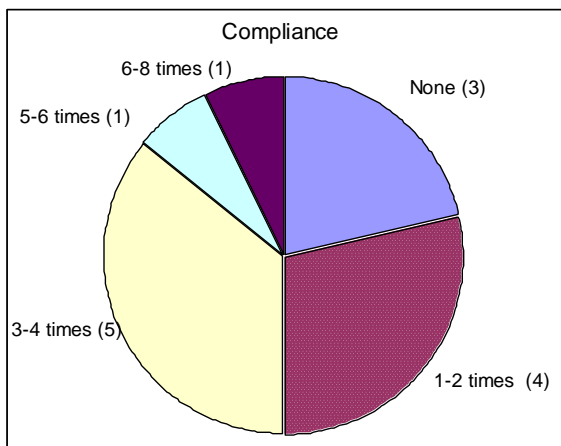
Question 8. How many times per year does your company send staff or agents to a factory?



Sourcing staff who decide about business visit factories on average twice a year. The agent sends sourcing staff more than 8 times a year. There was no difference between MIS and other buyers in terms of frequency of visits.

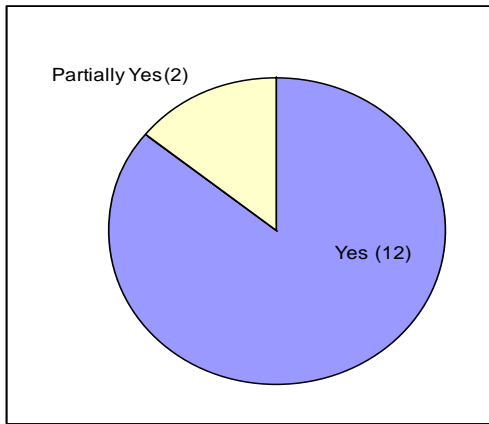


Quality control staff visit factories more often, more than 8 times per year.



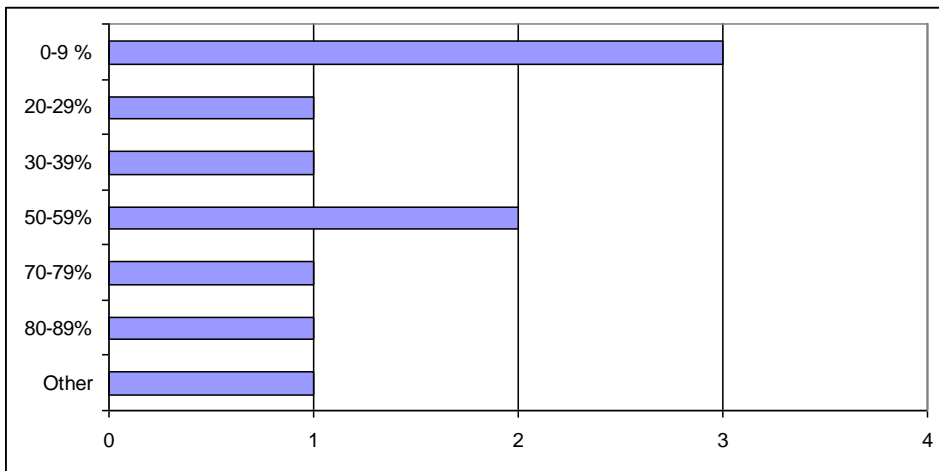
Compliance staff visit factories on average once or twice a year. Some BFC participating buyers have replaced their own compliance audits with ILO monitoring.

*Question 9. Does your company check compliance levels of factories before placing orders?*



All the companies responded check compliance levels of candidate factories. Two companies that check only partially are non-MSI buyers.

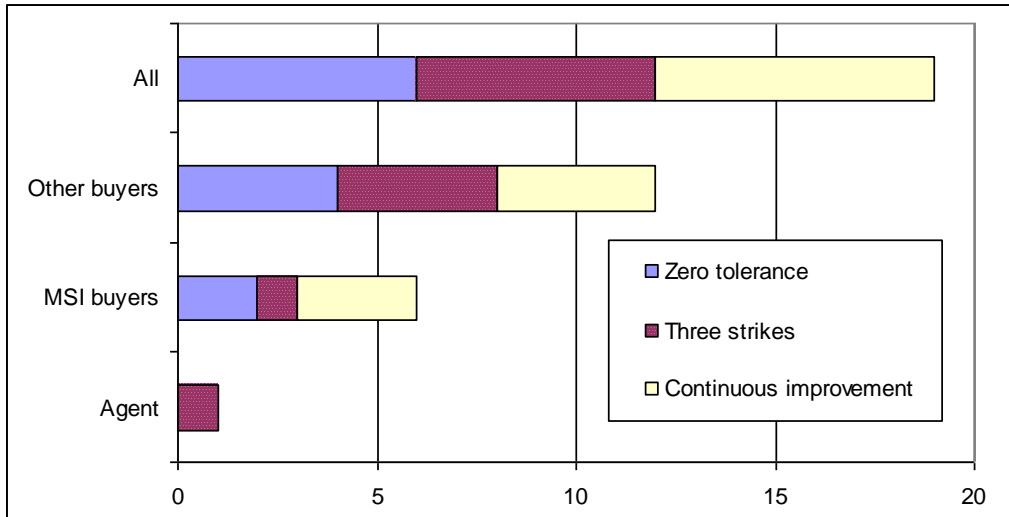
*Question 10. If yes to above, what is the percentage of factories that pass compliance checks at the first instance?*



The likelihood of candidate factories passing compliance checks at the first instance ranges from 0-9 % to 80-89 %. There is no major difference between MSI and other buyers. High probability of pass suggests that some buyers pre-screen candidate factories before conducting official audit.

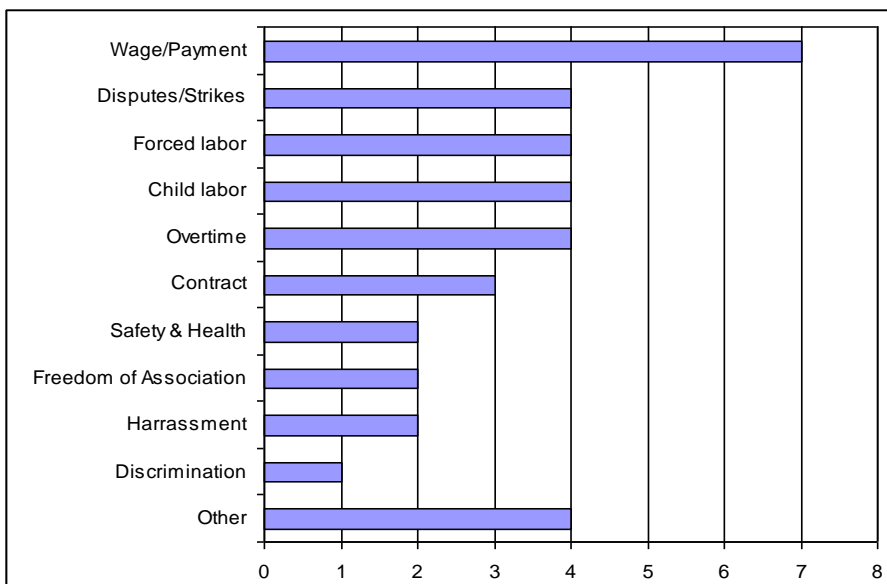


*Question 11. Which procedure, if any, does your company use to ensure an acceptable level of compliance at supplier factories? Multiple answers possible.*



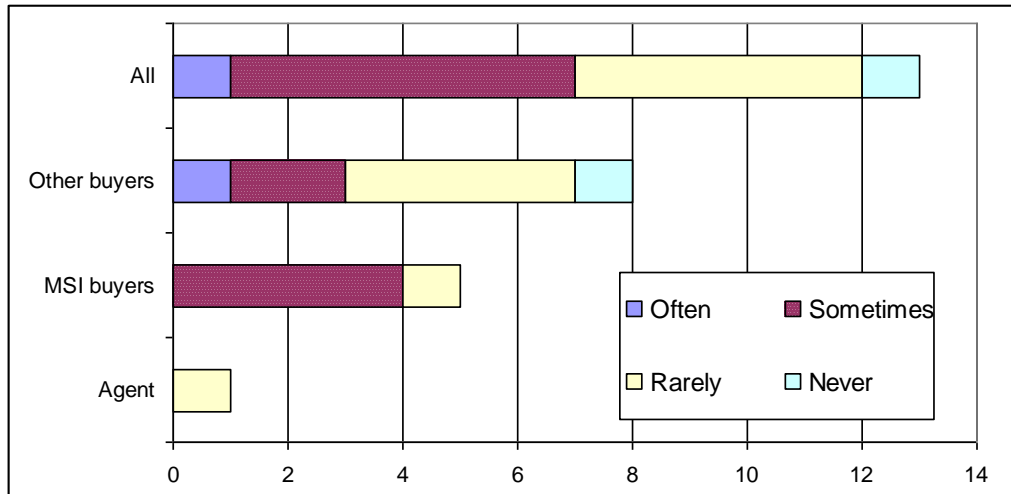
All the surveyed companies have some kind of procedure to ensure an acceptable level of compliance. “Zero tolerance” means that certain non-compliance leads to immediate cancellation of orders. “Three strikes” suggests that factories are required to achieve an acceptable level of compliance in three audits. “Continuous improvement” indicates that they do not necessarily apply stringent rules but work closely with factories to solve problems. Some buyers combine these procedures. While the three procedures are equally used, it is worth noting that MSI buyers tend to opt for continuous improvement instead of three strikes. Agent uses three strikes only.

*Question 12. Which are the key compliance issues for your company? Multiple answers possible. (10 out of 14 answered)*



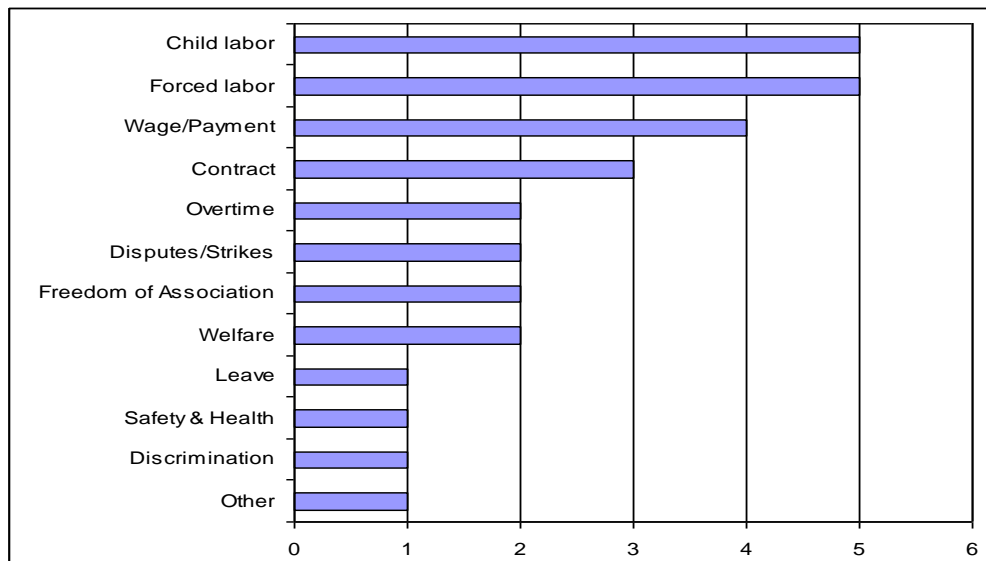
The key issue for most buyers is wage and payment while welfare and leave do not figure on the list. There is no major difference between MSI and other buyers. Other responses are inconsistent records and physical abuse. One buyer and the agent mention all issues covered by their CoC.

*Question 13. How often does your company issue warnings to supplier factories in Cambodia that certain non-compliance leads to cancellation of orders?*



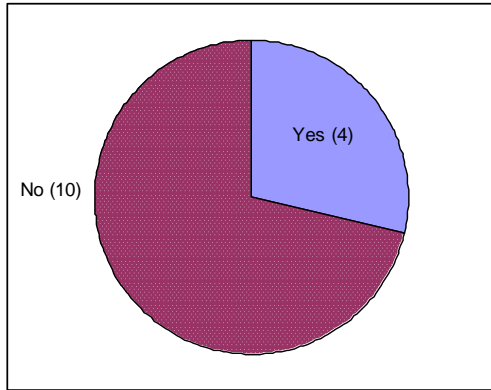
Most buyers issue warnings although not often. MSI buyers tend to issue warnings more frequently than other buyers or an agent.

*Question 14. If yes to above, regarding which issues? Multiple answers possible. (9 valid answers)*



Buyer warnings tend to concern child and forced labor and payment issues. There is no major difference between MSI and other buyers.

*Question 15. Has your company ever cancelled orders because of compliance problems in Cambodia?*

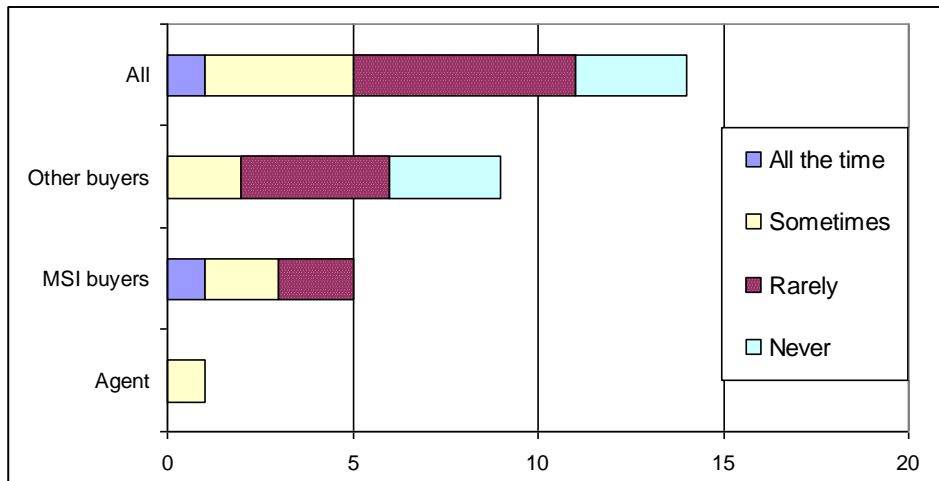


4 buyers have cancelled orders due to compliance problems, of which 2 are MSI buyers and 2 other buyers. One of the other buyers notes that Cambodia used to be a “terminated country,” meaning that the company prohibited sourcing from the country.

*Question 16. If yes to above, regarding which issues?*

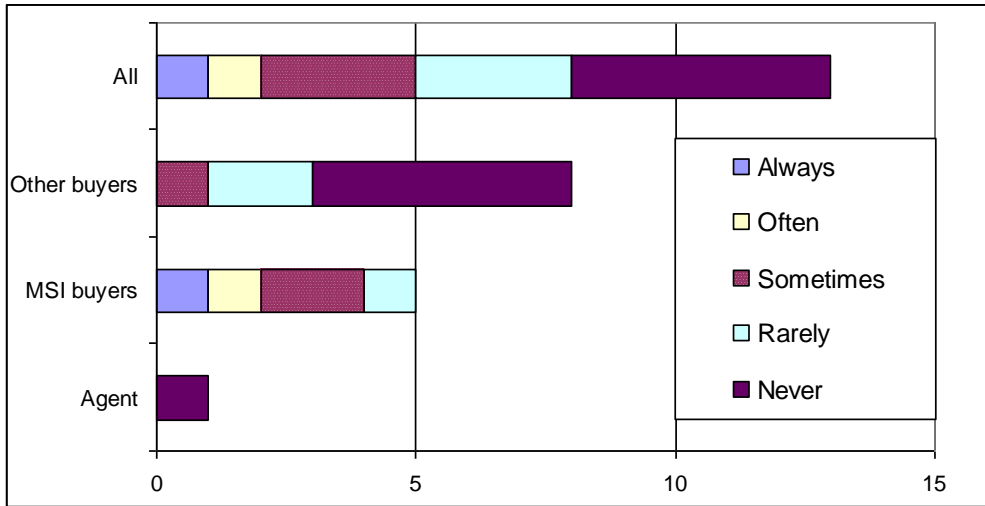
Of 4 buyers that have cancelled orders, 1 buyer cites contract, 1 buyer cites freedom of association, 1 buyer cites wage/payment, child and forced labor, and disputes/strikes, and 1 buyer cites all issues.

*Question 17. How often do unions and NGOs contact your company about working conditions in supplier factories in Cambodia?*



The frequency of contact by unions and NGOs varies. While one MSI buyer whose local compliance staff has extensive contacts with union leaders is contacted all the time, three other buyers are never contacted. In general, MSI buyers tend to be contacted more often than other buyers.

*Question 18. Does your company enforce non-binding awards of the Arbitration Council in supplier factories? (13 valid answers)*

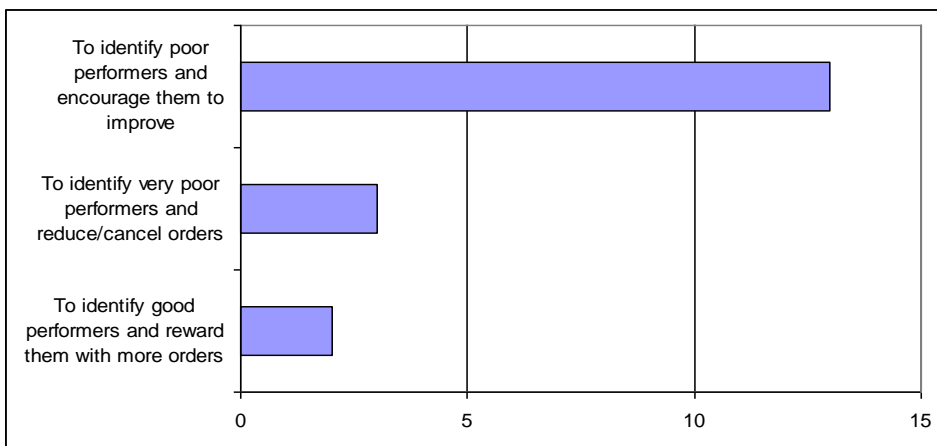


The Arbitration Council is a tripartite body set up by the ILO to resolve collective disputes. The degree of enforcement varies. While one MSI buyer with local compliance staff enforces all awards of the Arbitration Council by principle, other MSI buyers enforce often or sometimes. In contrast, other buyers never or rarely enforce non-binding awards.

*Question 19. Does your company rate compliance performance of supplier factories?*

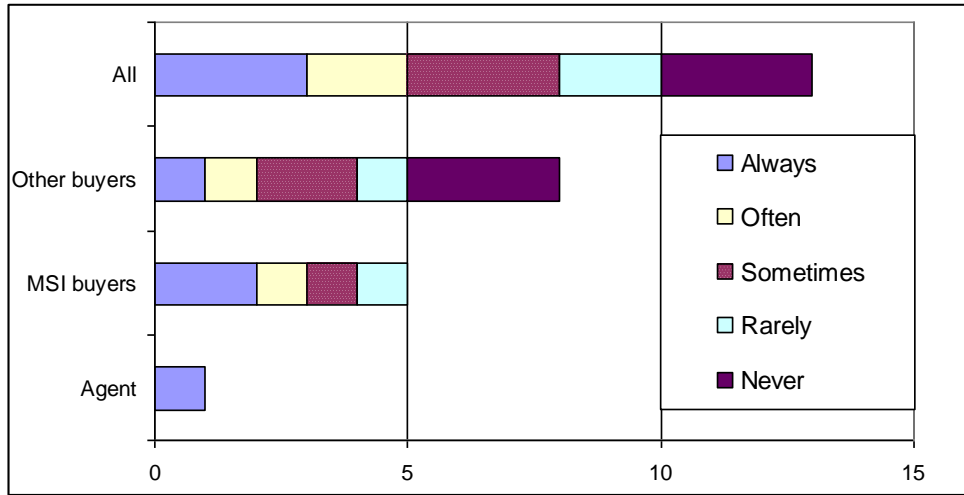
All 14 companies rate compliance performance.

*Question 20. If yes to above, how does your company use the rating? Multiple answers possible (13 valid answers)*



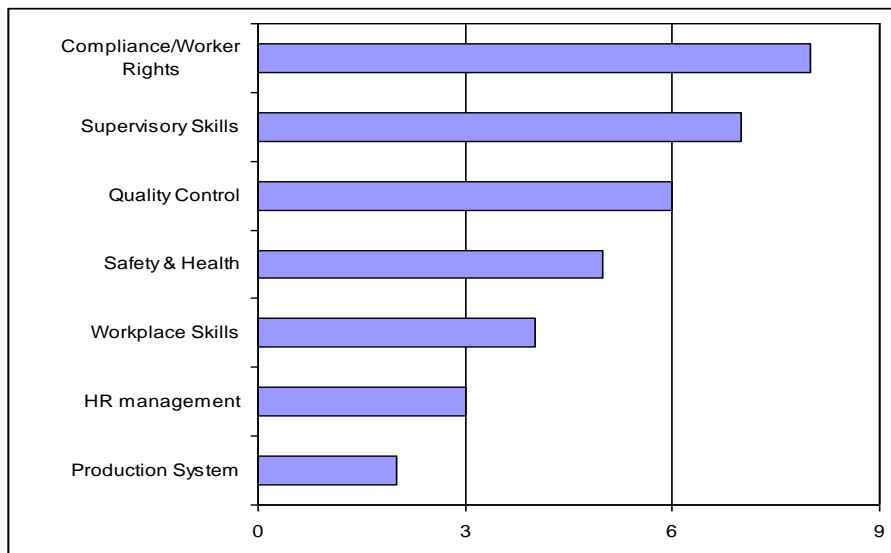
Buyers use compliance performance rating mainly to identify poor performers and encourage them to improve. Only two buyers use rating to reward better performers.

*Question 21. Does your company offer training and/or learning opportunities to supplier factories in Cambodia? (14 valid answers)*



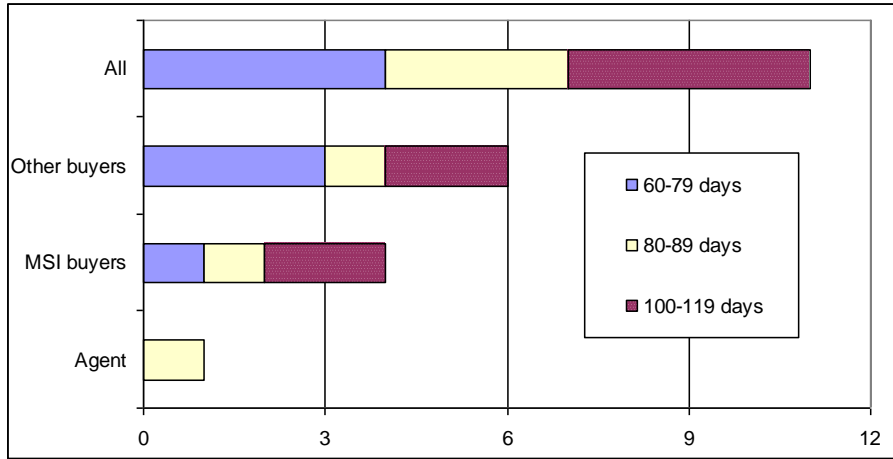
While most buyers offer some sort of learning opportunities some of the time, frequency varies. MSI buyers tend to offer training more often than other buyers. Agent also provides training systematically.

*Question 22. If yes to above, what kind of learning opportunities does your company provide to supplier factories? Multiple answers possible. (11 applicable answers)*



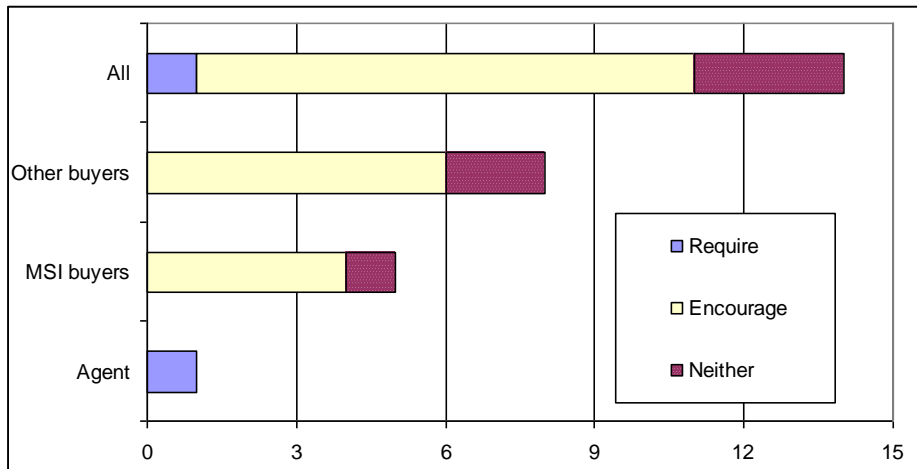
The most common area in which buyers give training is compliance, followed by supervisory skills and quality control. These answers may be biased given that the respondents are in charge of compliance. Interestingly, agent claims to offer the most extensive learning opportunities, all the above items except HR management.

Question 23. What is the typical lead time your company demands from factories in Cambodia? (10 valid answers)



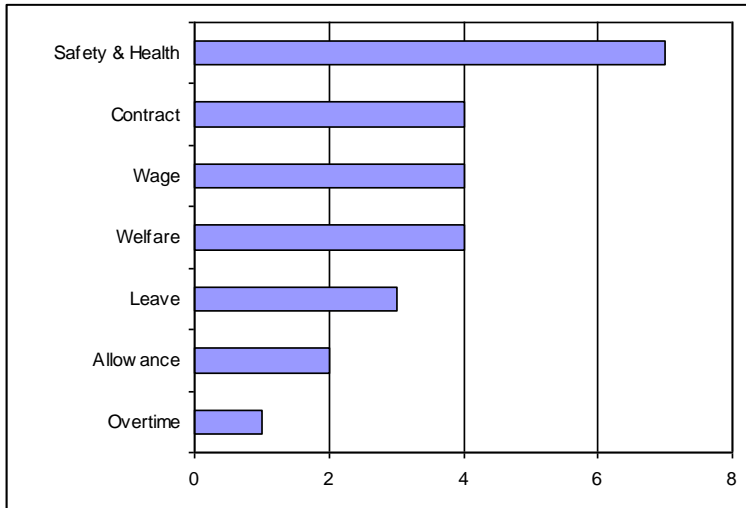
Typical lead time is 80-89 days and it does not differ among buyer types.

Question 23. Does your company encourage or require factories in Cambodia to provide working conditions that go beyond the national legal compliance? (13 valid answers)



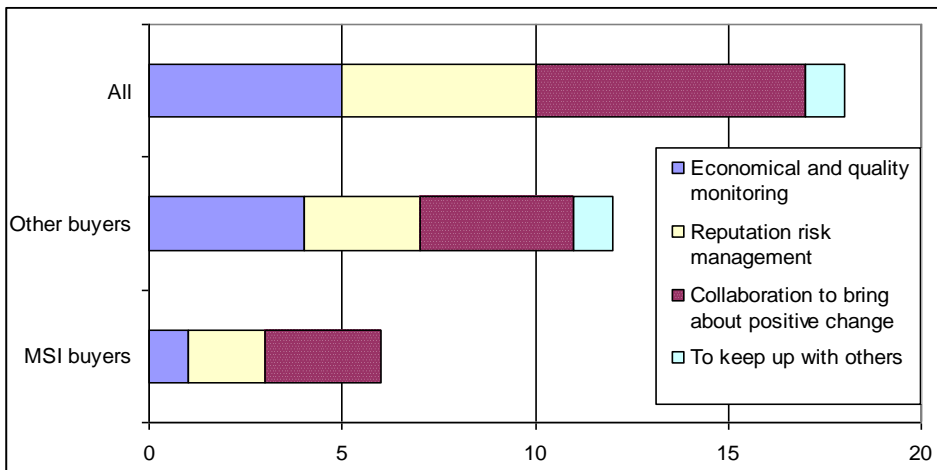
Most buyers encourage their suppliers to exceed the national legal requirements. Nonetheless, not all buyers were aware of whether or not their CoC exceed the national legal requirements. Agent was the only respondent that required beyond compliance.

Question 25. If yes to above, in which areas does your company push factories to go beyond the legal requirements? (9 valid answers)



The most common areas in which buyer CoC exceed the national legal requirements are safety & health, followed by contract, wage, and welfare. While there is no major difference between MSI and other buyers, agent responded affirmative for all the above items.

Question 26. What are the main motivations for your company to join BFC? Multiple answers possible. (9 out of 9 applicable answered)



Buyers join BFC for various reasons, such as economical monitoring, reputation risk management, and collaboration. Other buyers seem to see the economic benefit more than MSI buyers. None chose the option of competitive advantage (i.e. outperform others) although listed as one of possible answers.

### Summary

This buyer survey has reinforced the supplier survey results and in particular shown that different buyer types do differ in how they manage relationships with their suppliers. First, reputation-conscious MSI buyers tend to communicate directly with factories while other buyers tend to transact through vendors and sourcing agents. Second, MSI buyers often account for a large share of the production capacity of their suppliers whereas other buyers do not. This gives more leverage to MSI buyers vis-à-vis their suppliers. Third, MSI buyers have a tendency to emphasize continuous improvement while other buyers often turn to 'zero tolerance' and 'three strikes,' which is likely to prompt suppliers to hide problems rather than to be open about them. Fourth, unions and NGOs are more likely to contact MSI buyers than other buyers, reflecting the responsiveness of the former relative to the latter. Fifth, MSI buyers are much more likely to enforce non-binding awards of the Arbitration Council than other buyers, suggesting the rigor of their enforcement efforts. All in all, the buyer survey results indicate that reputation-conscious buyers are indeed qualitatively different from other buyers on various dimensions, which in turn affect their suppliers' compliance performance.