Responsible Exit Strategy Guidance

Fair Wear Foundation incentivises members to have a consolidated supply chain with long term business relationships. However, inevitably and for many different reasons, members also end business relationships. Through FWF's performance check system FWF assesses whether a member company evaluates it supplier base and how it takes working conditions into consideration in its business decisions. In recent years, FWF members have been asking for more specific guidance on steps that need to be taken when ending a business relationship. FWF has had several cases amongst others through its complaints helpline that made it clear more guidance was needed. This document attempts to provide this guidance. The FWF Committee of Experts and FWF board have reviewed and approved this document.

Supply Chain Responsibility

'Supply chain responsibility' requires companies to make purchasing decisions that ensure good working conditions wherever their goods are made. FWF requires its member companies to consistently monitor labour conditions and ensure improvements are made with their suppliers. Companies must use their business relationship with the supplier to improve conditions, rather than leaving the facility if problems are found. As long as the factory proves willing to work on improvements, the FWF member company does not leave its supplier for non-compliance. Having said that, the reality of the textile industry means ending business relations are inevitable and for several different reasons. This document describes steps for ending business relationships in a responsible way, taking the effect on workers' lives into consideration.

1. Evaluation & consolidation

The strategic setup of a supply chain should on the one hand contain as few as possible suppliers to enable the company to invest sufficient time and resources towards strengthening and improving the relationships. On the other hand, it needs to include as many suppliers as necessary to fulfil the requirements of the company to serve their market needs. FWF incentivises clothing brands to consolidate its supplier base which positively impacts quality, transparency, value of the product as well as lowers the risks of labour rights violations.

The process of preventing and mitigating adverse human rights impacts when ending business relationships with suppliers begins with systematic evaluation. Evaluation must take place when selecting new suppliers as well as through continuous assessments during the relationship with suppliers. The evaluation should not only cover the legal, industrial, environmental, and technological requirements and standards, it also needs to assess potential and actual human rights risks and violations which need to be pre-checked and secured by factory visits and in consultation with worker representatives. Both financial as well as human rights due diligence provides more assurance that suppliers are fulfilling all necessary requirements to start a long-term cooperation.
When needing more manufacturing capacities, FWF recommends member companies to grow with their existing suppliers and strengthen the relationship with them instead of starting with a new one. Investments in suppliers such as training, relationship building, new technologies, machines, and sound industrial relations, will result in lower transaction costs, increase speed to market, reduce production cost, better and more stable quality levels, higher transparency and improved working conditions.

2. Reasons for ending a business relationship

There can be several reasons creating the need to end a business relationship, which are mostly inherent to obligations towards the consumer. The reasons can be diverse and the below list is by no means exhaustive.

- Change in demand
- Consolidation of suppliers
- Constant delivery problems
- Constant quality problems
- Poor Factory & Management performance
- Structural unwillingness to resolve labour rights violations
- Pricing arbitrage/price negotiations
- Trade regulations, including Foreign Trade Agreements (FTAs)
- Geopolitical developments
- Availability of new technology & innovation

Above reasons are the most common for brands leaving a factory and in many cases, it is a combination of factors. Most of the causes that are internal to the supplier such as quality, delivery problems and poor management, can be improved by continuous improvement processes and dialogue between the brand and supplier. Poor quality and or delivery performance of a supplier can also be connected to the brands buying practices, planning and communication.

Externally driven factors such as change in demand, trade regulations including FTA's, geopolitical influence and consolidation are foreseeable to a certain extent and should be openly communicated and discussed as early as possible with the supplier. Therefore, it is necessary to continuously observe these changes and include them in your planning, evaluation and communication with your supplier.

Leaving a supplier and moving towards a new one will require additional resources and transaction costs within a brand and it is not unlikely that you will face similar challenges with a new supplier.

In this document FWF distinguishes in required steps for two different processes: 1) ending a business relationship because of labour-rights violations and 2) ending a business relationship because of any other reason.

3. Steps when ending a business relationship for reasons of labour rights violations

As mentioned above, FWF's approach means finding labour rights violations is never a reason for immediately leaving a supplier as this takes away the opportunity and leverage for improvement. FWF members are required to support the supplier in remediating the violation. In case the supplier shows structural unwillingness to cooperate and improve, (the threat of) ending the business relationship might be a last resort, though should be handled with great care. In line with the OECD due diligence guidance the step of disengaging should only be taken when steps to prevent or mitigate negative impacts have failed or are not feasible. Withdrawing from a non-compliant supplier should only happen as a last resort when no more effect on solving the issue can be gained from other strategies. This is difficult for a member company to assess and could be something FWF and its local stakeholders can help evaluate. Secondly, the member company must demonstrate to FWF it has worked actively on resolving the non-compliance and has exhausted options for improvements

When improvement options are exhausted and the decision has been made to end the business relationship, the following steps must be taken into consideration:

1. Member companies should involve relevant stakeholders, particularly unions, NGO's, and/or labour inspection where applicable.

2. In consultation with FWF and local stakeholders, determine the social impact of leaving the supplier and the role you should play to mitigate or prevent the negative impact based on leverage. Leverage is partly defined by the share of the production volume the brand buys from a factory and the length of the business relation, but is not a static concept. It can be influenced by a range of mechanisms, including the

size and power of the brand in the wider industry, but also through collaboration with other customers or parties. When functional[1] trade union(s)/worker representation exists in the factory, they must be included in the evaluation of the social impact.

3. Formally communicate the decision to the supplier and use this communication as leverage and as last step to engage supplier in change. Explain the upcoming disengagement is due to an identified continued violation of labour rights after failed attempts to prevent and mitigate impacts and no corrective actions taken by the supplier. Timing should not be influenced by business decisions (e.g. finishing orders, next season) but by the ongoing labour rights violation.

4. The member company must be able to answer the following question: does the exit lead to layoffs (or even closure) if nothing else would change? If so, FWF members must ensure the supplier is compliant with severance laws and monitor whether the supplier is financially able to cover those costs. FWF members are responsible for monitoring the compliance of this in collaboration with worker representatives and should use the results of their due diligence approach to mitigate the effects when supplier fails to be compliant with local severance laws.

5. In case the production location is part of a conglomerate of production units under the same ownership, the member company must investigate whether the labour rights violation(s) in question may have or might occur at the other production units where the member's products are being made. The owner(s) should be informed about the outcome of the investigation by the FWF member. If similar labour rights violation(s) occur in other production units, orders must be stopped as well. Member companies must report this to FWF.

6. FWF encourages members to cooperate from the start with other customers of the factory, and to do so also in remediating problems. In cases of leaving the supplier for labour rights violations, FWF expects members to cooperate and align their decision-making process for leaving the supplier.

1 By functional we mean a democratically elected worker representation that functions without involvement of management.

4. Steps when ending a business relationship for other reasons

1. Analysing the reason for ending the relationship and weigh all options for leaving versus staying with the supplier.

2. Inform the supplier as soon as the decision has been made internally and at least one season ahead, to allow the factory management to find new customers and orders to fill their capacities. The information should include a transparent explanation about the reasons for ending the business relationship.

3. In consultation with the supplier and stakeholders, determine the social impact of your decision and the role you should play to mitigate or prevent the negative impact based on leverage. Leverage is partly defined by the share of the production volume the brand buys from a factory and the length of the business relation, but is not a static concept. It can be influenced by a range of mechanisms, including the size and power of the brand in the wider industry, but also through collaboration with other customers or parties. When functional[2] trade union(s)/worker representation exists in the factory, they must be included in the evaluation of the social impact.

4. The member company must be able to answer the following question: does the exit lead to layoffs (or even closure) if nothing else would change? If so, FWF members must ensure the supplier is compliant with severance laws and monitor whether the supplier is financially able cover those costs. FWF members are responsible for monitoring the compliance of this in collaboration with worker representatives.

5. Inform FWF of your decision and the outcome of the above steps. In case needed, FWF can advise on the steps below.

6. In consultation with the supplier, define phase-out plan. Based on the above evaluation, determine a phase-out plan of production orders with a clear timeline. When functional[3] worker representation or union exists in the factory, they must be consulted. It should address the support needed to minimize the social impact and allow the factory to find new customers. It should include a plan for lowering the orders over time, temporary short timer work, reduction of shifts etc. The

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extent to which these measures come into place depends on the leverage and therefore differs on a case to case basis.

7. Involve additional stakeholders throughout the process. In the phase-out plan that is developed together with the supplier, member companies must ensure necessary stakeholders are involved to support the process of minimizing the social impact of the decision.

Limits to situations in which the above steps (4) are applicable

When ending a business relationships occur due to continuous labour rights violations and improvement options are exhausted, the steps listed under 1.3 are applicable regardless of the type and duration of the business relationship. However, when the member company leaves the supplier because of other reasons, FWF recognizes the implementation of the steps under 1.4 can differ depending on the type and duration of the business relationship.

There is a difference between when a brand works with a supplier for one season and decides not to continue the relationship and when that same brand has worked with a core supplier for years and decides not to continue the relationship. Or brands that place a one-off order for specific products where an 'exit' may not even be applicable when both parties know in advance it is a one-time order. Another scenario is when a brand has a supplier in its database for years but does not use that supplier every year. There can be a period with no orders, but communication is ongoing and an order might be placed a year later. That means an exit is not really in place, but the impact on production for that period would be the same as when you would exit (although very likely the production quantity of those cases will be low).FWF argues analyzing and evaluating the impact of ending a business relationship (step 1 and 2) is valuable in any case. For every order and supplier-buyer relationship, good planning and information flow is crucial to manage expectations on both sides.

However, following all steps under 1.4 is only applicable when:

1. The business relationship has existed for over a year, and the supplier has been used for at least 2 orders/seasons.
2. The decision to end the business relationship is the member's decision and not the supplier's.

FWF incentives members who consolidate their supplier base and will assess during the performance check what efforts the member takes to limit the number of small orders and shorten the length of the 'tail' of their supply chain.

Final notes

Be aware that FWF's complaints mechanisms is open to several parties: employees and their representatives employed by the factories supplying FWF members, by suppliers/factory management to complain about the way in which FWF procedures are carried out, or by NGOs and unions. Implementation of this procedure will be assessed during the FWF performance check.