The Determinants of Labour Standard Compliance: The Role of Buyers in Cambodia's Garment Sector

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ABSTRACT

Working conditions in global supply chains have come under increased public scrutiny. Faced with this growing demand for accountability, some multinational enterprises have come to play regulatory roles in developing countries where they do business. Using unique factory-level data from the Cambodian garment sector, this paper examines the effects of reputation conscious buyers on supplier labour standard compliance. This paper shows that factories producing for reputation conscious buyers are associated with better compliance levels than other factories, controlling for factory characteristics. Moreover, this positive effect of reputation conscious buyers is present across different categories of labour standards. The findings shed light on the opportunities and limits of buyer-driven regulation of labour standards.

INTRODUCTION

While the globalisation of production has contributed to the growing industrial capabilities in developing countries, the persistent lack of capacity of these governments has created regulatory gaps in labour conditions. In response to the transnational networks of activists that increasingly demand multi-national enterprises (MNEs) to assume responsibilities for regulating their supply chains, many MNEs have implemented Codes of Conduct (CoC) and monitoring procedures while some MNEs have joined multi-stakeholder initiatives (MSI) to safeguard their reputation (O'Rourke, 2006). To a larger extent, therefore, non-state regulation has become one of the dominant modes of regulating labour conditions in global supply chains.

The rise of non-state regulation of labour standards has provoked heated debates about its effectiveness. Is non-state regulation counter-effective? Does it create pockets of best practices at best? Do brands regulate suppliers more rigorously than other buyers? Do buyers influence only limited issues? These questions remain largely unanswered mainly due to lack of systematic data. The purpose of this paper, therefore, is to systematically assess the determinants of labour standard compliance and examine whether *different types of buyers* variably influence supplier compliance with *different categories of labour standards*. This article seeks to answer these questions by exploiting the unique factory-level data provided by the International Labour Organisation (ILO) programme, Better Factories Cambodia (BFC).

BACKGROUND

Non-state regulation of supplier labour standards. While non-state regulation has been criticised from various fronts, its impact has been rarely assessed quantitatively. CoC has been criticised for its narrow scope and bias against labour rights such as freedom of association (Jenkins et al., 2002) while private monitoring has been condemned for excluding workers and lacking transparency and credibility (Esbanshade, 2004; Seidman, 2008). Some scholars voice concerns that anti-sweatshop campaigns' focus on brands restricts the regulated realm to export sector for brand products (Elliott and Freeman, 2003), but it has not been tested. The studies of the Ethical Trading Initiative (ETI), a UK MSI, have found that CoC have some positive impact on *outcome standards* that are visible and easily codified but have little or no impact on *process rights* that enable workers to negotiate and access to their own entitlements (Barrientos and Smith, 2007). Nonetheless, their study is limited to participating members of the ETI and the impact is not

quantitatively assessed. In a rare quantitative treatment of the subject, Weil (2005) and Weil and Mallo (2007) evaluate a unique regulatory scheme in the US garment sector that combines public authority and private monitoring to enforce minimum wage and overtime regulation. While they find that rigorous monitoring by manufacturers has positive effects on compliance, they do not examine different characteristics of buyers and their effects on different labour standards.

Buyer influence on supplier working conditions. On the other hand, literature on buyer influence on suppliers tends to exclusively focus on branded buyers. 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. In their pioneering efforts, Locke et al. (2007) systematically assess Nike's internal monitoring results covering 830 suppliers in 51 countries and find that, when controlling for other factors, the compliance score is positively associated with the frequency of Nike's staff visits. Nonetheless, these studies are limited by their exclusive focus on one brand. Moreover, they do not examine different categories of labour standards. All in all, there is a lack of systematic investigation into the effect of *different types of buyers* on *different categories of labour standards*. This paper seeks to fill this gap by exploiting unique factory-level data from Cambodia's garment sector.

The Cambodian garment sector and the ILO programme. Cambodia's garment sector has been undergoing an innovative experiment to improve working conditions. All exporting garment factories are required by the Cambodian government to submit to regular monitoring by the International Labour Organization (ILO) programme called Better Factories Cambodia (BFC). In fact, this ILO monitoring programme grew out of the 1999 US-Cambodia bilateral trade agreement, in which an access to the US market was conditioned upon significant improvements in working conditions (Polaski, 2006). Over time, the Cambodian government has come to see the scheme as a niche strategy to attract reputation conscious buyers, which explains why the monitoring programme has been renewed even after the expiration of the quota regime at the end of 2004.

The Cambodian case provides an excellent opportunity to further our understanding about the role of buyers in regulating labour standards. First, ILO monitoring is more independent and credible than private monitoring owing to its independent financing scheme and locally-based and well-trained monitors. This helps ensure the quality of monitoring data. Moreover, given lack of government capacity, buyers often act as a virtual enforcement authority. ILO monitoring reports are accessible to buyers participating in BFC, and based on the reports, buyers select their suppliers and demand corrective action when important violations are found in the reports. Furthermore, the industry-wide and detailed monitoring and other factory-level data collected by ILO BFC enable us to quantitatively assess the determinants of labour standard compliance.

THEORY

Buyer enforcement behaviour and supplier compliance behaviour can be understood through the lens of the deterrence theory of compliance. The theory has been inspired by the economics of crime literature pioneered by Becker (1968), who argued that individuals and firms weigh costs and benefits of legal compliance in deciding whether or not to violate a law. According to this theory, a firm's propensity to comply with regulations is positively related with the probability of detection and expected penalty of violation. Those buyers who face 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, which in turn raises the cost of non-compliance for suppliers producing for these buyers. Expected penalty is higher for those buyers that derive much of their value from brand image, and knowing the vulnerability of brands, activists have deliberately targeted them (Conroy, 2007). Consequently, factories supplying for reputation conscious buyers are more likely to comply with labour standards than the other factories.

Most buyers enforce CoC in their supply chains through pre-order selection and post-order monitoring (Weil and Mallo, 2007). Before placing orders, most 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 signalled, 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 labour law and international core labour 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. Moreover, buyers may place emphasis on issues that are detrimental to their reputation such as child labour and poor physical working conditions.

DATA AND METHODS

This paper exploits the factory-level data collected by ILO BFC, and the dataset covers 344 factories for the period from 2006 to 2008, creating a panel data set of 1230 observations. ILO monitors conduct un-announced visits of all exporting garment factories every 6 to 8 months. Over 300 checklist items of labour standards are categorised under contract, wage, hours, leave, welfare, Occupational Safety and Health (OSH), and fundamental rights. While the overall compliance level is quite high, reaching 89 percent, full compliance is rare, especially for OSH (Table 1). Non-compliance across issue categories is positively correlated although the degree of correlation is low for fundamental rights (Table 2). Given the high weight of OSH in the total number of monitored standards (28 percent), performance for OSH influences overall compliance performance.

Table 1. Compliance performance across issue categories (2006-08)

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	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

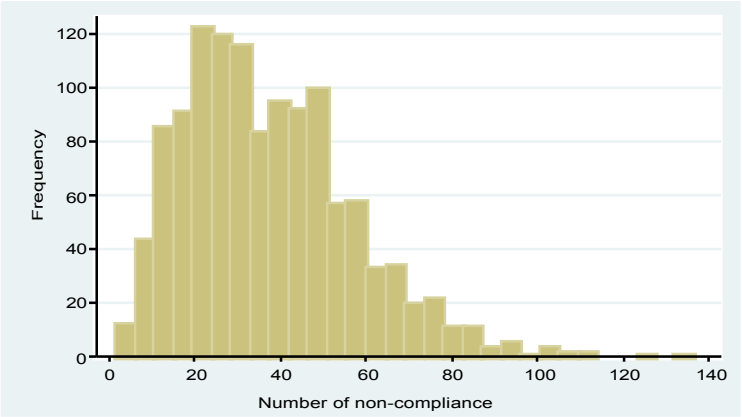
Table 2. Correlation matrix of non-compliance with different labour standard categories

	Contract	Wage	Hours	Leave	Welfare	OSH	Rights	Total
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		
Rights	0.25	0.25	0.25	0.23	0.16	0.17	1.00	
Total	0.77	0.78	0.67	0.77	0.75	0.90	0.30	1.00

The dependent variables are the number of non-compliance items for each issue category and the total number of non-compliance. As shown in Figure 1, there is large variation in non-compliance across factories, which needs to be explained. The category of fundamental rights, which includes discrimination, harassment, child and forced labour, freedom of association, requires a separate

treatment. Violation of fundamental rights occurs rarely in the sample, but one incidence of non-compliance has much more serious implications than one violation of minor OSH issue. Hence, non-compliance of fundamental rights is measured by a binary variable.

Figure 1. The frequency distribution of non-compliance (2006-08)



The independent variables are buyers' different degrees of reputation consciousness. This concept is measured by buyer membership of multi-stakeholder initiatives (MSI). This is a reasonable proxy given the tendency of reputation conscious buyers to participate in MSI to show their commitment and safeguard their reputation. The degree of reputation consciousness is operationalised 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. BFC-only buyers are considered less reputation conscious than the first group and these buyers are mostly large and well-known retailers that tend to compete on prices rather than ethical standards. The third category of buyers that participates in none of the MSI is least reputation conscious. Based on this classification, variables for the presence of MSI and BFC-only buyers as well as the number of BFC-only buyers are created (Given the small number of MSI buyers, the number variable is highly correlated with the presence variable, and therefore is dropped from the regression analysis).

In addition to these buyer variables, the following establishment-level characteristics are included as control variables: the size and age of the establishment, the presence and number of unions, factory ownership nationality (domestic and western), and year dummies. With these variables, three types of models have been estimated: an Ordinary Least Squares (OLS) estimate using the raw number of non-compliance (raw OLS) for all issue categories except fundamental rights, an OLS estimate using the natural logarithm of non-compliance (semi-log OLS) for total number of compliance given a high degree of heteroscedasticity, and a logit model for fundamental rights (logit).

RESULTS

Across all models and issues, buyer variables are highly significant and negatively associated with non-compliance (Table 3). In other words, factories producing for reputation conscious buyers have better compliance performance than other factories. Specifically, the presence of MSI buyers reduces total non-compliance by 35 percent in the semi-log OLS, which corresponds to 13 items in the raw OLS model. The presence of MSI buyers is highly significant across all issue categories except fundamental rights. Regarding the logit model for fundamental rights, while the overall model is statistically significant (chi square p=.000), the fit is not satisfactory (pseudo R square=.04). This suggests that fundamental rights may be qualitatively different from other issues and that it is

explained by some other variables outside the model. The presence of BFC-only buyers is generally significant and negatively related to non-compliance although it loses significance for welfare and OSH and in the semi-log model. As for the number of BFC-only buyers, a factory producing for a larger number of such buyers is associated with better compliance, particularly for welfare and OSH. In sum, reputation conscious buyers—not only MSI buyers but also BFC-only buyers—appear to have important positive effects on labour standard compliance across different issue categories.

Table 3. The Determinants of Labour Standard Non-Compliance

	OLS								Logit
	Ln (Total Non-Compliance)	Total Non-Compliance	Contract	Wage	Hours	Leave	Welfare	OSH	Fundamental Rights
Presence of MSI buyers	-0.346****	-13.254****	-1.160****	-2.134****	-0.579***	-1.964****	-1.353****	-5.856****	-0.440*
	(0.04)	(1.46)	(0.24)	(0.34)	(0.18)	(0.25)	(0.20)	(0.67)	(0.23)
Presence of BFC-only buyers	-0.048	-4.594***	-0.635**	-1.220****	-0.375**	-1.256****	-0.021	-0.857	-0.669**
	(0.05)	(1.56)	(0.27)	(0.33)	(0.19)	(0.28)	(0.21)	(0.73)	(0.27)
Number of BFC-only buyers	-0.112****	-2.769****	-0.130	-0.281**	-0.147**	-0.026	-0.489****	-1.747****	0.126
	(0.02)	(0.56)	(0.11)	(0.12)	(0.07)	(0.11)	(0.08)	(0.26)	(0.11)
Establishment size	-0.127****	-3.775****	-0.578****	-0.546***	-0.062	-0.315**	-0.351**	-2.041****	0.330***
	(0.02)	(0.87)	(0.13)	(0.21)	(0.10)	(0.15)	(0.14)	(0.39)	(0.12)
Establishment age	0.019**	0.551**	0.047	0.009	-0.041	0.099**	0.061*	0.401****	-0.065
	(0.01)	(0.24)	(0.04)	(0.05)	(0.03)	(0.04)	(0.03)	(0.12)	(0.04)
Union presence	0.026	0.718	0.164	-0.505	-0.154	0.079	0.203	0.999	-0.073
	(0.04)	(1.44)	(0.24)	(0.37)	(0.18)	(0.27)	(0.19)	(0.66)	(0.22)
Number of unions	-0.024	-0.590	-0.113	0.051	-0.054	-0.194**	-0.001	-0.271	-0.059
	(0.02)	(0.45)	(0.07)	(0.10)	(0.05)	(0.08)	(0.07)	(0.23)	(0.09)
Domestic ownership	0.190****	9.754****	0.847**	2.595****	1.022***	1.476***	0.835***	2.716**	0.954****
	(0.06)	(2.79)	(0.41)	(0.75)	(0.33)	(0.47)	(0.30)	(1.12)	(0.29)
Western ownership	-0.123*	-3.538*	-0.631**	-0.211	-0.031	-0.314	-0.496*	-1.794**	-0.080
	(0.07)	(1.82)	(0.30)	(0.41)	(0.27)	(0.33)	(0.27)	(0.88)	(0.31)
Year 2006	0.416****	14.297****	1.654****	2.215****	1.001****	2.892****	1.508****	4.774****	0.457**
	(0.04)	(1.26)	(0.21)	(0.29)	(0.15)	(0.23)	(0.17)	(0.60)	(0.18)
Year 2007	0.081**	2.115**	0.147	0.276	0.055	0.716****	0.186	0.798	-0.424**
	(0.04)	(1.05)	(0.18)	(0.23)	(0.12)	(0.18)	(0.15)	(0.51)	(0.19)
Constant	4.293****	62.416****	7.937****	8.848****	4.044****	5.591****	6.009****	30.26****	-3.090****
	(0.16)	(5.53)	(0.83)	(1.33)	(0.68)	(0.94)	(0.87)	(2.50)	(0.78)
Number of observations	1221	1221	1221	1221	1221	1221	1221	1221	1221
R-square	0.302	0.318	0.16	0.19	0.12	0.24	0.22	0.28	0.04
F-value	50.52	50.82	21.64	20.66	13.65	30.35	29.77	47.86	53.42
Prob>F	0.000	0.000	0.000	0.000	0.000	0.000	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, the Fair Labour Association (FLA) or the Ethical Trading Initiative (ETI). "MSI buyers" are those buyers participating in 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. Robust standard errors are in the parentheses. For the logit model, R-square represents pseudo R-square and F-value is Wald chi square.

Among the control variables, the size of the establishment is statistically significant across all issue categories except hours and it generally reduces non-compliance, probably owing to economies of scale and more readily available resources. The exception is fundamental rights, where the size variable increases non-compliance. This may be related to employee alienation that increases with size. The age of the establishment generally increases non-compliance, particularly for OSH, which is likely to result from the physical constraints of older facilities. Union presence and number are not statistically significant. The number of unions generally reduces non-compliance, particularly

regarding leave. 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 financial resources and managerial know-how to improve working conditions unlike Western-owned factories. Year dummy controls show that compliance performance was much worse in 2006 compared to 2008.

CONCLUSION

Based on the unique firm-level data from Cambodia's garment sector, this paper has sought to examine whether reputation conscious buyers variably affect supplier compliance with different categories of labour standards. The findings clearly show that factories supplying for at least one highly reputation conscious buyer tend to have better compliance levels across issue categories. Moreover, less reputation conscious buyers also tend to reduce non-compliance especially when more of them are sourcing from the same factory, creating a critical mass of pressures. Other factors that significantly influence labour standard compliance across issues include the size of the establishment and domestic ownership: larger and foreign owned factories tend to perform better.

The findings point to both the opportunities and limits of buyer-driven regulation. Contrary to the criticism that global brands are exacerbating a "race to the bottom" and that non-state regulation is ineffective, the findings suggest that reputation conscious buyers play an important regulatory role. The fact that not only highly reputation conscious brands but also less reputation conscious retailers have positive impacts on compliance performance suggests that the regulated realm is not necessarily restricted to brands and it is expanding. Moreover, the effect of reputation conscious buyers is not limited to one issue category but significant across different categories. Nonetheless, fundamental rights are not sufficiently explained by the model, which requires further investigation by unbundling the category and including other variables. Besides, the study has revealed large compliance gaps between factories supplying for MSI and BFC-only buyers and the other factories producing for least reputation conscious buyers.

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 that 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 labour 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 semi-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 monitored factories although working conditions in subcontractors are reportedly worse.

The inherent limits of non-state regulation and the critical role of public policy in supporting non-state regulation are increasingly acknowledged (Vogel, 2005; Kuruvilla and Verma, 2006; Seidman, 2008). Ultimately, sustainable progress in working conditions beyond branded products and export sectors requires capable government and effective international organisations. Even as the role of business in regulation continues to grow, governments and international organisations have important roles to play by providing the right framework and incentives for the private sector.

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