

Background document on the ICN/ADIDAS case

Introduction to the specific instance

ICN has brought the first specific instance to the attention of the Netherlands NCP since the review of the OECD Guidelines in 2000. It concerned the question whether Dutch companies as outsourcers and sellers of footballs produced in India, implement the Guidelines with respect to working conditions. It is stated in the General Policies of the Guidelines (chapter 2, paragraph 10) that enterprises should:

“Encourage, where practicable, business partners, including suppliers and subcontractors, to apply principles of corporate conduct compatible with the *Guidelines*.”

After communication between ICN and NCP, it became clear that ICN focused on the question whether the following aspects of the Guidelines were complied with in this respect:

II. General Policies

Enterprises should take fully into account established policies in the countries in which they operate.

Commentary on General Policies

2. Obeying domestic law is the first obligation of business.

According to ICN, this concerns amongst others the payment of minimum wages which has been established in local policies;

IV. Employment and Industrial Relations

Enterprises should, within the framework of applicable law, regulations and prevailing labour relations and employment practices:

1.
 - a) Respect the right of their employees to be represented by trade unions and other bona fide representatives of employees, and engage in constructive negotiations, either individually or through employers' associations, with such representatives with a view to reaching agreements on employment conditions;
 - b) Contribute to the effective abolition of child labour;
2.
 - a) Provide facilities to employee representatives as may be necessary to assist in the development of effective collective agreements;

- c) Promote consultation and co-operation between employers and employees and their representatives on matters of mutual concern.
4. b) Take adequate steps to ensure occupational health and safety in their operations.

ICN based the specific instance on the report “the Dark Side of Football – Child and adult labour in India’s football industry and the role of FIFA (June 2000)” and subsequent fieldwork. ICN reported that during a visit to Z, the Indian supplier of Adidas and another Dutch company, it was confirmed that there were no unions active. In addition, except for some ‘stitching centres’, there was no indication that homeproduction for Z, such as in Batala, provides workers with minimum wages. The same applied to health and safety measures. According to ICN’s data, Z also outsources the production to Batala, which occurs outside of the FIFA-inspection. There were strong signs that part of this production for Z in november 1999 was done by using child labour. Even though ‘the Sports Goods Foundation of India’ stated that no licensed production took place in Batala, Adidas had not provided any proof for this. ICN raised the question with the NCP, after it had tried, without success, to get a reaction from Adidas about these allegations.

Adidas’s relation with Z

Adidas informed the NCP and ICN that Adidas and Z have been in a buyer-seller relationship for four years. Adidas has no shares in Z and has made no physical investment (it does not own any of the buildings or equipment). However, Adidas does invest its ideas in Z, which could be considered as an intellectual investment in Z. Also, preconditions such as delivery time, price, labour standards and health and safety measures are laid down by Adidas in the manufacturing agreement with Z. Moreover, the amount of leverage that Adidas has on Z is considerable: Adidas is one of Z’s larger customers and its well-known brand is an important leverage-tool.

Adidas footballs sourced from Z are stitched in two large factories opposite the main buildings of Z. When orders by Adidas are low, Z may use these factories for supplying other buyers, but Adidas checks that all its products ordered from Z are only produced in these two factories. Each factory facilitates around 200 people, who are paid on a piece-rate basis. The first facility was built 3 years ago, the second 2 years ago. Adidas did not cover the costs of building the factories up-front, but they have been taken into account when product and price were negotiated with Z. In this respect, it should be noted that Adidas targets the top-tier market segment and is willing to pay more than most of its competitors to

assure premium-quality, including social quality during production.

Currently, Adidas only buys rugby-balls from Z. Nevertheless, sourcing could easily change and Adidas may well source its footballs from Z again in the near future.

1. On Standards to pursue

Adidas uses a code of conduct, called “standards of engagement” (SOE). The SOE is not based on the OECD Guidelines, but covers similar issues, including the core Labour Standards of the ILO. Adidas has written agreements with its suppliers that they comply with its code of conduct. Adidas has a team of 30 people working on its SOE. They are based in the countries of its main suppliers, they speak the local language and visit the factories to make sure that the SOE is upheld. In addition, the involvement of FIFA is important to note. As part of the licensing agreement between Adidas and FIFA, Adidas is required to ensure that its suppliers comply with the International Labour Organisation's Declaration on Fundamental Principles and Rights at Work (1998) as well as with the WFSGI-codes. These codes are similar to its SOE. Each contractor involved in producing FIFA licensed products has confirmed to Adidas that they comply with all these instruments and Adidas can be held legally accountable for this under FIFA-requirements.

a) Minimum wages

Adidas explained that workers get paid per ball. Wage-records are checked. The piece rate and the amount of balls that can be stitched by one person are determined by the quality of the material. On average, one worker can stitch 5 balls of thin (lower quality) material or 3 balls of thick (higher quality) material per day. One of Adidas's representatives at the NCP meeting has personally confirmed through interviews that workers are able to achieve wages equal to or above the minimum wage within reasonable working hours. Also, the concern of ICN that the middleman takes 10% of the price paid for each kit is not relevant to the workers producing for Adidas, since there are no middlemen in the factories.

Adidas mentioned that there does not yet exist a standard method to monitor issues such as compliance with the SOE clause on wages and benefits regarding the assessment of basic needs and discretionary income, but Adidas currently carries out a study to this effect in Indonesia. The results may also be used later in other countries. ICN was glad that Adidas had done studies on living wages (i.e. according to 8 hours work a day). ICN stressed that it was happy to see that Adidas was working at the forefront here, but that the union element is an enabling right and thus also very important.

After the meetings ICN posed some additional questions on the issue of wages:

Q: Are the factories of Z that are producing for Adidas functioning under the Factory Act (NB: This act gives employees a number of rights, including a labour contract, an annual bonus, double pay for overtime etc.)¹? If this is not the case, why not?

A: They are registered under the Factory Act but their functioning cannot be said that they comply 100% with the Act because workers are not confident about government agencies (Provident Fund Agency, ESI Hospital). Workers do not want deductions from their salaries for these services because they are badly managed. It takes a long time to get funds from these agencies, so workers bargain with management so that no deductions are made from their salaries.

Q: What are the minimum, average and maximum wages that stitchers in the two Z factories earn per day in eight hours a day?

A: The minimum wage earned is Rs96, average wage earned is Rs112, and maximum wage earned is Rs160.

Q: Should the first sentence of the paragraph on ‘Wages and Benefits’ in the Adidas Standards of Engagement be understood as an intention to move towards ‘living wages’ for workers in its production facilities? If so, what is the plan of action to reach this goal in the case of the football stitchers in India?

A: We would note that no company has resolved this issue. The Clean Clothes Campaign pilot projects have made no progress on this, showing this is a complex issue. As mentioned, we are checking the buying power of wages in Indonesia and hope to develop a methodology that can be used in other countries.

Q: Do the price calculations of Adidas include minimum and or ‘living wages’ and other secondary provisions under the Factory Act?

A: Prices are calculated on the basis of labour costs described above.

b) Access to trade unions

Adidas noted that Z does not yet have trade unions, but Adidas is encouraging Z to establish elective democratic unions. These will have to be introduced slowly.

¹ “the Dark Side of Football – Child and adult labour in India’s football industry and the role of FIFA (June 2000)”, p.11

Adidas recognises the importance of such trade unions, as they represent an important tool for workers to monitor their own conditions. In this respect, Adidas emphasises the importance of unions for local capacity building and tries to teach its suppliers how these unions can improve communication with workers on social issues, for instance by means of establishing committees on issues like health and safety concerns. The main problem in establishing these unions is of an elective nature.

ICN highlighted that the Industry response to its report talks about a union of contractors and workers, which, to ICN, is not a union. Moreover, ICN has heard that people find resistance when they try to organise a union.

Adidas responded that the issue of trade unions in India is complex. It is true that there is not always full representation of worker's rights. The problem is often no good governance on this by factory management or by trade union leadership. Also, some workers do not want to join because they are concerned that their rights are not represented. It is however Adidas's priority that workers can monitor their own work conditions. Therefore, Adidas has organised workers councils similar to workers councils as they exist in Adidas in Germany. Of course, worker's organisations should be independent, but these councils are a good first step towards effective representation. In Pakistan, the Chamber of Commerce is now open to trade unions and collective bargaining. Adidas's emphasis here is on capacity building, on building understanding within management of the importance to communicate with workers. It is Adidas's belief that trade unions are the solution to improving work conditions, monitoring in itself is not. Adidas is pushing suppliers down this road, and as long as management is moving in the right direction, Adidas will continue its relationship with them (if Adidas would leave, the chance that worker's rights are protected becomes smaller).

After the meetings ICN posed some additional questions on the issue of access to trade unions:

Q: What does Adidas mean by the statement that 'Adidas is encouraging Z to establish elective democratic unions'. How can Z introduce elective trade unions as unions are to be independent. How does Adidas and/or Z practically create space for unionisation and signal to the outside world that they are open to deal with trade unions?

A: Adidas-Salomon AG is working with ILO in some countries to provide training in worker/management communication. This includes collective

bargaining and the role of workers organisations. Suppliers will get more business from us if independent unions are working in their factories.

As we discussed during our NCP meetings, the first step is for workers to trust union representation and to request unionisation. However many workers have told us at Z in India that they do not trust unions to represent them.

Q: Can Adidas positively confirm the statement of the SGFI that unions of agents/contractors and workers are bargaining with the management of the sporting goods companies?

A: Yes, it is happening, agents/contractors bargain with the management of the sporting goods companies. However this is not a formally registered union. The key to improving SOE is meaningful communication between workers and management. We have made it clear to Z that this is required.

Q: Is there a workers council at Z and if so, what is their mandate and how do they function? If there is no workers council: what is Adidas doing to encourage Z to set up an effectively functioning workers council?

A: There is a workers organisation. We have made it clear to Z that appropriate worker representation is a top priority for our company.

Q: What is Adidas' view on the role of unions in external monitoring and what is its plan of action on this issue?

A: Unions really want to be involved in internal monitoring in the factories where their members work. Their primary interest is not external monitoring. Adidas-Salomon AG will continue to push for unions to be able to effectively internally monitor. Unions are members of ILO so in effect they are doing some external monitoring.

c) Adequate health and safety standards

Adidas stated that within its global team on SOE, experts (with previous experience in the oil industry) have worked with Z to make sure that health and safety measures such as good lighting, ventilation, fire escapes and fire extinguishers are complied with.

After the meetings ICN posed some additional questions on the issue of adequate health and safety standards:

Q: What aspects of health and safety are monitored by Adidas and SGS?

A: Adidas monitors all international HSE standards including lighting, ventilation, aisles marking, emergency lighting, escape routes, fire extinguishers, electrical set up, proper storage of materials, housekeeping, clean toilet facilities, first aid kits, trained personnel in first aid, proper placement of generator and compressor etc. As far as SGS is concerned two aspects are covered namely hygienic conditions (in context of cleanliness) and working conditions (in context of lighting, ventilation and toilet facilities).

d) *Child labour*

Adidas said that it is clear that ICN has no proof that Adidas has used children in its production, also since the ICN report talks about November 1999. Adidas did not outsource then and feels it has given sufficient evidence on this issue. On this issue of child labour in Batala, Adidas emphasises to its suppliers that it wants a consistent production line. This means that Z cannot have a horrible production line in one factory and a nice one in another, not even if the horrible one is used for production for other buyers than Adidas. Adidas monitors the whole company on this.

ICN responded it was glad to hear this and that the report is of course of 1999/2000. However, at that time, it was clear that Z produced to a great extent in Batala with the use of child labour and paying lower than minimum wages. ICN was unable to determine which balls ordered by each buyer of Z where made in the different factories.

2. *On Continuing Transparency*

Adidas reports about its social and environmental performance. It submitted copies of “Our World Social and Environmental Report 2000” and “The Environmental Statement 2001” to the NCP.

As part of encouraging suppliers such as Z to uphold the SOE, Adidas publishes a factory scoring system in its social and environmental report. These ratings (ranging from 1 to 5 stars) help determine whether Adidas will continue its relationship with the factory: when a factory gets only one star, the relationship may be terminated soon. Labour standards represent approximately 15% of the overall factory’s score.

Adidas views its annual report as providing more detail on its supply chain than many competitors do. Additionally, Adidas is acknowledged for its efforts by analysts and ranks at the top of the Dow Jones Sustainability Index. Adidas is

committed to giving more detail (the next report has also more detail on a road map on the implementation of the SOE of Adidas in all production locations).

ICN stressed that it would be helpful for a constructive dialogue with stakeholders if disclosure became a common practice: one would expect a timeframe on the objectives from FIFA. Lack of communication and transparency is the main problem for the NGO's and trade unions: if there would be more synergy and facts were open, the discussion between Industry and NGO's could reach a higher level.

After the meetings ICN posed some additional questions on the issue of continuing transparency on the implementation of standards:

Q: Given Adidas' statement that it would not want double standards of a supplying company like Z to it, how does Adidas make sure that the working conditions at Z's sub-contractors (stitching centres, homes etc.) are more or less equivalent to the factories. Can Adidas disclose any information on Z's management systems with regard labour conditions and employment relations, that verifies that Z is not using double standards?

A:

- eg. personnel systems. Each worker has a file with proof of their age, pay records, etc.

- eg. health and safety systems. Regular checks of fire safety equipment, etc.

Q: Why are working standards only 15% of Adidas factory rating? What are the other elements and for how much do they count? Is it possible that labour standards – accounting for 15% of the overall factory's score - are not or insufficiently implemented by the supplier, while Adidas continues its sourcing because of other positive factors?

A: Other factors are quality 35% and delivery is 50%, which recognises the business realities. Many companies do not rate suppliers on working conditions at all, so we feel 15% is a good share.

Q: given the 15% share on labour standards in Adidas' factory rating, could this mean that Adidas would continue to work with a supplier that is clearly violating (one or more of) its SOE and (one or more of) the OECD Guidelines, because the factory/supplier performs excellently on the factors that count for the remaining 85%? How does Z score with regard to working/labour standards and other factors?

A: We have zero tolerance on SOE issues, so if there are serious violations we will terminate business anyway. The reality is that if workers are badly treated the factory will not perform well on quality and production.

3. On Continuing External monitoring

ICN noted that FIFA, WFSGI, SGFI, SGS and ILO (in the Pakistan program) are all involved in the contract of FIFA with its licencees (e.g. Adidas) and the implementation thereof. According to ICN, SGS and ILO monitor solely on child labour, while WFSGI, SFGI, FIFA and the licencees do not have external monitoring done on the other labour standards mentioned in the contract.

Adidas stated that even though adequate labour laws are in force in India (for factories with more than 20 workers), the government is not monitoring this effectively. Possible co-operation between external monitoring and Indian labour inspectors on this is also lacking. Consequently, Adidas and other MNE's are checking compliance with social standards themselves. As a result, both Adidas, through its internal monitoring team, and FIFA, through the external monitoring agency SGS, check compliance of suppliers with social standards. Adidas visits the two factories regularly to make sure, for example, that records of ages are kept and fire exits are kept clear. All aspects of the SOE are checked during visits. Adidas checks the number of workers, how much they can produce and compares this capacity with the amount of footballs ordered to make sure none are produced outside these factories. In addition, people are placed at the entrance to make sure that no football-kits leave the factory for usage in homeproduction. Also, a quality controller visits the factories every fortnight. The SGS initially monitored only child labour, because it had hundreds of centres to monitor and the quickest way was by narrowing its focus. Since it started monitoring the industry, SGS has found around a hundred children stitching footballs in India. Today, SGS is looking at other social issues as well, notably health and safety aspects.

ICN wanted to know more on the issue of if there was independent monitoring on other issues than child labour in India. Adidas responded that in general, Pakistan where ILO is the external monitor is 2 to 3 years ahead of India. The ILO monitors on a wide range of issues, including health & safety, and freedom of association. In India, the intention is to broaden the monitoring. SGS has worked on health and safety issues, but trade unions are more difficult and are not yet covered. Vérité, who monitors in China, covers a whole range of core Labour Standards, which is also covered in Adidas's code of conduct. As for Z individually, Adidas has its own monitoring team that checks on all labour standard issues.

ICN continued that SGS should be more transparent in its work by systematically disclosing its findings and program of action. In addition, local NGO's and trade unions should become involved.

Adidas responded that SGS's reports are public.

After the meetings ICN posed some additional questions on the issue of external monitoring:

Q: Has co-operation with the Punjabi labour inspection system been sought? If so, what has been the outcome? (NB: This question relates to the possible role of a relevant local external agency in the monitoring of the OECD Guidelines (and Adidas' SOE).

A: The rejection by the Government Of India (GOI) of the ILO as monitors has made this difficult.

Q: In our view this rejection of the GOI does not mean that Adidas and/or the sourcing and manufacturing companies together (including Adidas) cannot take up labour issues with the Punjabi labour inspectorate. An effective labour inspectorate could be an important solution to many of the present problems in the Indian sporting goods industry and could therefore in principle be a very important stakeholder of Adidas.

A: We agree that an effective labour inspectorate is important, but it is the mandate of the ILO to work with governments to improve them. This is not our role.

Q: How can limited monitoring by SGS verify the internal monitoring by Adidas if SGS is only inspecting child labour and health & safety?

A: SGS do not have this role. The Fair Labor Association verifies our global monitoring programme.

Q: As far as we are informed – also by your Social and Environmental Report 2001 – the Fair Labour Association is not doing any external monitoring of Adidas' football suppliers in India. If SGS also does not have that role, can we then draw the conclusion that there is no external monitoring of the production of football for Adidas in India (yet)?

A: SGS are the external monitors for child labour. The FLA monitors our global supply chain SOE systems, including our work in India.

Q: According to information from FLA however the production of footballs by your supplier in India has not yet been externally monitored (yet). Could we have your comments on this?

A: The FLA audits our global systems with visits to our offices and checks of our monitoring records. They cannot do site visits globally - more details at www.fairlabor.org.

Q: Does Adidas favour monitoring of all standards by/through FIFA?

A: Yes we comply with all their requirements.

Q: Does Adidas support the idea that FIFA-supported monitoring and verification systems – like the ones in India and Pakistan – should not only monitor child labour but also the other labour standards that are part of the agreements between FIFA and its licensees (including Adidas and most sporting goods companies)? This is relevant in the present case because such independent systems would provide the external monitoring of football production for Adidas' which now seems to be lacking.)

A: We hope that SGS can take on a broader role.

Q: What time-frame for that does it have in mind?

A: On-going.

4. On Strengthening communication between stakeholders

The NCP highlighted that ICN is interested in communication on the issue with Adidas, otherwise it would not have brought the issue to the attention of the NCP. Adidas was happy with the opportunity to meet with a representative of ICN to discuss the issue.

Adidas apologised for the fact that it had failed to respond to the prior request by the ICN to comment on the issue. Adidas in principle takes every issue questioning its social conduct seriously, but the ICN issue unfortunately has never been dealt with. After the initial letter of a representative of ICN to Adidas in June 2000, there has not been any further contact between the two parties. SGFI has told Adidas that a copy of the response of the industry to the ICN report has been sent to the representative of ICN and that the SGFI was keen to discuss the issue with the representative of ICN, but that the representative of ICN never responded

to their invitation to do so. The WFSGI met with ICN 2 years ago and gave the Industry response to ICN.

ICN responded that this is incorrect. There was a meeting, but although ICN requested a reaction on its report, it never received any up until the NCP procedure.

ICN wanted to know more about the role of Adidas in FIFA and the Industry at large, as this is unclear to NGO's and unions. ICN added that more transparency would help. In addition, synergy by frontrunners like Adidas could help other companies. ICN wanted to know if Adidas ever discussed targets on work conditions with FIFA.

Adidas responded that it had met with FIFA and the industry on 4 March 2002 and had discussed the need to communicate the good news about the significant progress that has been made in India, Pakistan and China. They will aim to get facts on China, India and Pakistan out as soon as possible.

With regard to labour standards, ICN highlighted that international trade union confederations should be part of the worldwide agreements between FIFA and individual companies. Today, they are not. Besides, according to ICN, labour unions should be party to any system of independent monitoring.

Adidas believes it important to involve the industry foundation in this issue and suggests that ICN could meet with SGFI in India. Adidas is interested in helping to improve the workings of the industry, but to make an impact on the whole industry a meeting in Jalandhar would be most efficient. The meeting here between NCP-Adidas-ICN could however prove to be a good first step in this respect.

On this issue, ICN is of the opinion that the NCP should develop a practice in which not only individual companies, but also business sectors that violate the OECD Guidelines are being discussed. Organisations such as FIFA, WFSGI, and SFGI could play an important role in this respect. Individual companies in such a business sector will have difficulties in neglecting the market dynamics of a sector, especially when it concerns small companies that outsource production of cheap consumergoods. According to ICN, the OECD Guidelines can only help create a 'level playing field' for corporate social responsibility when the business sector approach is included in the NCP. ICN noted that when companies use the argument that they have to keep their margins in order to compete, this shows that it is a sectoral problem for which the WFSGI should suggest to take a joint position.

5. On Continuing Taking into Account Independent Information

According to Adidas, the concerns raised by ICN are based on a report published 5 years ago and are today outdated. The share of the informal economy in football stitching in India has declined considerably since then as 90% of production is now within the monitored program.

ICN responded that the fact NGO's do not acknowledge progress made, results from the problem of lack of both way communication: without new figures, NGO's fall back on the old ones. ICN would be happy to publish a progress report, but cannot do that without communication from the industry.

Conclusion

The NCP summarised that the parties agree on standards and objectives to be met, but that communication and transparency had not always been clear in the past.

Therefore, in the future, strengthening communication, also within the framework of FIFA, is important. Both parties agreed.

The NCP agrees that it will only step in again when communication breaks down between Adidas and ICN.