

Please cite this paper as:

OECD (2002), "Managing Working Conditions in the Supply Chain: A Fact-Finding Study of Corporate Practices", *OECD Working Papers on International Investment*, 2002/02, OECD Publishing.  
<http://dx.doi.org/10.1787/434666605557>



OECD Working Papers on International  
Investment 2002/02

# Managing Working Conditions in the Supply Chain

A FACT-FINDING STUDY OF CORPORATE  
PRACTICES

OECD



**DIRECTORATE FOR FINANCIAL, FISCAL AND ENTERPRISE AFFAIRS**

**WORKING PAPERS ON INTERNATIONAL INVESTMENT  
Number 2002/2**

**Managing Working Conditions in the Supply Chain:  
A fact-finding study of Corporate Practices**

**June 2002**

*This study was sponsored by the Swedish Ministry of Foreign Affairs, with the co-operation of the Ethical Investment Research Service (EIRIS). The paper was prepared by Mattias Chu (Senior Research Officer) of the Swedish National Board of Trade and Kathryn Gordon (Senior Economist) of the International Investment Division of the OECD, incorporating data and comments from Jeremy Baskin (Head of Research) and Niaz Alam (Social Researcher) at EIRIS. The paper is preliminary and should not be cited without the permission of the authors [mattias.chu@kommers.se and kathryn.gordon@oecd.org].*

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## **MANAGING WORKING CONDITIONS IN THE SUPPLY CHAIN -- A FACT-FINDING STUDY OF CORPORATE PRACTICES**

*Supply chain management is “an integrative philosophy to manage the total flow of a distribution channel from the supplier to the ultimate user”.*

*Cooper and Ellram (1993) The International Journal of Logistics Management*

### **I. Introduction and background**

The expanding geographical sweep of supply chains reflects important advances in the area of logistics management. Some of these advances are linked to progress in computing, telecommunications and robotics technologies as well as to the accumulation of management expertise. Managers have integrated new technologies into their production and distribution processes and have explored new ways of running their core businesses and of managing relations with business partners. As a result, the organisation of companies has evolved -- strategic alliances and closer relations with suppliers and contractors have tended to blur the boundaries of the enterprise. This restructuring has been accompanied by new ways of looking at and organising the roles and responsibilities of various actors in supply chains -- sourcing and supplying firms, business service providers and policy makers.

The greater sophistication in the management of supply chains is part of the long-standing process in which companies and national and regional economies sharpen their focus on their areas of distinctive competence and comparative advantage. This process offers potential benefits for investors in both sourcing and supplying firms as well as for consumers and workers. As part of this trend, some businesses in the developed world have focused more closely on their core areas of expertise and competence (for example, distribution, marketing, design or brand-based retailing). They have left manufacturing to other companies with expertise in that area. As a result, some businesses in lower wage countries have found that they are competitive in labour intensive agriculture, manufacturing, assembly and services. These developments offer suppliers an entry door not only into world markets, but also into world management trends and practices. Managers in these companies become familiar with the demands of advanced consumer markets and business partners as well as with management practices used for accountability and legal and regulatory compliance. These include control of product flow and quality, inventory and facilities management, record keeping and tighter labour and environmental management.

At the same time, the growth of supply chains has raised concerns. Indeed, as businesses themselves often point out, it poses significant challenges for nearly every aspect of corporate responsibility. This is a concern to many investors, consumers and trade union and NGO representatives. Consideration of this complex topic needs to take into account various competing factors and trends. In particular, whilst the highly publicised cases of abuse and exploitative conditions have often been located in poorer countries, it is also widely acknowledged from a development perspective that trade and foreign investment generate far more much-needed employment and wealth in developing countries than is provided by foreign aid projects. Hence, many actors now consider it vital to ensure that raising concerns about working conditions does not unduly undermine such benefits or lead to “back door protectionism” by wealthy countries.

This issue is also relevant for many of the areas of business ethics covered by OECD Guidelines for Multinational Enterprises. These include consumer interests (especially product quality and safety), employment and industrial relations, environment, technology transfer, competition and many of the areas covered in the “General Policies” chapter (human rights, management systems, human capital formation, employee awareness and training). Several participants at the 2001 Roundtable on Corporate Responsibility identified supply chain issues as a promising area for future consideration<sup>1</sup>.

The present paper reflects work sponsored by the Swedish Ministry for Foreign Affairs. This study was conducted by a research officer of the Swedish National Board of Trade working on firm level data supplied by the Ethical Investment Research Service (EIRIS). EIRIS provides “independent research into corporate behaviour needed by ethical investors to help them make informed and responsible investment decisions<sup>2</sup>”. The project focuses on one aspect of supply chain management -- corporate policies and management practices with respect to working conditions in their supply chains. It extends earlier work with EIRIS, whose data on environmental management practices formed the basis of a study published as Chapter 6 of *Corporate Responsibility: Private Initiatives and Public Goals*<sup>3</sup> (OECD 2001a).

This paper provides new data about company practices of relevance to this important issue. Its aim is primarily “fact finding” -- that is, it seeks to clarify how important certain practices are among a given set of businesses. In particular, it seeks to answer the following questions:

- What percentage of the companies in the EIRIS sample have policy statements (or codes) giving guidance to their suppliers on how they would like labour conditions to be managed?
- What issues are covered in these statements (child labour, forced labour, working hours, etc.)?
- How many companies have sourcing systems designed to influence outcomes in this area and what management tools are used in these systems (communication with suppliers or procurement teams, senior executive responsibility, remediation, whistleblowing)?
- Do companies report on their systems and performance?
- How do these findings compare with an earlier study of environmental management practices (recognising that the issues, context and control problems are quite different between the two areas of corporate responsibility)?

## **II. The data and the companies**

The data reported here is based on aggregations of EIRIS’ firm level data on working conditions in “global sourcing systems<sup>4</sup>”. The data was collected in late 2001 and covers 147 firms. Some background about the EIRIS methodology is provided in the Annex. It is summarised below.

- *Sources.* The data comes from publicly available sources (primarily company annual reports, web sites and membership lists for relevant business initiatives.) and from the Global Sourcing Standards survey sent to all companies with global supply chains operating in sectors that EIRIS has identified as being “of concern” for this issue.
- *Publicly quoted companies.* The businesses are all publicly quoted companies contained in the Financial Times Stock Exchange All-world developed index.<sup>5</sup>

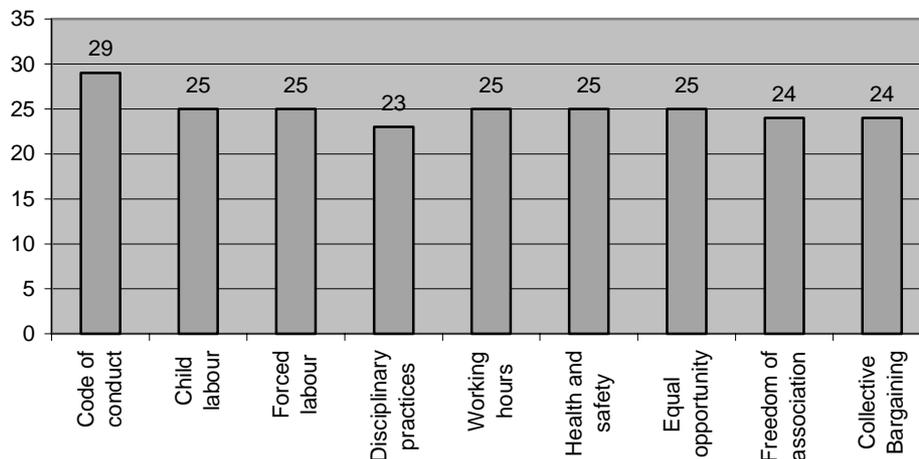
- *Sectors "of concern" and global operations.* The companies in this sample all have global supply chains and operations in sectors "of concern" in relation to working conditions. They are retailers (including general food, drugs, apparel and household goods); apparel manufacturers (clothing, textile, footwear), sports goods manufacturers, food producers and processors and tobacco. EIRIS notes that "clothes and sports goods manufacturers [in the EIRIS database]... have both highly visible operations and also typically a high degree of influence over their supplier companies, which are often wholly dependent on them for orders. Similarly, retailers and food producers and processors often source products from all around the world, and have a high degree of leverage over their suppliers due to their purchasing power."<sup>6</sup>
- *Selecting the sectors "of concern".* The sectors identified as being "of concern" were chosen by EIRIS for researching these issues because they are among the sectors that have the "greatest concentration of activities involving global supply chains and have been the subject of significant public concern in relation to working conditions." The choice of sectors has been largely dictated by the needs of EIRIS clients who are most interested in comparing companies operating in areas of greatest potential reputational risk. Hence, work in this area has to date typically concentrated on high profile "consumer-facing" areas, as these are the sectors which have been the focus of the most NGO campaigns and media interest. EIRIS plans to look at ways to expand coverage to include other key industries with relevant global supply chains."<sup>7</sup>
- *Countries.* EIRIS identifies home countries according to the location of the stock exchange on which the company has its primary listing. This sample of 147 companies is heavily weighted toward the United Kingdom (61 companies) and Japan (32 companies). Other countries whose companies appear in the sample are France (7 companies), Greece (7) and Australia (5), Canada (4) Belgium and Italy (3). Ten other countries have only one or two companies in the sample<sup>8</sup>. The United States was not included in this study because the EIRIS database on US companies is still being collated, as not all US companies will have received the same set of questions last year. Further survey data is expected to be compiled by EIRIS for all countries including the US later in 2002. The reason for the heavy bias toward UK companies seems to be the high propensity of UK companies involved in the sectors "of concern" to be listed within the FTSE All-World Developed Index.
- *Data attributes.* EIRIS divides its data on company sourcing practices into three categories -- sourcing policy, sourcing systems and reporting. Under sourcing policy it looks at commitment to core ILO conventions (child labour, forced-compulsory labour, equal opportunities, freedom of association); commitments to other ILO conventions. Under sourcing systems it looks at communication, auditing, monitoring of suppliers and subcontractors, remediation, whistleblowing, senior level accountability and incentives. Under reporting, it looks at the detail and content of company reports on their implementation of codes. EIRIS has closely monitored these developments including consulting with expert practitioners directly involved in assessing company supply chains in order to develop its criteria. The Annex summarises EIRIS' methodology.

### III. Basic findings on policies, systems and reporting

*Sourcing policies or codes.* Company's can express their expectations for labour practices in their supply chains by means of a policy or code. Of the 147 companies in the EIRIS database that operate in "sectors of concern", 29 -- or about 20% -- have a code of conduct on working conditions in their supply chains.

The commitments made in these codes are summarised in Figure 1. They show that 25 codes cover child labour, forced or compulsory labour, working hours, health and safety and equal opportunities. Commitments to freedom of association are made in 24 codes and 23 codes make commitments to collective bargaining.

**Figure 1. Working conditions in the supply chain -- content of policy statements**  
(number of companies mentioning an attribute or standard in their codes of conduct or policy statements; total sample is 147 companies)

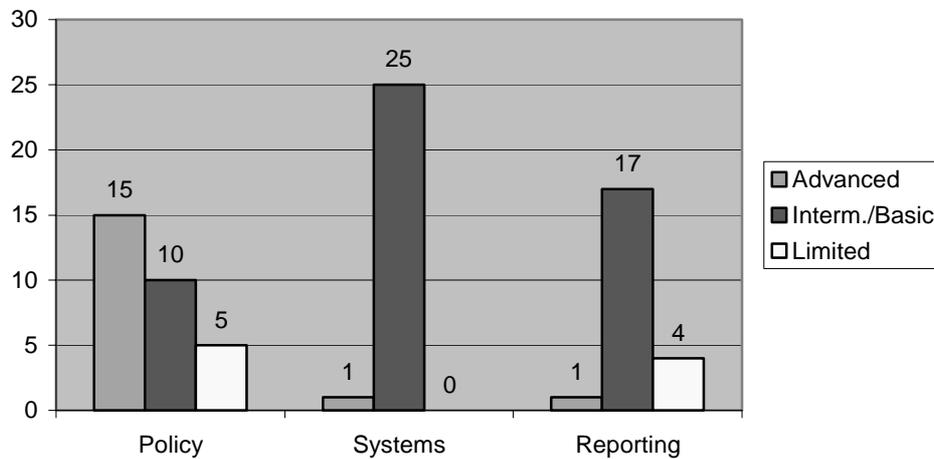


Source: OECD/EIRIS.

Only one of the 26 companies for which information on supplier systems is available is rated by EIRIS as having an advanced system (Figure 2). This means the company communicates its policy to factory managers and workers, engages in internal and external monitoring of suppliers, can demonstrate procedures for remedying non compliance with sourcing standards and has both incentives for compliance and clear senior executive responsibility on this issue. Most other companies -- 25 -- fall in EIRIS' "intermediate" or "basic" categories, which means they use some combination of communicating with factory managers and workers or monitoring (internal and external). Intermediate companies must also have remediation procedures and a senior level executive must be responsible .

*Reporting on supply chain systems and outcomes.* Again, only one of the companies in the sample has advanced reporting practices meaning that it provides detailed and independently verified reports on labour conditions in its supply chains. Seventeen companies produce "intermediate" level reports, a further four have "limited" reports. "Limited" means that the company does not completely ignore reporting on sourcing standards, but either it does not provide substantive details on labour conditions in its supply chain or it only indicates that it is planning or preparing such a report.

**Figure 2. Sourcing Systems and Reporting**  
*(Number of companies with sourcing systems and reports;  
 by qualitative level assigned by EIRIS)*



Source: OECD/EIRIS.

#### IV. Patterns of company behaviour

The above findings reveal a number of patterns:

*Labour management in the supply chain versus environmental management.* The companies included in this sample are all global, publicly listed companies operating in sectors designated by EIRIS as being “of concern” for working conditions in the supply chain. This use of sector of activity as a means of defining a sample is similar in spirit to the one it uses to define the sample of companies working in “high environmental impact” sectors. This group of companies was the focus of the OECDs 2001 study of environmental management practices. The data for these two sets of companies suggest that there are major differences in their propensities to engage in policy, management and reporting.

Compared with the study of environmental management, the current data set of labour management in the supply chain points to comparatively low propensities to engage in advanced practices among companies that EIRIS has identified as being in sectors of concern. The earlier study of the environmental management practices of companies in “high environmental impact” sectors produced an overall propensity among European companies -- with a rate of codes issuance of 75% -- that was more than three times as high. The propensity of HEI Japanese firms to adopt advanced environmental commitment, management and reporting practices was also very high (see OECD 2001a). In contrast, none of the current sample of Japanese firms issues supplier codes on working conditions. This comparison raises some interesting questions, but the data cannot answer them. The companies in the sourcing sample are all highly visible in their national environments and, indeed, many of their names are household words in their own countries. Many of them have made heavy investments in brands. They are all professionally managed and (compared with smaller, closely held companies operating in the same sector) probably have the resources required to manage their supply chains closely. The companies in the high environmental impact sample studied earlier were also large, well capitalised, professionally managed companies, but generally they had less brand exposure and consumer visibility than the companies in this sample.

Understanding the reasons for these differences would shed light on the differing incentives and obstacles companies face in different areas of corporate responsibility. These differences are, almost by definition, linked to different evaluations of the costs and benefits of such practices in environmental management versus labour management in the supply chain. This, in turn, is probably linked to the differing natures of the control problems posed in the two areas of corporate responsibility, to differences in the regulatory or legal environments, or to sectoral differences in the degree to which the benefits of such practices accrue to individual companies.

*Evidence of the emergence of a de facto standard of commitment?* Another notable finding is the similarity of the commitments made by the firms issuing supplier codes. Although the overall propensity to issue supplier codes is low, the companies with codes tend to refer to the same set of basic issues. The coverage of core labour standards is quite uniform among the companies issuing codes and the vast majority of these companies mention all of the core labour standards. This finding contrasts with the findings of an earlier study of apparel industry supplier codes -- based on data that is now about 3 years old -- that showed wide divergences in the commitments made in these codes. For example, less than half of that earlier set mentions freedom of association (Chapter 3, *Corporate Responsibility: Private Initiatives and Public Goals*, OECD 2001, Paris). This apparent shift in commitment practices across time could be pointing to the gradual emergence of a de facto standard of commitment in sectors where labour conditions in supply chains are a concern.

*National patterns.* The findings of an earlier study based on EIRIS's data on environmental management systems tended to undercut the view that corporate responsibility and associated management and reporting practices are an "Anglo-Saxon" phenomenon. The companies with the most advanced environmental management practices tended to be based in the northern rim of continental Europe -- the UK firms had only a mid-ranking propensity to engage in such practices. Likewise, the Japanese companies also showed a high rate of adoption of advanced environmental management practices.

This set of data on managing working conditions in the supply chain arguably revives the "Anglo-Saxon" hypothesis as the data suggests that UK companies are much more involved in this issue than their counterparts in other countries. Though fewer than half the UK companies engage in these practices, they still have much higher rates of adoption than companies from other countries. For example, none of the 32 Japanese companies in this sample has adopted any of these practices. For other countries the sample size is often very small, but the results are similar: none of the 7 Greek companies or of the 5 Australian companies have adopted any of these practices either. This suggests that, although these are global companies in some respects, home country factors can still tend to have an important influence on conduct in this particular area of corporate responsibility. It is important to note however that thinking and practice on social issues in supply chain management is much less developed than for corresponding environmental impacts where there are much better established international benchmarks such as ISO 14001 and EMAS. The picture may change therefore as more uniform social standards develop and more large global companies adopt common standards of reporting on these issues.

## **V. Summary of findings**

This fact-finding exercise provides information on corporate policies, management practices and reporting in relation to working conditions in supply chains for a sample of 147 public quoted, global companies. It suggests that such companies have comparatively little involvement in this area of management. Only 20% of them have formulated a policy for suppliers. However, among those companies that are active in this management area, the nature of the commitments made tend to be very similar. This differs from earlier findings, which showed wide divergences of commitment among branded apparel manufacturers for working conditions in their supply chains.

The study also shows that, at least in the particular sectors covered here -- retailing, clothes and sporting goods manufacturing and tobacco -- the behaviour of UK companies is quite different than others in the sample. UK companies -- which account for 61 of the 147 companies in the sample -- have a much higher propensity to formulate sourcing policies, to have sourcing systems and to report on these systems and their outcomes. However, most countries have few companies in the sample.

While the study raises some issues, it does not form a basis for explaining these findings. For example, the finding that companies with supplier policies now seem to agree on the issues that should be covered by those policies could point to the emergence of a de facto standard. Alternatively, it could be a reflection of the strong UK dominance in this particular sample of companies formulating such policies and to the role of initiatives (such as the government, union, NGO and business endorsed Ethical Trading Initiative) in harmonising UK companies approaches to these issues. EIRIS' write-up of its methodology suggests that this might be the case. It states that "Thanks to the emergence of organisations such as the Ethical Trading Initiative and of specialist organisations such as Social Accountability International and Account Ability who promote and audit quality assurance standards on supply chain working conditions, there is growing consensus about the elements that constitute a worthwhile code of conduct." Shedding light on the underlying forces that underpin these findings would require further investigation and contact with companies.

## Annex. Background and Methodology

### *Annex 1. Data sources and definition of sample<sup>9</sup>*

The sources of information on labour conditions in the supply chain are:

- Company annual reports and any relevant social or sustainability reports.
- Information revealed on company websites (checked at least once a year).
- Survey sent to all companies in sectors of high concern at least once every two years.
- Membership information received from appropriate multi-stakeholder programmes that are working on improving supply chain conditions.

EIRIS examines the activities of each company individually to determine whether or not it has significant operations in a sector of high concern and if so, if these involve global supply chains. Sectors of high concern are defined by EIRIS as follows: Retailers (including general, food, drugs, apparel, household goods, etc), Apparel manufacture (clothing, textile, footwear), Sports goods manufacture, Food producers and processors and Tobacco. These sectors have been identified because they have the greatest concentration of activities involving global supply chains, which have been the subject of significant public concern in relation to working conditions.

EIRIS includes all companies identified in these sectors as having operations in a sector of high concern *unless* it is made clear that the majority of the company's operations do not in practice involve global supply chains. (*E.g.* a company making a limited range of food products sourced from only one country.)

The survey on which the grading system is based was sent in autumn 2001 to all UK and European companies. EIRIS has also worked with partners to assess results for companies based in Japan, Hong Kong, Australia and Canada. A further survey is being sent out to all companies (including US companies) in summer 2002.

### *Annex 2. Policies*

Methodology on Policies: EIRIS examines evidence of company policies to assess if they promote minimum standards for their suppliers and sub-contractors. In particular, it notes if the company actively requires suppliers to uphold the minimum employment conditions promoted under 8 Key headings by the International Labour Organisation (ILO).

These relate to the following topics covered by the core conventions promoted by the ILO:

- **Child Labour** – Avoiding or eliminating Child Labour (ILO conventions 182 and 138).
- **Discrimination** -- Avoiding or eliminating Discrimination in respect of Employment and Occupation (ILO conventions 100 and 111).

- **Forced Labour** -- Avoiding or eliminating Forced or Compulsory Labour (ILO conventions 29 and 105).
- **Freedom of Association** – Supporting Freedom of Association and the Effective Recognition of the Rights to Collective Bargaining (ILO conventions 87 and 98).

In addition, EIRIS looks at 4 other key policy areas that are the subject of major ILO conventions:

- **Disciplinary procedures** -- to not condone or engage in mental and physical coercion, the threat of physical abuse, sexual or other harassment and verbal abuse as part of company's disciplinary procedures.
- **Health and safety** -- Taking all necessary steps to ensure all workers have a safe and healthy workplace and to avoid and eliminate potential health and safety hazards.
- **Working hours** -- complying with national laws on working hours, and in any event not on a regular basis requiring personnel to work in excess of 48 hours per week and to ensure that overtime is voluntary, not excessive and remunerated at a premium rate.
- **Living wage** -- to ensure that wages paid at least meet national legal or industry benchmark standards, whichever is higher, and in any event are sufficient to meet basic needs and provide reasonable discretionary income.

Where applicable, membership of a relevant multi-stakeholder initiative will be taken to imply commitment to particular ILO conventions. The main multi-stakeholder initiatives whose membership is monitored by EIRIS are the Ethical Trading Initiative, and Fair Labor Association.

What EIRIS measures:

No evidence	◆ No policy or little or no information available
Limited	◆ Company can only demonstrate commitment to three or less of the four core ILO conventions – or has indicated it has a policy in practice
Basic	◆ Company can demonstrate commitment to the four core ILO conventions
Intermediate	◆ Company can demonstrate commitment to the four core ILO conventions and at least two of the other key ILO conventions selected by EIRIS and communicates its policy to its suppliers
Advanced	◆ Company can demonstrate commitment to the four core ILO conventions and all the other key ILO conventions selected by EIRIS and can show that it communicates its policy to its suppliers and procurement teams

### **Annex 3. Sourcing Systems**

Thanks to the emergence of organisations such as the Ethical Trading Initiative and of specialist organisations such as Social Accountability International and Account Ability who promote and audit quality assurance standards on supply chain working conditions, there is growing consensus about the elements that constitute a worthwhile code of conduct. The focus here is very much on the ability of a company to effectively implement and monitor the standards upheld within its supply chains. Factors held to be of most significance are:

- Proper communication of the code to suppliers;
- Effective monitoring of the code (both internally and externally);
- Existence of procedures to remedy breaches of standards identified by the company, including the use of incentives to promote improved standards.

EIRIS’ data on sourcing systems attempts to answer the following questions: what is the extent of the company’s systems on global sourcing standards? EIRIS looks in particular at:

Procedures used to remedy non-compliance with sourcing standard policy can include

- Whistleblowing protection to enable and encourage employees to highlight cases.
- Contractual provision allowing company to issue warnings and vary or ultimately terminate contracts with suppliers who do not comply with labour standards requirements.
- Performance incentives for procurement teams or supplier factory managers.

The “Systems “ data in Figure 2 are based on the following “scores”:

No evidence	◆ No systems or little or no information available
Limited	◆ Company only has systems in development or says it has systems but few details available
Basic	◆ Company communicates policy to supplier factory managers/workers or indicates relevant monitoring of suppliers and sub-contractors
Intermediate	◆ Company communicates policy to supplier factory managers/workers or indicates relevant monitoring of suppliers and sub-contractors and can demonstrate some procedure to remedy non-compliance on sourcing standards by suppliers and sub-contractors and has clear senior level responsibility to champion the company’s policy on this issue
Advanced	◆ Company communicates policy to supplier factory managers/workers and indicates monitoring (both internal and external) of suppliers and sub-contractors and can demonstrate full and extensive procedure to remedy non-compliance on sourcing standards by suppliers and sub-contractors and has both incentives and clear senior level responsibility for this issue

#### ***Annex 4. Reporting***

The quality of working conditions in global supply chains is a high profile issue of concern to many investors and other users of corporate information.

Because many companies are yet to actively address some of these concerns, a helpful indicator of progress is the extent to which a company reports on its global sourcing standards.

The emergence of specialist organisations such as Social Accountability International and Account Ability who promote and audit quality assurance standards on supply chain working conditions, has helped generate consensus about the types of details that companies should be encouraged to report in relation to supply chain working conditions. This includes more than simply reporting on the basic standards required by the company, although this is a helpful first step.

In particular, it is considered very helpful for aspects of a company’s report dealing with supply chain conditions to be independently verified or to provide details of working conditions going beyond the fundamental employment rights highlighted by the core ILO conventions. (eg; providing details of wages paid and how the company benchmarks its conditions against similar companies in the same sector). By independent verification, EIRIS means confirmation by an independently recognised third party, such as a professional auditing firm or quality assurance/social auditor.

EIRIS’s reporting data in the outsourcing module attempts to answer the following question: What is the extent of reporting on global sourcing standards?

EIRIS looks at:

- Public reports on implementation of code of conduct;
- Details of remedies provided in cases of non-compliance with code;
- Details of the methods and proportion of facilities/ operations monitored;
- Independent verification of code of conduct report;
- Inclusion of extra details such as living wage assessment details in the report.

The “Reporting “ data in Figure 2 are based on the following “scores”:

No evidence	◆ No report or little information available
Limited	◆ Company does not report substantively on labour conditions in its supply chain or indicates that it is collating a report for publication.
Basic	◆ Company can demonstrate commitment to the four core ILO conventions
Intermediate	◆ Company reports substantively on labour conditions in supply chain including providing details of remedies for non-compliance and either has this report independently verified or provides some notable details.
Advanced	◆ Company reports meaningfully on labour conditions in supply chain and provides notable details of remedies for non-compliance and operation of its policies and procedures, including extra factors (such as providing comparative details of wages paid in its supply chain), which is also independently verified.

## Notes

1. OECD (2001) *OECD Guidelines for Multinational Enterprises: Annual Report 2001*. Paris. This interest was confirmed in subsequent consultations by business, trade union and NGO representatives with the OECD Committee on International Investment and Multinational Enterprises (CIME).
2. See [www.eiris.org](http://www.eiris.org).
3. OECD (2001) *Corporate Responsibility: Private Initiatives and Public Goals*. Paris.
4. See Guide to EIRIS Research. Global Sourcing Systems. Available on EIRIS website: [www.eiris.org](http://www.eiris.org).
5. Sometimes clients ask EIRIS to collect information about companies not appearing in the FTSE indices, but this is relatively rare.
6. Quote from Guide to EIRIS Research -- Global Sourcing Standards.
7. For example, companies in the telecommunications and electronics sectors often have substantial global supply chains, as do many manufacturers of automobiles and household goods. EIRIS is researching these sectors in consultation with partners to add to the range of ratings it provides for global sourcing standards.
8. Denmark, Ireland, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, Hong Kong.
9. More detail on EIRIS methodology can be found In EIRIS (2002) *Global Sourcing Standards*, London.