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Inquiry: The Establishing a Modern Slavery Act in Australia

26 April 2017

Ausbil Investment Management Limited ("Ausbil") welcomes the inquiry into establishing a Modern Slavery Act in Australia. As Ausbil's attached statement on slavery highlights, investment risks related to slavery include reputational risks and brand damage as well as general business risk. Ausbil therefore welcomes improved transparency on how companies are managing modern slavery risk in their supply chains and own operations.

We believe the UK Modern Slavery Act provides a useful base for equivalent legislation in Australia, for instance in terms of the definition of slavery, and in a similar fashion, we believe an Australian act should be authorised by the board and include an annual reporting requirement. Harmonising with the equivalent legislation in the UK, means limited disruption to companies currently covered by and reporting under the UK Modern Slavery Act.

We believe guidance notes, similar to the UK Modern Slavery Act, would be helpful, but we do not believe in an overly descriptive formula; we believe companies themselves are best placed to choose to report on what and how they tackle the issue of modern slavery in their operations and their supply chains. This is a similar approach taken by the ASX Corporate Governance Council's Corporate Governance Principles and Recommendations for disclosure on sustainability risks (Recommendation 7.4).

Please see attached Ausbil's statement on slavery for more information on Ausbil's position.

Yours Sincerely,

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Ausbil statement on Slavery

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Slavery and investment risks

Slavery, which encompasses forced labour, bonded labour, human trafficking and child slavery, remains a widespread global issue and a hidden risk in companies' supply chains. This means there is a risk to investors. At Ausbil Investment Management, we believe there is a strong business argument for companies to take an active role in tackling these issues.

What are the issues?

According to the International Labour Organisation (ILO), there are almost 21 million people that are victims of forced labour[i]. The victims are typically the most vulnerable people in society, such as migrants who are stuck in debt bondage, women or farm workers. The ILO estimates that approximately 26% of the victims are less than 18 years old. The Asia-Pacific region accounts for the largest number of forced labourers, while the ratio of victims per thousand inhabitants is highest in central and south-eastern Europe and Africa.

It is estimated that 18.7 million of these people are exploited in the private economy and 14.2 million are victims of forced labour exploitation in economic activities.

Some of the most concerning sectors include manufacturing (e.g. electronics), agriculture (e.g. cotton, palm oil, coffee, cocoa and sugar), fisheries, the garment industry, cleaning, mining (so-called 'conflict minerals') and construction. As a result of supply chains becoming increasingly global and complex, there is a big risk that goods sold in Australia may have links to slavery.

According to research done by the Ashridge Centre for Business and Sustainability at Hult International Business School and the Ethical Trading Initiative (ETI) in late 2015, 71% of companies surveyed in the UK believe there is a likelihood of modern slavery happening at some point within their supply chain[ii].

Why is slavery an important issue for investors?

The investment risks related to slavery include reputational risks and brand damage, but also regulatory changes and general business risk.

Brands are key assets and slavery issues in a company's supply chain can cause brand damage, which in turn could lead to the loss of sales or impact a company's ability to win new business. Independent brand valuations indicate that the brands themselves can be equivalent to a significant proportion of a company's total market capitalisation.

Brands can be vulnerable to reputational issues and it can be very costly and time-consuming to restore that value once the initial damage has been done. This brand damage can stem from not only a company's direct suppliers but also further down in the supply chain. In addition to the impact on a company's external reputation, exploitation of people in the supply chain might also impact a company's staff engagement and its ability to attract talent.

Source: www.ilo.org

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Slavery is a complex transnational, as well as international problem, and globally there are various conventions and protocols against it. This includes the Forced Labour Convention, which was supplemented by the Abolition of Forced Labour Convention, the UN Global Initiative to Fight Human Trafficking, the Universal Declaration of Human Rights and more. In recent years there has been increased international regulatory focus on supply chain transparency and there is also specific regulation on the issue of slavery, such as the UK Modern Slavery Act, the Californian Transparency in Supply Chain Acts, the Dodd-Frank Act and more. In the UK, the Modern Slavery Act was followed by the Transparency in Supply Chain Provisions, which requires companies over a certain turnover threshold to publish annual statements confirming steps have been taken to ensure slavery and human trafficking are not taking place in their business or supply chain. There will likely be more regulations in the future.

Human rights and labour rights issues in the supply chain can also have direct impacts on the business. Leading thinking on ethical sourcing demonstrates some positive links between ethical sourcing efforts on the one hand and fewer product quality issues, shorter lead times and better productivity and/or lower costs on the other. Poor ethical sourcing practices can also result in significant supply chain and business disruption as well as being a distraction to a company's management and board.

While there are strong links between human rights and business performance, one of the greatest barriers to change is that slavery itself is very profitable. The ILO estimates that the annual profits of forced labour amounted to US$51.8 billion in the Asia Pacific alone. As a result, while buying patterns of companies can influence suppliers to improve working conditions, there is no incentive for those who profit from forced labour to improve.

What can companies do?

Modern slavery needs to be tackled with regulation and law enforcement. Some companies are actively lobbying governments to make improvements, but there are many other things they can do too.

Vertical integration in supply chains is rare and often exists in small pockets only. At the core of the problem of modern day slavery is the lack of visibility over what may often be very complex and global supply chains. One such example is cotton from Uzbekistan, which is a country that has historically had major issues of forced labour, including children. The cotton is often exported to China and Bangladesh, for example, and used in garment production. While many companies have pledged not to use cotton from Uzbekistan as long as forced labour remains an issue (e.g. the Responsible Sourcing Network's Cotton Pledge) and some have attempted supply chain traceability programs, lack of transparency along the supply chain can be a major issue. Cotton fibres are often mixed in the early stages of the supply chain and by the time the cotton has been made into garments it is very difficult for a brand company to track the origin of the cotton. However, many brand companies' codes of conduct are also applicable to players beyond their immediate suppliers. For instance, some relate to spinners and mills. Some brand companies have responded by having spinners do self-assessments and some are auditing the spinners themselves.

We believe one of the key approaches to tackling issues deep in the supply chain is the ability to influence direct suppliers. Some factory owners that we have spoken to highlight the issue of a lack of loyalty among their buyers. We believe brand companies that are overly transactional might have little influence over a factory's ethical sourcing standards. This, combined with increased price pressure, can lead to issues further down

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the supply chain too. In particular, we believe they run the risk of their suppliers sub-contracting orders to others in the supply chain where the brand company has little or no oversight at all. As a rule of thumb, the longer the supply chains, the less control and visibility and the more likely that someone in that chain will not receive a proper payment. The risk of sub-contracting can also be linked to last minute orders or late changes requiring fast turnaround times.

To tackle the issue and to have more leverage and influence further back in the supply chain, we believe companies first need to establish strong relationships with their first tier suppliers. The key word for that is trust and that can take time to build. Historically, many brand companies have relied on external third party auditors to audit supplying factories. However, such audits may not be done frequently and they might be limited in scope, particularly in terms of issues further down in the supply chain. In our view, audits might identify issues but not necessarily the underlying reasons for those issues, nor suggest how to solve them. In contrast, leaders on ethical sourcing have typically established a sourcing team on the ground that has regular contact with the suppliers. They also reward improving suppliers with more business. Another important element is the use of whistle-blowing policies and hotlines where workers can report issues without fear of reprisal.

At the time of the Rana Plaza tragedy in Bangladesh in 2013, where over 1,100 garment workers died from a factory collapse, we identified that many brand companies were spread across a large number of suppliers where each one represented a small percentage of the total volume, thus giving them limited influence over their suppliers and limited visibility over their complex supply chains. On a positive note, many brand companies have consolidated their supply chains since then by sourcing more from fewer suppliers. Also, in our view the Rana Plaza building collapse acted as a catalyst for increased senior management attention on ethical sourcing issues.

Following our conversations with factory owners in South-East Asia which produce for Australian brand companies, one common hurdle for building trust is that many companies' ethical sourcing managers and procurement professionals place conflicting demands on their suppliers. Importantly, ethical sourcing needs to be integrated in to the way that a company operates and companies need to be aligned in terms of strategy, policies and KPIs throughout the organisation. To that end, we believe that when management takes a strong stance on ethical sourcing and modern day slavery, it can have a major impact. Slavery is a profitable business and those responsible for it typically do what they can to conceal it, which means companies need to think beyond traditional approaches based on annual factory audits. Collaboration between brand companies has historically been a major barrier to improvement. But this has improved in recent years with various retailer-driven collaborative ethical sourcing initiatives and, more importantly, multi-stakeholder initiatives including unions and NGOs. This is an important step given that many issues are deep in the supply chains where brand companies often have very little direct influence or visibility.

Historically, transparency has also been poor. However, one positive development in recent years has been the improved transparency on factory names and location, which allows for more collaboration with NGOs. We believe this collaboration can lead to positive social outcomes as well as better business practices and it reduces the risk of unexpected reputational brand damage.

Summary

Modern slavery is a complex issue with no magic silver bullet of an answer. The key barrier is that slavery is a profitable trade and can be concealed in complex global supply chains with poor visibility, which means the risk is high, even for companies with the right intentions. However, as investors, we believe companies have a vested interest in attempting to tackle the issue. Companies still differ widely in their approaches, but leaders are moving away from traditional models focused on factory audits to an increased focus on building relationships with suppliers and they are also increasingly focused on transparency and collaboration with their peers and other stakeholders.

References

i http://www.ilo.org/global/topics/forced-labour/lang--en/index.htm

ii https://www.ashridge.org.uk/faculty-research/research/current-research/research-projects/corporate-approaches-to-addressing-modern-slavery/

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