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**Suppliers' Compliance with MNCs' Codes of Conduct:**  
Behind the Scenes at Chinese Toy Suppliers

**Niklas Egels-Zandén**

Centre for Business in Society  
School of Business, Economics and Law at Göteborg University  
Box 600  
SE – 405 30 Göteborg, Sweden  
[Niklas.Egels-Zanden@handels.gu.se](mailto:Niklas.Egels-Zanden@handels.gu.se)  
+46-31-7732729 (telephone)

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# **Suppliers' Compliance with MNCs' Codes of Conduct:**

## **Behind the Scenes at Chinese Toy Suppliers**

### **Abstract**

Despite increased academic and practitioner interest in codes of conduct, there has been little research into the actual compliance of suppliers in developing countries with the codes of conduct of multinational corporations (MNCs). This paper addresses this lack by analysing Chinese suppliers' level of compliance with Swedish toy retailers' codes of conduct. Based on unannounced and unofficial interviews with employees of Chinese suppliers, the study shows that all of the nine studied suppliers breached some of the standards in the toy retailers' codes, with over two thirds of the suppliers not complying with the majority of the studied standards. While there are different explanations of this lack of compliance, the main explanation seems to be that Chinese suppliers successfully deceive toy retailers' monitoring organisations by decoupling the formal monitored part of their organisation from the actual operational part of their organisation. The paper concludes with a discussion of how to increase compliance with MNCs' codes of conduct.

*Key words:* China; codes of conduct; corporate social responsibility; labour practice; multinational corporations; supplier relations; toy industry

## **Introduction**

During the 1990s, multinational corporations (MNCs) started to acknowledge a responsibility for working conditions at their suppliers' factories in developing countries, and codes of conduct emerged as the dominant way for MNCs to operationalise this extended sense of responsibility (Emmelhainz and Adams, 1999; Kolk and van Tulder, 2002b; Sethi, 2002; Radin, 2004; Egels-Zandén and Hyllman, 2007). A growing number of MNCs are now adopting such codes (Sethi, 1999; Cowton and Thompson, 2000; Somers, 2001), and increased outsourcing and globalisation will likely further increase the corporate focus on codes of conduct (Frenkel and Kim, 2004).

Parallel to increased corporate adoption of codes of conduct, academic interest in these codes has grown. However, despite a growing body of research, little is known about the implementation of codes of conduct at MNCs' suppliers' factories in developing countries. Still unanswered is the central empirical question of whether or not suppliers are actually complying with the standards specified in the codes. Answering this question is important, since it would provide an indication of how effective MNCs' codes of conduct are in achieving the envisioned alterations of working conditions at suppliers' factories. In turn, such an indication of code effectiveness is central for critically evaluating their prescribed role as the dominant way of operationalising MNCs' extended responsibility for working conditions at suppliers' factories.

It is reasonable to assume that extensive alterations of operations are needed for most suppliers in developing countries to comply with MNCs' codes, since conditions in suppliers' factories, for example, in China (the focus of this paper) have been described as poor compared to the standards set forth in most MNCs' codes of conduct (cf. Chan and Senser, 1997; Chan, 1998, 2000; Lee, 1998, 1999). High compliance with MNCs' codes would, hence, indicate that the current system of codes and monitoring effectively promotes the alteration of supplier operations. On the other hand, low compliance with MNCs' codes would indicate that such codes, despite their current dominance as a way for MNCs to operationalise responsibility for working conditions at suppliers' factories, are ineffective.

This paper contributes to our understanding of the effectiveness of MNCs' codes of conduct by describing the extent to which suppliers comply with the standards specified in them and discussing possible explanations of suppliers' current level of compliance or lack thereof. This is done in the context of Swedish toy retailers and their suppliers in the Chinese province of Guangdong. The analysis shows that the studied suppliers exhibited low compliance with the retailers' codes of conduct, indicating that codes in their current form are seemingly ineffective in altering suppliers' operations. The paper concludes by discussing how to increase compliance with MNCs' codes of conduct.

## **Previous research into codes of conduct**

Along with growing corporate interest in codes of conduct, academic interest in such codes has increased as well. One existing stream of research examines the extent to which codes of conduct have been adopted in specific countries and industries. American and Canadian MNCs are the most likely to adopt such codes, with over three quarters of the largest of these

firms having a written code of conduct (White and Montgomery, 1980; Schlegelmilch and Houston, 1989; Nijhof et al., 2003). In other countries, such as Spain and Australia, approximately half of the firms have adopted codes (Guillén et al., 2002; Nijhof et al., 2003). Among the industries with the earliest and broadest adoption of codes for their suppliers' operations are the garment, footwear, and toy industries (Cottrill, 1996; Connor, 1999, 2004; Emmelhainz and Adams, 1999; Roberts, 2003; Kaufman et al., 2004).

A second stream of research examines the content of the codes of conduct, doing this from both a *normative* perspective analysing what codes ought to include (e.g. Murphy, 1995; Sethi and Williams, 2000; Schwartz, 2002; Sethi, 2002), and from a *descriptive* perspective analysing what different types of codes actually include (e.g. Montoya and Richard, 1994; Emmelhainz and Adams, 1999; Kathryn and Miyake, 2001; van Tulder and Kolk, 2001; Kolk and van Tulder, 2002a, 2002b; Carasco and Singh, 2003; Kaptein, 2004). Additional research streams include analyses of drivers of corporate adoption of codes (e.g. Weaver, 1993; Diller, 1999; van Tulder and Kolk, 2001; Roberts, 2003; Bondy et al., 2004), and analyses of changes induced by the adoption of codes (e.g. Cassell et al., 1997; Cowton and Thompson, 2000; Somers, 2001; Healy and Iles, 2002). Research concerning the changes induced by codes, i.e. the effectiveness of codes, has mainly been conducted in US and European settings and in the context of firms' 'own' codes, compared to, for example, suppliers implementing a buying firm's code (e.g. Cassell et al., 1997; Cowton and Thompson, 2000; Somers, 2001; Healy and Iles, 2002).

Despite this growing academic interest in codes of conduct, research into the *level of compliance* with MNCs' codes by suppliers in developing countries is scant. This lack of research is likely due to problems accessing *primary* data concerning suppliers' compliance with codes – what limited research there is has primarily relied on secondary information provided by the organisations monitoring the codes (e.g. Murphy and Mathew, 2001; Graafland, 2002; Sethi, 2002; Winstanley et al., 2002). Frenkel (2001), Frenkel and Scott (2002), Frenkel and Kim (2004), and O'Rourke and Brown (1999) – the most notable exceptions to this use of secondary data – rely on primary data collected mainly via announced, official interviews with suppliers' employees and managers. While reliance on such primary data is preferable to reliance on secondary data, both approaches used in previous compliance research are problematic, since, as will be shown in this paper and has been argued elsewhere (cf. O'Rourke, 1997; Hemphill, 2004), it is difficult to gather accurate information concerning working conditions during official, announced interviews. By gathering primary data via unannounced, unofficial interviews with employees when they are outside suppliers' factories, this paper makes important contributions to existing research into codes of conduct, in terms of uncovering suppliers' current compliance with MNCs' codes and outlining a research methodology that could prove fruitful in future research into codes of conduct.

### **Codes of conduct among Swedish toy retailers**

In 2003, the European toy industry had a turnover of over €18.000 billion (at retail prices), representing a 5% increase over 2002. A high percentage of the products sold were imported from outside Europe; Asia was the leading supplier with 88% of the imports, and China alone provided 75% of the Asian imports in 2003 (compared to 62% in 2002).<sup>1</sup> In China, toy suppliers, like, for example, garment and footwear suppliers (Frenkel, 2001), are mainly

located in three free-trade zones in the Guangdong province in Southern China. This province is not only a large toy exporter to the European market; in fact, a total of 70% of the world's toys are estimated to be produced in this region (Schrage, 2004).

The Swedish toy market greatly resembles the overall European market in that the majority of its imports come from the Chinese Guangdong province. Toy imports to Sweden from this region have also more than doubled in the last eight years.<sup>2</sup> The market leader with a 35% share of the Swedish toy market is Top Toy, which operates the American outlet Toys R Us in the Nordic countries. Other companies with large shares of the toy market are Barnens Hus, Leklust, Lekia, BrioPartner, and Coop.

During the 1990s, several Swedish and international toy retailers started to adopt codes of conduct regarding working conditions at their suppliers' production facilities. In 1995, the international industrial organisation, the International Council of Toy Industries (ICTI), adopted the 'ICTI Code of Business Practice' to apply to the international toy industry. This code has since been adopted by the Swedish toy industry organisation. However, a review of Swedish toy retailers in 2003 showed that several companies had not adopted either the ICTI, or a similar, code (Göthberg, 2003). In particular, smaller firms and firms that did not directly import toys (such as Barnens Hus, Leklust, and Lekia) had not adopted codes of conduct (some, however, forbade the use of child labour). On the other hand, the larger firms which directly imported toys (in particular Top Toy, BrioPartner, and Coop) adopted codes of conduct and developed systems for monitoring suppliers in the mid 1990s. Top Toy adopted its code of conduct and monitoring system (including unannounced visits) in 1999, BrioPartner in 1995, and Coop in 1998. The firms' codes include standards governing, for example, working hours, minimum working age, pay structure (i.e. minimum wage and overtime pay), and use of forced or involuntary labour. Additionally, the firms commit to follow local laws regarding matters not regulated in the codes. It is worth noting that none of the firms have any policies regarding the matter of freedom of association in China (cf. Frenkel, 2001; Wang, 2005).

A comparison between the codes of conduct and monitoring practices of these three, in terms of codes of conduct proactive, Swedish retailers (Top Toy, BrioPartner, and Coop) and proactive international toy retailers reveals that all these codes are very similar (cf. Sethi, 2002). This similarity is likely related to the fact that most toy retailers have based their codes on the ICTI Code of Business Practice. The codes and monitoring practices of the Swedish toy retailers are also similar to those of proactive Swedish retailers in related industries, such as the garment and footwear industries (cf. Åhlström and Egels-Zandén, 2006; Egels-Zandén and Hyllman, 2006), as well as to those of proactive international retailers in related industries (cf. Frenkel, 2001; van Tulder and Kolk, 2001; Murphy and Mathew, 2001; Graafland, 2002; Winstanley et al., 2002). While the Swedish toy retailers' codes of conduct are generally similar to those of international retailers, this is particularly so in the Chinese context. After the passing of China's new strict labour law in 1994, the central content of retailers' codes of conduct came to be based on Chinese regulations. Hence, Swedish, and international retailers have imposed few demands (at least in relation to the criteria analysed in this paper) on their suppliers in addition to compliance with the new Chinese labour law.

As well as having similar codes of conduct and monitoring practices, Swedish and international toy retailers also use the same suppliers in Guangdong province. This is illustrated in the conducted study in that several of the examined suppliers in addition to supplying products to Swedish retailers also supplied products to international buyers such as Mattel, Walt Disney, Wal-Mart, Toyman, Playbox, Alrico, Eber Toys, and Ahold. Given the similarities in their codes of conduct and suppliers, Swedish toy retailers can be regarded as comparable to international toy retailers, as well as to Swedish and international retailers in related industries.

## Method

The empirical study reported in this paper uses what Flyvbjerg (2001) refers to as a ‘critical case’ approach. In this approach, one selects as favourable a setting as possible for examining a certain phenomenon – in this case, Chinese suppliers’ compliance with MNC codes of conduct. The strength of the critical case approach is that *if* it is shown that suppliers in the favourable setting are *not* in compliance with MNC codes of conduct, it is reasonable to assume that suppliers operating in less favourable settings are not in compliance either (cf. Yin, 2003). Hence, a critical case approach provides a way to generalise from a single, or a few, case(s), through logical deduction based on a rationale closely linked to Karl Popper’s notion of falsification (Flyvbjerg, 2001). Of course, this also implies that a critical case approach does not allow for generalisations if suppliers in the favourable setting *are* in compliance with MNC codes of conduct, since this provides little information regarding suppliers in less favourable settings.

The first step in identifying suitable critical cases for examination in the conducted study was to identify MNCs that were proactive in terms of their codes of conduct. The focus on Swedish toy retailers was chosen because they were, together with garment and footwear retailers, among the first corporations to adopt codes of conduct for their suppliers’ operations, and have consequently worked with their suppliers for a long time to ensure compliance with the codes. To select Chinese toy suppliers and obtain their addresses, the three largest Swedish toy retailers with codes of conduct and monitoring systems, namely, Top Toy, BrioPartner, and Coop, were contacted. The firms were selected based on Göthberg’s (2003) previous evaluation of Swedish toy retailers, which indicated them to be the most proactive regarding codes of conduct. The three firms have a combined market share of approximately 50% of the Swedish market.<sup>3</sup> The firms were informed of the purpose of the study, i.e. to study supplier compliance with their codes, and asked to provide addresses of some of their Chinese suppliers. All firms agreed to this, and each provided a short list of three to six suppliers (all in Guangdong province) that they claimed as among their best in terms of compliance with the codes. Three suppliers from each of the retailers’ lists were chosen, as the intention was to examine the same number of suppliers for each retailer. These nine selected suppliers were thus defined as the ‘best’ in terms of compliance with the codes of conduct of the most proactive MNCs in one of the most proactive industries (‘proactive’ at least in relation to codes of conduct). Consequently, the suppliers can be classified as ‘critical cases’ regarding compliance with MNC codes of conduct. Table 1 summarises the characteristics of the nine suppliers examined in the study.

| Supplier | Buyers                         | Examples of additional buyers <sup>4</sup> | No. employees |
|----------|--------------------------------|--|---------------|
| A        | Top Toy, Coop, and BrioPartner | Toyman, Playbox, Alrico, and Eber Toys     | 750           |
| B        | Top Toy, Coop, and BrioPartner |  | 2500          |
| C        | Top Toy and Coop               | ICA  | 8000          |
| D        | Top Toy and BrioPartner        |  | 3000–5000     |
| E        | Top Toy and BrioPartner        | Walt Disney and Wal-Mart                   | 2000          |
| F        | Coop                           |  | 3000–5000     |
| G        | Coop                           | Mattel, Walt Disney, and Wal-Mart          | 2000–3000     |
| H        | Coop                           |  | 3000–6000     |
| I        | Top Toy                        | Walt Disney, ICA, and Wal-Mart             | 600–700       |

*Table 1 – Characteristics of examined suppliers*

Each of the nine suppliers' compliance was examined based on nine criteria included in all of the firms' codes of conduct and in the new Chinese labour law (cf. Warner, 1996; Chan, 1998; Ding and Warner, 1999):

- 1) Working hours (maximum of 40 hours base work per week, maximum of 3 hours overtime per day, and maximum of 36 hours overtime per month)
- 2) Working days per week (maximum of 6 working days per week)
- 3) Guaranteed minimum wage (approximately €40 per month)
- 4) Overtime compensation (50% extra on weekdays and 100% extra on weekends)
- 5) Health and safety education
- 6) Physical examinations (once per year)
- 7) Child labour (minimum working age of 16)
- 8) Copy of employment contract
- 9) Accident and pension insurance

Information concerning the suppliers' operations was gathered from interviews with the employees. In total, 108 employees were interviewed in the spring of 2004 (10–15 interviews per supplier) for an average of 20 minutes each. The interviews were conducted unannounced and unofficially outside the suppliers' factories at lunch and dinner time, and the employees were guaranteed anonymity. In previous research it has been suggested that such an interview



setting yields the most reliable answers regarding working conditions in developing countries (O'Rourke, 1997; Hemphill, 2004). The selection of interviewees was guided by the intention to interview as heterogeneous a sample of employees as possible in terms of differences in factory department, sex, age, and place of origin. Hence, the focus in selecting employees was on breadth of experience (cf. Kvale, 1996; Bryman, 2004). Since most employees in low-skill industries in Guangdong province are 18–25-year-old female migrant workers (cf. Frenkel, 2001), this category of employees still dominated, though not as much as would have been the case if representative sampling had been done. Of the approached employees, about half agreed to be interviewed, and there were no evident differences (in terms of the aspects mentioned above) between those who agreed to be interviewed and those who declined. The interviews were focused on allowing employees to talk about each of the nine studied criteria as concretely as possible. Additionally, employees were asked to describe how the supplier acted when being externally monitored regarding compliance to MNCs' codes of conduct. Attempts were initially made to record the interviews, but employees were resistant to this. Instead, the interviewers took extensive notes during the interviews and documented the results afterwards.

There were seldom any difficulties obtaining seemingly reliable answers to the interview questions, and there was little variance between different employees' answers at the same supplier. For the supplier to be categorised as non-compliant with the MNC codes of conduct, at least two employees had to identify non-compliance with code criteria, and no other interviewed employee of the same supplier could provide evidence of compliance. If only a certain department in a supplier's factory was non-compliant, the supplier was categorised as non-compliant, since MNC codes of conduct specify the standards for *all* of a suppliers' employees and departments. However, in nearly all cases, nearly all employees of the same supplier provided similar answers regarding both compliance and non-compliance, despite representing multiple departments. Given this, there were rarely any difficulties in categorising suppliers as compliant or non-compliant according to each of the examined criteria.

Given the difficulties foreigners face in conducting unannounced and unofficial interviews with employees at factories in China, two former Chinese factory workers currently associated with an NGO, the Hong Kong Christian Industrial Committee (HKCIC), were commissioned to conduct the interviews. HKCIC was chosen for its extensive experience in conducting such interviews in the toy and related industries in the Guangdong province (AMRC, 1996, 1997; HKCIC and AMRC, 1997; HKCIC and CAFOD, 1999; HKCIC, 2000a, 2000b, 2000c, 2001, 2002; HKCSPT, 2003). The results from their previous studies are frequently cited in academic research to support factual claims regarding working conditions at suppliers' factories in China (e.g. Chan, 1998; Snyder, 1999; Tracy, 1999; Langer, 2004). In the process of contacting, communicating with, and commissioning HKCIC to conduct the interviews, the Swedish NGO SwedWatch played an active and important role.<sup>5</sup> SwedWatch was also in active communication with the Swedish toy retailers for the duration of the study, and has previously published a report based on the conducted study (Bjurling, 2004). This type of research collaboration with NGOs has previously been said to be fruitful when studying sensitive issues related to corporations in developing countries (Pegg and Wilson, 2003).

Besides the fact that HKCIC as an organisation has extensive experience in this type of interview studies, the two HKCIC interviewers involved in this study were employed for several years as production workers and managers in supplier factories in the Guangdong province. The interviewers have also worked for several years as interviewers for HKCIC in the Guangdong province. While interviewer effects stemming from the personal characteristics of the interviewers can be expected to be low, thanks to their nationality, educational background, professional background, gender, and social class (Dohrenwend et al., 1968; Campbell, 1981; Davis, 1997; Kim, 1997), there are potentially other interviewer effects stemming from the use of non-academic interviewers with a clear political agenda, effects that might lower the credibility of the empirical data (cf. Pegg and Wilson, 2003). The interviewers might, for example, influence the employees to answer in a way that the interviewers perceive desirable for future NGO campaigns (Kvale, 1996).

To minimise these potential effects, it was decided that HKCIC should not themselves publish any of the study's results. Furthermore, several measurements were taken to ensure that reliable data were obtained in the interviews. The interviewers commenced each interview by providing a short standardised description of the study to each interviewee, explaining the purpose of the study (i.e. to describe factory working conditions), their organisational affiliation (no interviewees had previously heard of HKCIC), and that study results would not be used by toy retailers to end contracts with the supplier (cf. Kvale, 1996).<sup>6</sup> The interviewers then followed a predefined interview guide (see Appendix) containing short, specific, non-leading and, as often as possible, open-ended questions about the factual situation at the factories (cf. Kvale, 1996; Bryman, 2004). While the core, and some follow-up, questions were predefined, the interviewers had the freedom to phrase additional follow-up questions and vary the order of the questions. The purpose of the follow-up questions was to obtain more specific answers to the predefined core questions. Combined with the fact that interviewer effects are less likely in factual, as compared to attitude, questions (Boyd and Westfall, 1965; Frenkel and Scott, 2002; Davis and Silver, 2003), I believe that these measurements yielded highly credible interview data regarding the situation at suppliers' factories as seen from the employees' perspective.

Since only 10–15 employees were interviewed at each supplier factory, the description of each factory's compliance with the retailers' codes of conduct is tentative and likely incomplete (cf. Frenkel, 2001). Therefore, it is difficult to make credible comparisons between the different suppliers in attempting to explain differing levels of compliance with the codes. Rather, the empirical data has been analysed in the aggregate, to indicate the overall level of compliance with retailers' codes of conduct, and no attempt has been made to explain differences between suppliers.

To help interpret the empirical data, 15 additional semi-structured interviews were conducted in 2004 with purchasing and CSR managers of Swedish toy and garment retailers,<sup>7</sup> and 10 semi-structured interviews were conducted with managers of Chinese toy suppliers in the Guangdong province.<sup>8</sup> Each interview lasted an average of one and a half hours and was focused on understanding how toy retailers work with codes of conduct in their daily operations, and how managers at Chinese suppliers perceive codes of conduct.

## Chinese suppliers' compliance with codes of conduct

### Working hours and Working days per week

Top Toy's, BrioPartner's, and Coop's codes of conduct stipulate that a regular working day should consist of 8 working hours and a maximum of 3 overtime hours. Hence, in total the maximum allowed number of *working hours* per day is 11 hours. Additionally, employees' total overtime must not exceed 36 hours per month, and employees are not allowed to work more than 6 *days per week*. The conducted interviews reveal that breaches of these standards are most common during the high season (May–October), when suppliers are producing toys for the European and US Christmas shopping season.

Of the nine studied suppliers, seven did not comply with the maximum allowed number of working hours per day, none complied with the maximum allowed amount of overtime per month, and seven did not comply with the maximum allowed number of working days per week. Hence, none of the suppliers complied with all the working hour requirements specified in the codes, and seven of the nine suppliers breached the working day requirement. While two suppliers allowed employees one day off per week, even during the high season, employees at three other suppliers worked seven days a week during the entire high season. The other four suppliers occupied a middle position, with employees occasionally having one or two days off per month. In terms of working hours, employees at three suppliers worked up to 13–14 hours per day, while employees at two other suppliers were the only ones not working more than 11 hours per day. In terms of overtime, all suppliers extensively exceeded the maximum allowed amount of overtime defined in the codes. Employees at several suppliers worked 3–6 hours overtime per day, seven days a week during the high season, leading to working weeks of 80–100 hours for 3–6 months of the year.

### Minimum wage and Overtime compensation

The toy retailers' codes of conduct prescribe that all employees are entitled to a *minimum wage* of approximately €40 per month. The codes also prescribe that *overtime compensation* should be at least 150% of the salary on weekdays and 200% on weekends. The results of the conducted study suggest that breaches of these standards are particularly common during the high season (May–October). While the high season is problematic in terms of overtime compensation, the lower production levels during the low season (November–April) seem to make suppliers inclined to decrease compensation level below the minimum wage during these months.

A majority of the studied suppliers (five out of nine) did not pay employees the guaranteed minimum wage prescribed in the codes of conduct. Employees' salaries at two suppliers were as low as €15–20 during the low season, i.e. less than half the required minimum wage. Among those suppliers that did pay the minimum wage, employees' salaries ranged from €45–55 to €75–80 (in the high season). Furthermore, a majority of the suppliers (five out of nine) did not comply with the compensation standards regarding overtime. Three suppliers provided no additional compensation for overtime, while two provided too little compensation, by, for example, only paying 150% of the salary on weekends and by not paying overtime compensation for the ninth working hour of the day.

### **Health and safety education and Physical examination**

The retailers' codes of conduct prescribe that employees should have *physical examinations* at least once a year. Additionally, the codes prescribe that employees have the right to *health and safety education* to avoid work-related accidents. Among the nine examined suppliers, only one provided health and safety education according to the codes. At this supplier, new employees were required to attend a three-day health and safety course. Four other suppliers offered fire-safety education, while four suppliers offered no health or safety education for the employees. Regarding health examinations, four suppliers provided physical examinations regularly (some also offered hearing examinations). However, at one of these suppliers the employees had to finance these examinations themselves. The other five examined suppliers did not offer any type of physical examination for either new or existing employees.

### **Child labour, Employment contract, and Insurance**

In addition to the six above discussed criteria, the suppliers were studied in regards to *child labour, employee contracts, and pension and accident insurance*. The toy retailers' codes of conduct stipulate that no person under 16 years of age is allowed to be employed in the factories. Of the nine suppliers, all but one complied with this standard. Additionally one supplier had supposedly previously used child labour, but after being discovered during a monitoring of the factory, seemed to have stopped the practice.

Concerning the provision of employment contracts and copies of contracts, the codes prescribe that employees are entitled to a copy of their employment contract. However, five of the suppliers did not comply with this in practice. Some employees at three of the suppliers had not signed an employment contract, while employees at two other suppliers lacked copies of their contracts.

Finally, all employees are entitled to both pension and accident insurance according to the codes. However, seven of the nine suppliers did not provide insurance for all of their employees. Most suppliers provided some employees with either health or pension insurance, but only two provided it for all employees.

### **Summary**

An overview of the results from the conducted study of the nine Chinese suppliers is presented in Table 2. The study's results show that over two thirds of the suppliers did not comply with the codes' standards in the majority of the studied criteria, with one third of suppliers being in breach of all but one of the studied standards. Furthermore, no supplier complied with all the standards specified in the codes, with the best supplier breaching two of the nine standards. It can, therefore, be concluded that there was a lack of compliance with retailers' codes of conduct on the part of the studied Chinese suppliers. It is important to point out that this lack of compliance does not indicate that the toy retailers impose unreasonable demands on their suppliers, since the evaluated code of conduct criteria are based on Chinese labour law, which stipulates a nonnegotiable minimum level of supplier performance (unless, of course, one regards Chinese labour law as too demanding).

| <b>Studied criteria</b>         | <b>No. of suppliers complying with the criteria</b> |
|---------------------------------|---|
| Work hours                      | 0   |
| No. working days                | 2   |
| Minimum wage                    | 4   |
| Overtime compensation           | 4   |
| Health and safety education     | 1   |
| Physical examination            | 4   |
| Child labour                    | 8   |
| Employee contract               | 4   |
| Pension and accident insurances | 2   |

*Table 2 – Suppliers’ level of compliance with retailers’ codes of conduct*

The identified lack of compliance occurred despite the fact that the studied suppliers were likely among the best in terms of compliance with the codes of conduct of the most proactive Swedish toy retailers – ‘proactive’ in terms of such codes. Given the ‘critical case’ approach used in the study, the identified lack of compliance allows for general trends to be discussed, despite the small number of studied suppliers. Since even some of the best Chinese suppliers to among the most proactive retailers in one of the most proactive industries did not comply with the retailers’ codes of conduct (and most retailers in the toy, and related, industries have similar monitoring practices and codes of conduct), it is reasonable to assume that other Chinese suppliers to both Swedish and international toy retailers that were not identified as among the best suppliers also do not comply with the standards specified in the toy retailers’ codes of conduct. Furthermore, it is also reasonable to expect that Chinese suppliers to retailers in related industries having similar codes of conduct and monitoring practices (such as the garment and footwear retailers) display similar low levels of compliance. Hence, the study indicates that the vast majority of Chinese suppliers do not comply with retailers’ codes of conduct. However, despite the merits of the critical case approach, much caution is needed when making such generalisations from the results of the study. The number of studied suppliers is small, so the results should be treated as tentative indications of widespread non-compliance, indications that merit large-scale verification in the toy and related industries in future research.

In addition to being considered as among the best suppliers by the Swedish toy retailers, all the examined suppliers were also monitored several times a year for compliance to the codes of conduct. For example, one supplier (breaching eight of the nine studied criteria) was monitored several times a year by Mattel, yearly by Coop, and likely also yearly by numerous other large toy retailers. Another supplier was monitored by all the three Swedish retailers and is SA8000 certified. In spite of this, the supplier complied with fewer than half of the studied criteria. The key question then becomes: How is this lack of compliance possible with such extensive monitoring?

### **Explaining suppliers’ lack of compliance with codes of conduct**

Based on the study’s empirical data it is not possible to pinpoint precise changes in suppliers’ operations induced by the retailers’ codes of conduct, since the data were collected at a single

point in time. However, the extensive gap between the codes' standards and suppliers' operations indicates that the current system of codes and monitoring seems, at least to some extent, to be ineffective in promoting alteration of the suppliers' labour practices as outlined in the codes. In this section, I will discuss three potential explanations of the ineffectiveness of, and suppliers' lack of compliance with, retailers' codes of conduct. I will discuss these explanations in order of importance, starting with the seemingly most important – the decoupling explanation.

### **Decoupling explanation**

The first potential explanation of the suppliers' lack of compliance with codes is that the toy retailers' monitoring organisations are unable to detect suppliers' breaches of code standards. Such an inability would create the illusion that the working conditions in suppliers' factories are in accordance with the codes' standards, and consequently, eliminate the reason for retailers to demand alterations to suppliers' operations. In turn, this would eliminate much of the incentive for suppliers to alter their operations. The conducted study's results strongly indicate that this is the main reason for the identified lack of compliance with codes among the studied suppliers. First, even though access was not granted to the monitoring organisations' protocol by each of the nine suppliers, information was provided by the retailers stating that several of the studied suppliers had passed theirs, and other toy retailers', monitoring controls without detection of breaches of the codes' standards. Second, the toy retailers appeared both surprised and appalled by the findings of this study. Hence, it seems as though the toy retailers were unaware of their suppliers' lack of compliance with their codes of conduct.

This unawareness, due to non-detection of breaches of the codes by the toy retailers' monitoring organisations, could have arisen from poor monitoring in general by the retailers' monitoring organisations (cf. O'Rourke, 1997, 2000, 2002, 2003; Burnett and Mahon, 2001; Florini, 2003; French and Wokutch 2005). However, the conducted study indicates that the lack of detection of breaches was mainly related to the fact that the studied Chinese suppliers had consciously developed methods for deceiving the monitoring organisations. The suppliers had seemingly successfully managed to decouple the formally monitored part of their organisations from the actual operational part of their organisations (cf. Meyer and Rowan, 1977; Brunsson, 1989; Westphal and Zajac, 2001). Hence, the monitoring was of a formal system decoupled from the suppliers' actual operations, leading to few areas of non-compliance being detected by the monitoring organisations, despite the fact that in practice there were multiple areas of non-compliance.

Both decoupling tendencies and efforts by suppliers to deceive monitoring organisations have been noted in previous research into codes of conduct (Doig and Wilson, 1998; Frenkel and Scott, 2002; Graafland, 2002; Healy and Iles, 2002; O'Rourke, 2002; Winstanley et al., 2002). For example, Graafland (2002), O'Rourke (2002), and Winstanley et al. (2002) suggest that suppliers falsify documents regarding employees' ages, wages, and working hours and punish employees for saying the 'wrong' thing during monitoring occasions. Similar tendencies of decoupling, i.e. 'greenwashing' or 'bluwashing', have also been observed in studies of corporate responsibility not directly related to codes of conduct (e.g. Greening and Gray, 1994; Weaver et al., 1999; Kirchhoff, 2000; Kärnä et al., 2001; Laufer, 2003). Despite these

indications in previous research, little is known about the different measures MNCs' suppliers use to deceive monitoring organisations.

Table 3 outlines the most common ways in which the nine studied suppliers try to deceive monitoring organisations. The table shows that seven of the nine studied suppliers tried to deceive the monitoring organisations. The most common way, used by seven suppliers, was for managers to instruct employees what to say and how to act during monitoring occasions. A third of the suppliers also provided financial compensation of €2–10 to employees responding 'correctly' to the questions asked by the monitoring organisations. On the other hand, employees not responding 'correctly' were punished both financially and in other ways. Other common approaches to deceiving monitoring organisations included using forged salary lists and time cards. Some suppliers had systematised this forgery by making employees sign both correct and incorrect salary lists and time cards, and keeping the incorrect lists and cards for inspections. Additionally, four of nine suppliers hid part of the workforce when being monitored. This was done by, for example, sending them to the local movie theatre. Employees were also made to pack and hide their belongings to create the appearance that the supplier had fewer employees than they actually did. Finally, one supplier distributed forged employment contracts prior to monitoring.

| <b>Ways of deceiving monitoring organisations</b> | <b>No. of suppliers using the deception technique</b> |
|---|---|
| Instructing employees on what to say              | 7   |
| Compensation for 'correct' answers                | 3   |
| Forged salary lists                               | 3   |
| Forged time cards                                 | 3   |
| Hiding part of workforce                          | 4   |
| Forged employee contracts                         | 1   |

*Table 3 – Suppliers most common ways of deceiving monitoring organisations*

The interviewed employees gave two main reasons for not reporting the actual conditions to the monitoring organisations. First, they perceived there to be risks of being punished by the suppliers' management and risks of foregoing additional financial compensation for answering 'correctly'. Second, they were afraid that if the true conditions were known, the retailers would cease purchasing products from the supplier, costing them their employment. Additionally, the interviews with suppliers' management indicated that they perceived that while it would enhance the organisation's legitimacy, compliance with codes stood in conflict with other organisational goals, e.g. on-time delivery of products and profitability (cf. Meyer and Rowan, 1977; Weaver et al., 1999). Hence, both suppliers' management and employees perceived themselves to have incentives to sustain and improve the decoupling between the formally monitored part and the actual operational part of the suppliers' organisation.

Since the evaluated code of conduct criteria are based on Chinese labour law, the suppliers have, in addition to deceiving monitoring organisations, also since 1995 (when the labour law came into effect) been violating Chinese law. Cooney et al. (2002) argue that similar gaps

between labour law and corporate practice exist in most East Asian countries, but are less common in the European Union and the USA (cf. Zhu and Fahey, 1999). Furthermore, Cooney et al. (2002) argue that China and Vietnam have recently made more profound changes to their labour laws than, for example, Malaysia, South Korea, or the Philippines have, making a greater gap between law and practice likely in China (or Vietnam) than in other East Asian countries (cf. Frenkel and Kim, 2004).

Three additional factors have also been suggested to be important in explaining the lack of enforcement of Chinese labour law (Zhu and Fahey, 1999; Lau, 2001; Liew, 2001; Cooney et al., 2002; Chen, 2003; Cooke, 2004). First, the new labour law was probably passed for other reasons (such as to attract foreign investment and accommodate demands from the US government and the European Union) than solely to protect workers' rights, making Chinese officials inclined to ignore and even sanction violations to the law in practice. Second, high levels of corruption exist among the officials who should be enforcing the labour law. Third, there is a lack of union organising in China, and those unions that do exist are state controlled, a situation that likely hampers the enforcement of workers' legal rights. Liew (2001) also argues that the lack of enforcement of Chinese labour law increased after the Asian financial crisis in 1997, because of increased competition for investment between sub-national Chinese governments.

Hence, Chinese companies, including toy suppliers, seem accustomed to conveying a public image of compliance with the labour law, an image inconsistent with their actual practices (cf. Chan, 1998; Ding and Warner, 1999). Consequently, the introduction of codes of conduct and monitoring seems to have refined the prevailing decoupling practice among Chinese suppliers, by further increasing the incentives for such behaviour, rather than to have introduced novel practices. In sum, it seems as though the tendency of suppliers to decouple the formally monitored part of their operations from the informal operational part can be expected to be prevalent in most East Asian countries, while likely being more common and elaborate in China (due to less vigilant labour law enforcement) than in, for example, South Korea, Malaysia, and the Philippines.

### **Additional explanations**

The study also found two additional and complementary explanations of suppliers' lack of compliance with the codes. First, the retailers seemed occasionally to disregard reports of non-compliance provided by their monitoring organisations, and not demand alterations to their suppliers' operations. Most previous research into codes of conduct either implicitly or explicitly assumed that firms without exception demand change upon detecting breaches in compliance with their codes' standards (e.g. Sethi, 1999, 2002; Graafland, 2002; Radin, 2004; Wang, 2005). However, the conducted interviews with managers in the Swedish toy and garment industry indicate otherwise. Purchasing managers seemed occasionally to disregard demands for greater compliance with codes in favour of other criteria. In essence, compliance with codes of conduct seemed at times to be treated as a non-economic purchasing criterion that could be traded for other non-economic (e.g. delivery time, quality, and timely delivery) and economic (i.e. price) purchasing criteria (cf. Drumwright, 1994, 1996; Maignan et al., 2002). There are some indications in previous research that this *trade-off explanation* is not restricted solely to Swedish toy and garment retailers (Montoya and Richard, 1994;



Winstanley et al., 2002; Dhanarajan, 2004). However, while retailers at times seemed to make trade-offs, they in general seemed to demand alterations to suppliers' operations when informed of breaches to the codes' standards.

A second complementary explanation of suppliers' lack of compliance with codes is that there is a time-lag between the retailers' demands for changes and realisation of them. The lack of compliance with codes found by this study would in that case only be temporary. There are some case-based indications of this *time-lag explanation*, suggesting that it takes time to change suppliers' operations (Graafland, 2002; Winstanley et al., 2002; Harris, 2004; Hemphill, 2004; Radin, 2004). For example, it might take time to rebuild factories, change salary levels, lower overtime levels, etc. The conducted interviews with managers and employees support this picture to some extent. However, in isolation the time-lag explanation seems inadequate to explain suppliers' extensive lack of compliance with codes, not to mention their intentional efforts to hide such non-compliance.

## **Concluding discussion**

So far, I have shown that there was a lack of compliance with retailers' codes of conduct among toy suppliers in the Chinese Guangdong province, with all studied suppliers breaching some of the codes' standards and over two thirds breaching the majority of the studied standards. I have also argued that the main explanation of this lack of compliance, and seeming ineffectiveness of codes, is that suppliers have decoupled the formally monitored part of their organisation from the actual operational part. The study found a lower level of supplier compliance with MNCs' codes of conduct than that found by most previous studies (e.g. Frenkel, 2001; Frenkel and Scott, 2002; Graafland, 2002; Sethi, 2002; Winstanley et al., 2002; Frenkel and Kim, 2004). While this is partly linked to geography-related differences, i.e. Chinese suppliers likely have lower compliance with codes than do suppliers in other East Asian countries (cf. Cooney et al., 2002; Frenkel and Kim, 2004), the main difference is most likely related to the different methodologies used for collecting the empirical data. As shown in this study, it is problematic to rely on either secondary data provided by monitoring organisations or primary data collected through official, announced interviews, since the main explanation of the lack of compliance with codes seems to be that suppliers have developed systematic ways of deceiving monitoring organisations, and potentially researchers, collecting information in this manner. In comparison, reliance on unofficial, unannounced interviews seems more promising for examining suppliers' level of compliance with MNCs' codes.

The study has also shown that economic incentive structures are central to understanding both suppliers' lack of compliance with retailers' codes of conduct and the expected compliance differences between countries. Retailers, supplier management, and employees all to some extent have incentives to decrease compliance with retailers' codes of conduct. With lack of compliance, retailers enjoy lower purchasing prices – among the most important purchasing criteria in the toy industry – and potentially also other advantages, such as on-time delivery, since compliance with the codes' standards can be expected to cause higher production costs (cf. Lee and Lim, 2001; Liew, 2001; Cooney et al., 2002; Cooke, 2004). On the other hand, retailers also acknowledge the potential costs of negative campaigns if non-compliance with their codes of conduct is revealed, so on the whole they tend to opt for a high level of supplier compliance with codes. Supplier management has more unambiguous economic incentives to

decrease compliance with retailer codes – while retaining an appearance of compliance. Compliance increases production costs, while suppliers in low-skill industries with low investment thresholds operate under near perfect competition and consequently have little opportunity to increase product prices (Gereffi, 1994; Traub-Werner and Cravey, 2002; Braun and Gearhart, 2004; Lipschutz, 2004). Hence, increased compliance would likely decrease supplier profits and even render some suppliers unable to compete with suppliers in other East Asian countries. This is supported by Lee and Lim's (2001) observation that investors expressed concerns that China, with the passing of the new labour law, was pricing itself out of the market, making it more profitable to invest in other East Asian countries such as Indonesia, Bangladesh, and Vietnam. Additionally, the lack of enforcement of Chinese labour law further increases suppliers' economic incentives for non-compliance, by lowering the risk of being identified as breaching the law. Finally, employees also have economic incentives to contribute to low-compliance levels by deceiving monitoring organisations, since supplier management has created reward and punishment systems for instances of monitoring, and employees fear that retailers would switch suppliers upon identifying breaches of the codes of conduct. Hence, in explaining the lack of compliance, understanding the economic incentive structures is important, since supplier management, employees, and even, in part, retailers all have economic incentives to uphold the decoupling of the monitored part of the organisation from the actual operational part.

Furthermore, economic incentive structures are also central in explaining the expected differences in supplier compliance in different countries. Since the incentives for lack of compliance are lower in countries with less strict labour law, more vigilant enforcement of the labour law, and fewer workers prepared to accept working conditions worse than those specified in the codes of conduct and labour law, suppliers in such countries (for example, the USA and most European and other East Asian countries) can be expected to have higher compliance levels than those of Chinese suppliers.

Based on the discussion of economic incentives and the study's findings, there seem to be three main ways for MNCs to increase supplier compliance with their codes of conduct. First, MNCs can work internally to ensure that purchasing managers do not trade-off supplier compliance with codes in favour of other non-economic and economic purchasing criteria. Compliance with codes of conduct needs to be established as a minimum demand in purchasing decisions. Second, previous research indicates that MNCs can work with suppliers' management to increase compliance with codes. This could be done by, for example, forming closer relationships with suppliers and altering suppliers' management style, so that it is more in line with a human resource approach (Frenkel, 2001; Frenkel and Kim, 2004). To form closer relationships with suppliers, MNCs would in practice likely need to decrease their number of suppliers.

Third, MNCs can improve the monitoring of suppliers' compliance with codes. The core problem with the current monitoring system is that it is based on a situation of asymmetric information and poorly aligned incentives. The individuals possessing the relevant information, i.e. suppliers' management and employees, perceive themselves to have incentives to deceive monitoring organisations. This likely leads to continuous improvements in suppliers' ability to deceive monitoring organisations rather than improvements in the actual working conditions

in suppliers' factories. To alter the perceived incentive structures, employees' participation in the monitoring of codes of conduct needs to be increased and the monitoring of suppliers altered (cf. O'Rourke and Brown, 2003). This could be done by, for example, increasing the role in the monitoring process of NGOs with strong local presence (O'Rourke and Brown, 1999, 2003; Burnett and Mahon, 2001; Sethi, 2002), adding unofficial off-site interviews to the monitoring (cf. O'Rourke, 1997; Hemphill, 2004), and ensuring employees that their responses to the monitoring organisation's questions per se will not affect retailers' future purchasing decisions (cf. Hemphill, 2002). Combined, these three measures are likely to increase suppliers' compliance with codes of conduct, and hence, improve the effectiveness of MNCs' codes.

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<sup>1</sup> Toy Industries of Europe (TIE) facts and figure brochure 2004 (accessed at: [www.tietoy.org](http://www.tietoy.org), 2005-06-10).

<sup>2</sup> Statistics Sweden's reports *Detaljhandeln 2002* and *Lek.sak.shandeln 2002* (accessed at: [www.scb.se](http://www.scb.se), 2005-06-10).

<sup>3</sup> Top Toy 35%, BrioPartner 8%, and Coop 7%.

<sup>4</sup> The additional toy retailers buying from the suppliers were identified through the interviews with the suppliers' employees and have not been confirmed with the toy retailers.

<sup>5</sup> SwedWatch was established in 2003 to investigate Swedish firms' operations in developing countries.

<sup>6</sup> At the outset of the study, an agreement was made with the Swedish toy retailers that they would not end contracts with the studied suppliers based on the study's results, hence jeopardising the employment of the respondents. To ensure compliance, the Swedish NGO SwedWatch committed to follow-up and publicly report any deviations from the terms of the agreement.

<sup>7</sup> The Swedish garment and toy industries work in similar ways regarding codes of conduct and monitoring (cf. Åhlström and Egels-Zandén, 2006; Egels-Zandén and Hyllman, 2006). The interviewed garment retailers were among the most proactive Swedish retailers in terms of codes of conduct (Åhlström and Egels-Zandén, 2006). The interviewed toy retailers were: Top Toys, Coop, and BrioPartner.

<sup>8</sup> The interviews with managers of Chinese toy suppliers were conducted and videotaped by Swedwatch. The interviewed suppliers were all suppliers to Top Toys, Coop, and/ or BrioPartner, and some were among the nine suppliers studied for this paper.

## **Appendix – Interview Guide<sup>1</sup>**

### **1. Personal Information**

- 1.1 What is your name (optional)?
- 1.2 How old are you?
- 1.3 What department do you work in?
- 1.4 Where are you from?
- 1.5 How long have you been working in the factory?
- 1.6 What are you employed as?

### **2. Factory Information**

- 2.1 What is the name of the factory?
- 2.2 What products are produced in it?
- 2.3 Who are the major clients of the factory?
- 2.4 When are the factory's peak and low seasons? (Follow up: Specify months)

### **3. Workforce information**

- 3.1 How many workers are there in the factory? What is the male–female ratio?
- 3.2 What different departments are there in the factory?
- 3.3 What is the age range of employees? Mean age?
- 3.4 At what age are workers recruited? (Follow up: Are there any workers under 16 years old working in the factory?)

### **4. Wages, working hours, and vacation**

- 4.1 Could you explain the organisation of working hours used at the factory? How many hours do you work per day/week? (Follow up: Please specify the differences between weekday and weekend hours, regular working hours and overtime, and peak and low season working hours)
- 4.2 How many days off do you have per week/month?
- 4.3 Could you explain the wage system of the factory? (Follow up: Does the factory use a piece-work rate or a time rate? Are there differences between departments?)
- 4.4 Is overtime compensation provided? If so, how?
- 4.5 What is the average monthly income of the workers? (Follow up: Please specify the differences between the peak and low seasons)
- 4.6 What happens if the factory does not have enough work for the workers in the low season?
- 4.7 Are workers guaranteed a certain minimum income every month?

### **5. Employment**

- 5.1 Does management sign a written contract with workers? If so, are you given a copy of the contract?
- 5.2 What is the average length of the contract?
- 5.3 Does the management provide health check-ups for workers? If so, how often?
- 5.4 Can workers resign from the factory at will (observing the legal term of notice)?
- 5.5 Does the factory ever fine or punish workers? If so, when?

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<sup>1</sup> The predefined follow-up questions are indicated in the interview guide by either “If so” or “Follow up”.

## **6. Insurance and welfare**

6.1 Does the factory buy social insurance for its workers? (Follow up: Please specify whether this includes old age, medical, unemployment, and industrial injury insurance)

6.2 If so, is anything deducted from wages for each type of coverage? If so, how much?

## **7. Occupational safety and health (OSH) conditions**

7.1 Could you tell us about the industrial accident situation in the factory?

7.2 Does management pay compensation for injuries or occupational diseases related to work?

7.3 Which department is most likely to have industrial accidents?

7.4 Is a clinic provided at the factory? If so, how much does it charge for its services?

7.5 Have you received any occupational training, either before or during employment?

7.6 Is there any fire prevention training for new and current workers?

7.7 Are there fire drills at the work place and in the dormitories? If so, how often?

7.8 Do you know how to get to the fire exits if there is a fire?

7.9 Is there any formal OSH training for new and current workers?

7.10 What is the daily production quota in your department during peak season? What happens if you fail to meet the quota?

## **8. Code of conduct auditing**

8.1 Do any clients perform social audits inside the factory?

8.2 If so, could you tell us how such an audit is conducted? (Follow up: How often do social auditors come? What would they check? Do they talk to workers? How does factory management prepare before the social auditors come?)

8.3 Have you heard of codes of conduct? If so, how can workers access the details of the codes of conduct?

8.4 Do you think that social audits can help improve factory conditions?

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