



USING CAPACITY BUILDING TO DRIVE CONTINUOUS IMPROVEMENT IN GLOBAL SUPPLY CHAINS



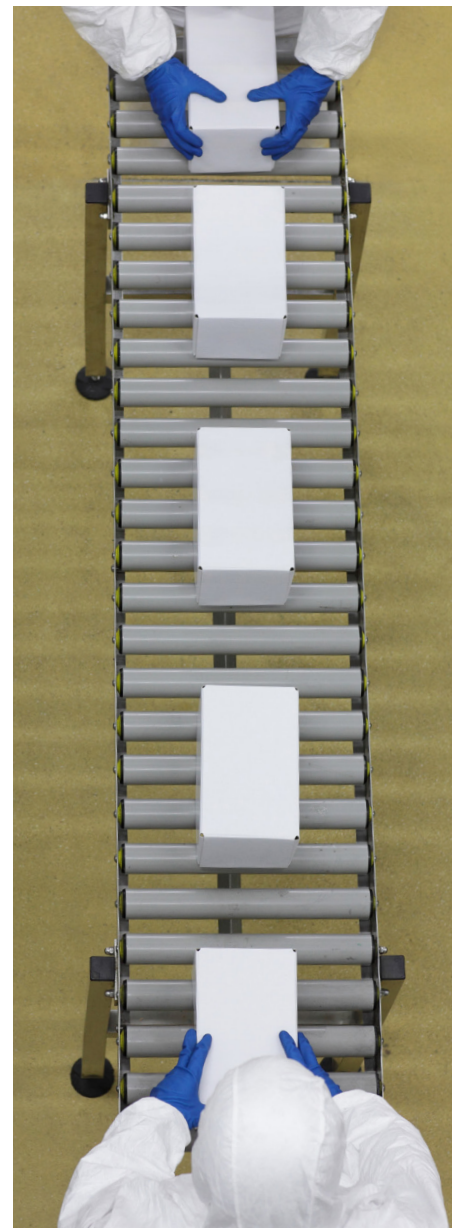
Using Capacity Building to Drive Continuous Improvement in Global Supply Chains

Corporate social responsibility (CSR) programs allow businesses large and small to drive fundamental societal changes through a balanced focus on people, the planet and profits. The impetus for companies to adopt CSR measures vary from the desire to manage business risks and create efficiencies to bringing business practices and corporate values into closer alignment. As corporate social responsibility becomes an integral element in the business model of many global enterprises, companies are also adopting programs and management systems that support and maintain responsible business practices throughout their entire supply chain.

As a manufacturer or supplier, demonstrating compliance with the social responsibility and sustainability goals of a corporate customer can be challenging. Complying with the requirements of CSR sustainability programs can demand a significant commitment from supplier company management and employees, and suppliers sometimes struggle to see the correlation between requirements and tangible factory improvements. In addition, the effort to meet program requirements is often seen as just another part of the overall compliance effort, serving only to meet the expectations of demanding customers and bringing little direct benefit in return. Viewed from this perspective, it can sometimes be difficult for suppliers to understand the potential synergies between a customer's social responsibility initiatives and their own financial and operational objectives.

For both corporate customers and suppliers, a robust supply chain sustainability program in support of CSR goals can more than offset its cost by driving change in central business practices, leading to improved financial performance for all involved. To achieve these results, efforts must include a broader approach that uncovers the root causes of performance gaps and establishes an effective process for closing them. This "capacity building" methodology not only addresses systemic issues, but paves the way for real change that can drive increased productivity, greater employee commitment and stronger financial results.

This UL white paper provides an overview of the methods and benefits of a capacity building approach in fostering supply chain sustainability. It begins with background information on the current approaches to supply chain monitoring. The paper then presents the benefits of capacity building, and details the structure of a typical initiative. Finally, the paper concludes with a case study that illustrates capacity building in practice.





The Continuous Improvement Approach

The globalization of manufacturing is an essential element of today's dynamic economy. It has provided companies with access to more efficient and cost-effective production capabilities, and resulted in lower prices for many manufactured products. Global manufacturing capabilities have also played a significant role in the economic emergence of developing countries and regions around the world.

At the same time, global manufacturing presents a new set of supply chain management challenges for companies. Materials can come from virtually anywhere, complicating the process of monitoring and controlling critical aspects of the material supply chain. With factories located in remote regions of the world, companies often have limited oversight into the manufacturing practices that produce their products. These and other factors result in less transparency in the sourcing and manufacturer of products.

Additional complexity stems from efforts to achieve supply chain sustainability objectives to support CSR program goals. The impetus for businesses to implement a CSR program may be driven by consumer interests in supporting companies that exemplify responsible sourcing and manufacturing practices, or by an intrinsic belief in the importance of such an approach. In either case, companies are more closely scrutinizing every aspect of supply chain activity, including material sourcing and production, so that actual practices match their stated values.

To address these and other challenges,

companies are implementing more rigorous supply chain management systems, with the goal of achieving greater influence and transparency. These efforts to influence supply chain activity typically require that manufacturers, vendors and suppliers adopt specific practices in order to achieve compliance with a company's CSR program requirements. The effectiveness of these practices is then assessed through various monitoring and reporting activities, and through periodic audits conducted by independent third parties.

However, while ongoing monitoring is useful in assessing conformity with supply chain performance requirements, it is not intended to identify the root causes of noncompliance. In many cases, the focus on individual noncompliance findings can unintentionally mask an underlying issue, resulting in well-intended but misdirected remediation efforts that fail to fix the real problem. The mistaken diagnosis comes to light only when the problem fails to go away, and the issue is identified in a subsequent audit. Equally important, an approach that focuses exclusively on monitoring and reporting can fall short when it comes to focusing attention on emerging issues of concern, or in supporting the development of a culture of continuous improvement.

As a complement to monitoring and reporting initiatives, capacity building programs strengthen the relationship between corporate customers and suppliers by jointly defining areas of continuous improvement, and by providing suppliers with the tools and incentives required to achieve the desired results. This approach complements existing oversight mechanisms, and

serves to align the goals and objectives of customers and their suppliers. The result is a genuine customer/supplier partnership that enables both parties to achieve greater success.

Capacity Building Basics

Capacity building (sometimes referred to as capability building) is a supply chain sustainability tool that can lead to more consistent and effective improvement of supply chain management issues. Capacity building efforts focus on developing a more in-depth understanding of the causes for noncompliance. This approach leads to the identification of solutions that address root cause issues, providing the foundation for improvements that help bring actual performance in closer alignment with the established goals.

An essential element of capacity building is the reliance on key performance indicators (KPIs) as the preferred method of assessing conformity. By focusing on performance and outcomes, KPIs help to bridge the gap between generic requirements and actual operations. Activities and results that are measured are also more likely to be actively managed than those that are not. The use of KPIs to assess conformity provides a mechanism for continuous feedback, enabling managers and employees to promptly address issues as they emerge, rather than after an audit.

In addition to the use of KPIs to drive performance, capacity building also leverages data from other vendors and suppliers as a tool for encouraging continued improvement. Rather than looking exclusively on whether or not an individual vendor or supplier is meeting supply chain sustainability requirements,

peer data offers a broader perspective by placing individual performance in the context of comparable operations. This framework allows for relevant performance comparisons and encourages healthy competition among participants in the supply base.

A key advantage of capacity building is the level of commitment it can generate among supplier managers and employees. As capacity building initiatives take hold, participants experience how these initiatives not only addresses sustainability concerns but can actually lead to tangible, and sometimes unexpected, improvements in performance and efficiency. These successes can strengthen employee commitment to the capacity building model, spurring continued progress in other areas.

Capacity building can be a particularly effective tool in addressing difficult supply chain sustainability concerns such as excessive overtime or underpayment of wages as well as issues like workplace discrimination. Capacity building is also useful in efforts to address long-standing or repeat issues uncovered during the typical audit process. This benefit can be especially important with key suppliers that are vital to a company's supply chain but that consistently fail to meet supply chain sustainability program requirements.

Structure of a Capacity Building Initiative

A typical capacity building initiative consists of three distinct phases, incorporating the following activities:

Phase 1 – Initial Review

- **Audit review** – This activity involves a review and evaluation of prior audit data and findings to identify recurring issues and to pinpoint specific areas and suppliers that can derive the greatest benefit from a capacity building initiative.
- **Pre-engagement meeting(s)** – A pre-engagement meeting is designed to introduce the capacity building program to a company. It includes a discussion of program requirements as well as the identification of program expectations, including deliverables and the anticipated return on investment.

Phase 2 – Assess and Plan

- **Gap assessment** – A gap assessment evaluates nonconforming issues throughout the facility with the goal of understanding the root causes for noncompliance. The assessment can address all noncompliance issues identified in prior audits, or focus exclusively on a single area. Specific areas targeted for investigation include factory management, production planning, operations policies, training programs, communications efforts, system monitoring and corporate governance. Additional areas can be included in the gap assessment to address unique aspects of the operation.
- **Implementation planning** – This activity involves prioritizing supply chain goals to provide

a roadmap for continuous improvement. The product of implementation planning is a corrective action plan that details required tasks, assigns specific responsibilities, and sets a timeline for achieving both short-term and long-term goals.

Phase 3 – Remediation

- **Implementation** – Implementation involves the execution of specific activities identified in an action plan created during the planning effort. Formal program management tools are used to identify start and end dates for individual projects and to track progress against defined timelines.
- **Reporting and follow-up actions** – An effective capacity building initiative also includes regular reporting that measures progress in completing individual projects as defined in an action plan. Frequent reporting allows for timely identification of projects where progress has been blocked, and enables participants to develop workarounds to achieve program goals.
- **Program management and oversight** – Finally, like any successful initiative, capacity building requires robust program management and rigorous oversight in order to stay on track. It also requires a strong commitment from senior management to support the goals of the initiative and any operational changes that are required.



Other Capacity Building Elements

Capacity building efforts may include elements in addition to the above activities. For example, formal communications systems can help strengthen worker engagement by creating a structured system for two-way dialogue between employees and management. Such systems support the collection and recording of employee concerns and suggestions, so that they can be acted upon in a timely and consistent manner.

An important aspect of improved communications is an employee handbook. An effective handbook clearly outlines the rights, responsibilities and expectations of employees and management. Combined with other employee communications programs, an employee handbook can support the development of a productive and stable workforce.

Additional documentation such as compliance manuals may be useful tools in assisting vendors, importers and licensees in understanding corporate social and legal expectations. Retailers and brand custodians may benefit from regular performance indicator reporting, in which compliance data is compiled from key vendors and suppliers to gauge overall program success. Performance indicator reporting also provides advanced notice of problem trends, allowing for prompt corrective actions.

Capacity Building in Practice

A recent UL engagement illustrates some of the benefits of a capacity building initiative in support of a supply chain sustainability program. A factory operated by a generic pharmaceutical manufacturer was found to be deficient in a number of key areas involving the factory's employees. The deficiencies included excessively-lengthy work schedules, with some factory employees working more than 90 hours per week. In addition, employees were not offered consistent weekly rest days, and frequently worked as many as 30 consecutive days without a day of rest.

The goal of this capacity building initiative was to reduce individual working hours to a level consistent with the customer's CSR program-mandated limits. As part of the initial assessment, a UL engagement team evaluated how factory employees were being used in production operations, and whether there were sufficient employees to appropriately staff those parts of the factory where production bottlenecks slowed overall output. The team then evaluated possible changes in workspace design and workflow that would not compromise overall productivity.

Based on its evaluation, the UL team determined that the factory could





increase the number of machines operated by a single employee simply by repositioning equipment. From this small change, the factory was able to redeploy its work force from two teams working two shifts to three teams working two shifts, substantially increasing production capacity. The factory also reduced the average number of hours worked per week by employees and was able to guarantee one rest day per week for all employees. But, because of the increased production that resulted from the changes, there was no reduction in employee compensation.

The factory is also continuing to monitor the results from the implementation of a new time tracking process that is expected to reduce instances of employee underpayment. These results, along with those generated by other aspects of the factory's capacity building action plan, are expected to address audit

noncompliance issues while providing significant improvements in workplace conditions for employees, and overall labor management.

Other Benefits of Capacity Building

As the preceding example illustrates, capacity building not only supports efforts to achieve compliance with social responsibility requirements but can also contribute to significant performance improvements.

For manufacturers, capacity building initiatives directly support efforts to optimize manufacturing systems, leading to increased productivity and an emphasis on continuous improvement. They can also support employee retention goals through improved human resource management systems, better work/life balance and stronger training and communication programs.

Capacity building also supports efforts to meet applicable laws and other performance management standards.

For vendors, suppliers, licensees and agents, capacity building initiatives offer an integrated and streamlined process to identify and address root causes on noncompliance issues. Compared with standard monitoring and reporting approaches, capacity building represents an approach to achieving supply chain sustainability goals that builds productive customer/supplier partnerships.

For retailers and brand custodians, capacity building initiatives rely on KPIs and peer comparisons to track tangible results from compliance efforts, and can support efforts to drive continuous process improvement through the supply chain. In that way, effective capacity building initiatives can generate a real financial return on program investment.



Conclusion

Capacity building is an important tool in the overall effort to meet supply chain sustainability requirements in support of CSR program goals. Capacity building initiatives focus on the root causes behind nonconforming issues, providing a foundation for actions that actually address core problems. Capacity building uses KPIs to measure performance against relevant metrics and to bridge the gap between generic requirements and actual operations. The capacity building approach also leverages peer data comparisons as a tool to spur continuous performance improvement. Effective capacity building initiatives can not only help to drive conformity with social responsibility requirements, they can improve operational production efficiencies, and provide a tangible return on investment for all parties.

UL has developed a range of services to help companies implement capacity building initiatives and to address other supply chain sustainability efforts in support of CSR programs. For further information about UL's services in responsible supply chain management, contact Monica Puksta, senior manager, Research & Program Development, UL Verification Services, at Monica.Puksta@ul.com.