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Attacking the Roots: Shiraishi Garments Company and an Evolving Thicket of Business Ethics in China

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Teaching Note

Courses and Audience

This case can be used in graduate level Business Ethics, Entrepreneurship, and Supply Chain Management courses. For Business Ethics, it should be used at the beginning of the course to spur student attention toward ethical issues in international business. In Entrepreneurship courses, this case illustrates the sometimes unintended negative effects of a growing business that expands its operations into a foreign country. The case is unique in this respect because, though written in English, it concerns the countries of China and Japan. For Supply Chain Management classes, this case shouldn't be assigned until students have learned the general structure of supply chain and the relationships between purchasers and vendors.

Topics

This case covers one major topic: business ethics in the supply chain of a growing firm. The secondary topic is the improvement of labor conditions.

Teaching Objectives

Through reading, discussion, and deliberation of this case, students build understanding of three principal business issues:

1. Social responsibility in supply chains from ethical and strategic perspectives that reduce operational and reputational risks.

2. How to formulate new approaches to growing a business internationally.

3. How to distinguish and address drivers of poor labor conditions.

Synopsis

This case addresses multiple social dimensions of business in terms of its effect on labor conditions. Supply chain labor problems are key risk factors for country-based companies in developing economies. As such, companies face important moral issues associated with the production of low-cost goods at the expense of employee health, safety, and welfare.

Priority is given in the case to understanding the root causes of labor issues in the case. More specifically, the case addresses how purchasers can provide practical support to suppliers wih respect to social purpose. The possible strategies discussed in this case offer an alternative approach to the audit model and are instrumental in addressing the underlying issues. They also align the key elements of a successful supply chain: productivity, responsibility, and reliability.

Questions for Students

General Issues

1. What problems is SGC facing in its supply chain?

2. How have these problems emerged with the growth of SGC?

3. What is the current approach to deal with these problems and why it is not effective?

Discussion Drivers

1. If SGC moves out of China and into other developing countries, what are the potential benefits? What about if SGC stays in China?

2. What are the principal drivers of SGC's problems in China? Why did SGC likely not incur such problems in its previous supply chain in Japan?

3. Based on the drivers from #2 and SGC's experience in Japan, do you think SGC could find a way to solve its problems in China? If so, what should SGC do?

Teaching Plan

Discussion of this case can last 60-90 minutes depending on the preparation by students and desired depth of discussion. The facilitator should divide students into four groups:

1. Foreign purchasers (i.e., like SGC)
2. Local managers (i.e., of the Chinese manufacturing facilities)
3. Laborers (i.e., to be employed at the Chinese manufacturing facilities)
4. Non-government organizations (i.e., interest groups concerned with human rights issues)

With a short briefing to each group to argue their point of view as strongly as possible, this organizational approach can inspire a heated debate during the case study. The result is a close engagement of the issues that can results in rich student learning outcomes. The outline below is just one example of how to structure the discussion.

The Reasons for Poor Labor Conditions in China (30–45 minutes)

Current labor conditions in China lead to two outcomes: poor organizational performance (e.g., reduced efficiency, poor quality, high accident rates) and high worker turnover. There are several drivers behind China's poor labor conditions. These problems will be brought to the fore by students when the facilitator encourages each group to blame its problems on other two groups. The drivers discovered by the students can be divided into two categories: internal and external

Internal Drivers

Human Resource Management. Middle managers and supervisors do not feel responsible for retaining workers and do not appreciate the importance of training them. They see recruitment as an HR task and simply request new employees

whenever people leave. Factories recruit unskilled workers but fail to provide education or training. There are few systems for monitoring worker performance and little opportunity for workers to improve their skills for promotion to better jobs. This predicament robs companies of tools for improving productivity and creates few incentives for skilled workers to perform or stay. In addition, the high turnover rate is forcing factories to take on more low skilled workers.

Communications. Workplace conditions often suffer from limited trust between workers and supervisors. Supervisors and middle managers lack management and HR skills and have a tendency to speak rudely and shout at workers. Insufficient communication about changes in product specifications can lead to increased levels of rework and overtime. This predicament creates a situation where there are few effective channels for workers to raise concerns with managers, who often do not respond to workers' concerns or suggestions.

Low-skilled Workers. Most workers arrive at factories with low skill levels. Because they are often paid piecemeal, without overtime premiums, factories have no financial incentive to reduce long hours. Workers build skills "on the job" so factories do not pay directly for training. Thus they face hidden costs of low productivity, low quality and factory overhead for long hours.

Poor Productivity and Quality Control Systems. Poor production planning, lack of knowledge, unawareness of time needed to produce items, and other forms of poor communication exist between merchandisers, factory management, and production employees. Quality management is driven purely by customer requirements rather than the need to promote efficiency in the factory. Therefore, productivity measures are underdeveloped. Piecemeal workers are not paid for reworking. Thus, a significant proportion of working time is unproductive and unpaid.

External Drivers

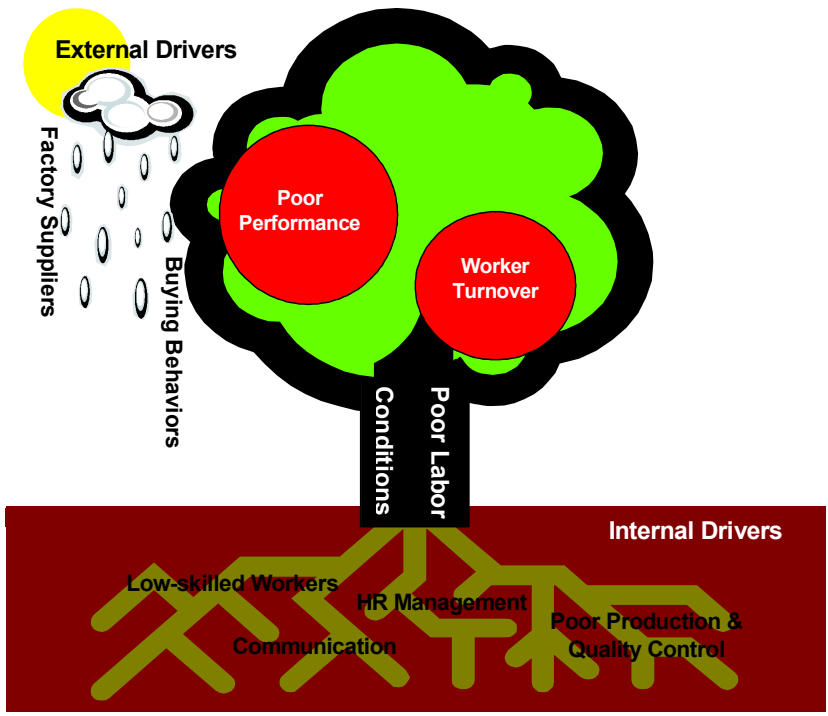
Buying Behaviors. Excessive overtime is driven by inefficiency of internal systems as well as buying trends towards shorter lead times and lower prices. Late changes to orders and sample approvals can push factories to work longer hours. These negative buying behaviors dramatically reduce local factory planning time, product design time, processing time, changeover time, and delivery time. To catch up to customer requirements, factory managers force workers to work longer.

Factory Suppliers. Poor-quality and delayed supplies cause disruptions in workflow. Buyers regard price as a major determinant in sourcing, and typically

use multi-source purchasing. As such, buyers play suppliers against each other to get better pricing arrangements or other concessions. The downside of this practice is that suppliers cannot rely on long-term relationships with buyers and feel no loyalty to a particular buyer. Furthermore, suppliers often seek to protect themselves from losing buyers by increasing the number of buyers they supply.

Figure 1 is a simple heuristic model of a tree that summarily describes the interrelations between labor conditions (trunk), outcomes (fruit), internal drivers (roots), and external drivers (climate).

Figure 1: Labor Conditions: Drivers and Interrelations



Carving Out a Sustainable Solution (20–30 minutes)

Chinese managers are typically progressive and keen to improve. However, the lack of systematic guidance on where and how to apply advanced management techniques, coupled with the alluring visions of "infinite cheap labor in China," leads many managers to focus purely on cost-saving strategies. Foreign purchasers know the benchmarks of advanced management systems. For example, SGC has rich experience in forging relationships with its sewing

subcontractors and suppliers in Japan (e.g., sharing market information, giving advice on quality and production improvement, helping subcontractors record and analyze defects). Foreign purchasers should work more closely with local factories over extended periods of time and provide support and guidance for change rather than demanding compliance. The approach would be a one possible sustainable solution because it would bring fundamental business benefits to local factories which, in turn, would benefit foreign companies.

Improving the Buying Behaviors of Purchasers. Foreign purchasers need to acknowledge responsibility to agree on realistic lead times and keep to the timelines they set with factories. The primary challenge for foreign purchasers is discussing and reaching consensus with local factories on issues of hours and pay instead of demanding compliance. Understanding the pressures on factories, promoting realistic expectations of changes, and rewarding factories for honesty are worthwhile, even if they still lead to non-compliance. Foreign companies need to work with Chinese factories to encourage and support incremental change and rebuild the trust that has eroded through strict compliance practices.

Internal Improvement. Foreign purchasing companies may not have direct responsibilities for internal conditions, but they can effect gradual improvements in supplier factories. For example, SGC helped its Chinese suppliers improve standard first-aid emergency response processes.

Possible Solutions

Some operational aspects of Chinese factories do stand to be improved. Foreign companies need to develop clear orientations about these issues to help promote socially responsible behaviors in Chinese supply chains (Tencati, Perrini & Pogutz, 2004).

Employee Training and HRM. Factories should improve systems for worker recruitment, evaluation, and training. They may develop processes for worker evaluation at the recruitment stage (e.g., graded skills exams for new workers) and throughout employment, with regular evaluations and annual appraisals for all workers. Wages must be adjusted to reflect performance levels and extra training should be offered as necessary.

Managers should develop a grading system to rate all workers according to skill level and provide training to assist workers desiring higher skilled jobs. To understand why workers are leaving, managers might conduct exit interviews, allowing them to identify reasons for discontent among workers. Factories should move away from punitive human resource techniques such as fines, and instead use incentives and productivity bonuses. Bonuses could be earned when workers

exceed production targets, which would provide incentive for workers to perform during ordinary time rather than incurring overtime hours.

Communication. Middle managers and supervisors need to improve people management skills and not speak rudely and shout directly at workers when they miss production goals. Communication skills training is thus necessary for both the task and person-related elements of management. Workers need to be given a voice to raise concerns and negotiate with management.

Productivity and Quality. To improve productivity and quality, some new management techniques should be introduced to local factories. Process analysis, line balancing, shop floor control, production scheduling, target setting, aggregate planning, and other approaches would be well-received. Factories should analyze production processes and highlight where bottlenecks occur. These activities could facilitate creation of databases based on standard product cycle times to be used for planning.

Manage Factory Suppliers. Factories should appraise suppliers before placing orders and rate materials received in terms of quality level. This practice would allow better control over delivery timing of raw materials and components and reduce downtime.

Chinese suppliers cannot quickly improve labor conditions in their factories to match the standards of developed countries. Vogel (2005) points out that there are limits to how responsibly companies can behave, as responsible behavior raises costs and customers are generally unwilling to pay higher prices. Thus, market dynamics can constrain the pursuit of virtue.

Conclusion (10-15 minutes)

As there is still a presumption by some foreign purchasers and Chinese managers that low labor costs inevitably offset low productivity, labor problems have emerged as a key risk factor for China-based companies pursuing long-term sustainable supplier relations. The existing audit and compliance approach does not address actual underlying problems.

In this case, priority is given to understanding root causes of labor issues and for purchasers to provide support for suppliers to improve those issues. The strategies discussed in this case offer an alternative approach to the audit model. The alternative addresses underlying issues and is aligned with key elements of a successful supply chain relationship (i.e., productivity, responsibility, & reliability). Purchasing companies should ensure their own processes do not create additional pressures against more fair and productive workplace environments. Local factory managers should understand that badly managed

workplaces with poor labor conditions are inefficient and not productive. Better production management and responsible buying practices are necessary to break the long-standing pattern of labor violations and low productivity in China.

Epilogue

After SGC applied the above solutions to its Chinese suppliers, the suppliers achieved improvements in quality (e.g., reduced reworking) as well as productivity (e.g., number of pieces produced per worker per hour). The factories reduced the number of hours worked because of the increased output per worker hour. For Supplier 1, peak season overtime hours per day reduced from five hours to three. For Supplier 2, peak season overtime reduced from a range of 225 overtime hours per month to 132, representing a reduction of over 40%. Wages increased as factories introduced a bonus scheme linked to work skill and output.

The total monthly take-home pay of each worker rose even though workers were working fewer hours. This increase was instructive because it demonstrated to managers and workers that total wages could remain static or even increase when hours were reduced, so long as there were (a) productivity increases and (b) the difference was passed on to the workers. Supplier 2's average adjusted annual turnover rate fell to 9.6%, a tremendous improvement over the original level of 140%. A lower turnover rate suggested that the combination of an improved working environment with increases in wages and reduction in working hours had a positive effect on how workers felt about their employer.

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