

# The wages of fear



With new US regulations and EU due diligence rules coming down the track, companies are under increasing pressure to scrutinise their supply chains. Hannah Shoemith examines how we engage with companies on this challenging issue.

## Setting the scene

**The UN Sustainable Development Goals (SDGs) include the eradication of poverty and ensuring decent work for all – key foundations for building thriving societies and economies. Decent work is recognised in the Universal Declaration of Human Rights, while poverty erodes access to fundamental human rights and can make it impossible to seek justice to address human rights impacts.**

**Many of the problems targeted by these two SDGs can be disproportionately found in supply chains, due to their complex, dynamic and opaque nature. Although this is well known, poverty, modern slavery and inequalities persist. However, tough new US and EU regulations will put companies under more pressure to scrutinise their supply chains, and identify and address human rights abuses.**



**Hannah Shoemith**  
Theme co-lead: Human Rights

Runaway fuel and food prices, and the Covid-19 pandemic, have pushed many people closer to the brink of destitution over the last two years. The climate crisis is also negatively impacting working conditions for millions of people around the globe. Low-income outdoor workers, such as those employed in agriculture or construction, are especially vulnerable to heat stress, making their working lives a misery, and vastly impacting productivity and output.<sup>1</sup> India and Pakistan suffered in near 50°C heat this spring, a foretaste of what is to come.<sup>2</sup>

Against this backdrop, the business case for corporate action is compelling. Social inequality is a systemic risk that undermines political and economic stability. A commitment to wider stakeholders and economic sustainability must include helping to lift communities out of poverty and finding ways to reach the vulnerable and disenfranchised. Beyond the ethical case for

<sup>1</sup> ILO: Occupational Heat Strain and Mitigation Strategies in Qatar [wcms\\_723545.pdf \(ilo.org\)](https://www.ilo.org/wcmsp5/groups/public/-/dgreports/otherpublications/wcms_723545.pdf)

<sup>2</sup> <https://www.theguardian.com/world/2022/may/02/pakistan-india-heatwaves-water-electricity-shortages>

respecting human dignity, and the fact that forced labour and child labour are illegal, being able to articulate human rights risks and implement effective human rights strategies is indicative of robust enterprise risk management.

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Finally, decent labour standards and fair treatment have been enshrined in international standards for many years, through International Labour Organization (ILO) Conventions and corporate codes of conduct. A corporate responsibility to respect human rights is outlined in the United Nations Guiding Principles on Business and Human Rights (UNGPs). Building on these soft law expectations, current and pending regulations will pose significant challenges to businesses globally that may be unwittingly connected to human rights abuses in their operations and supply chains (see box).

### What are the key issues?

By decent work we mean that employees should be safe, treated with respect and compensated fairly. Yet long supply chains may involve forced labour, child labour, poverty wages, abuse of workers and even the death of workers due to negligence. Poverty may be a result of debt bondage, the non-payment of minimum wages, or insecure/seasonal work, which maintains vulnerable people in a spiral of poverty and dependency. This disproportionately affects migrant workers, women, children and ethnic minorities. It is most common in sectors such as manufacturing, agriculture, construction and mining, but also exists in other less manual sectors, such as the technology supply chain.

Companies may commit to being a living wage employer, but this is more common for direct employees. Whilst companies can commit to paying a living wage across their supply chains, it is widely acknowledged that there is no clear definition of what this means or how it will be paid, particularly in low-income markets where it may be most relevant.

In a recent paper,<sup>5</sup> human rights consultancy Shift, collaborative network Business Fights Poverty and the University of Cambridge argued that most businesses still view living wages as a challenge, not an opportunity to address inequalities, drive employee engagement and productivity, and improve customer purchasing power. Despite this, there are some signs of a shift in company commitments with leading businesses and investors coming together to develop systemic solutions. In 2020, Unilever committed to paying a supply chain living wage, but said it would take until 2030 to do so. This remains one of the most ambitious living wage targets set by a company for its supply chain.



### Key regulatory developments

New regulations are coming into force to tackle human rights issues, adding to existing Modern Slavery Acts in the UK and Australia, and the French Duty of Vigilance Law. Investors and companies must get ahead of these, or run the risk of fines, lawsuits or reputational damage.

- The US Tariff Act dates from 1930 but in recent years there has been a significant increase in enforcement actions on items where modern slavery is suspected in production, including fish, palm oil and rubber gloves.
- The US Uyghur Forced Labor Prevention Act (UFLPA) was passed in December 2021, effective from June 2022. This works on the assumption that goods mined, produced or manufactured (wholly, or in part) in China's Xinjiang Uyghur Autonomous Region are made with forced labour and therefore will be subject to a US import ban.<sup>3</sup>
- The EU's proposed Corporate Sustainability Due Diligence Directive<sup>4</sup> would mandate companies to carry out due diligence and annual reporting on environmental and human rights issues throughout their global supply chains. Under the proposal, companies falling within the scope of the directive would be required to identify and, where necessary, prevent, end or mitigate the adverse impacts of their activities on human rights, such as child labour and exploitation of workers, and on the environment, for example through pollution or biodiversity loss.
- Fines may be imposed in the event of non-compliance, and victims would be able to sue for damages, if the negative impacts could have been avoided with appropriate due diligence measures. This directive would be applicable to EU companies of a certain size threshold, or operating in high-impact sectors, as well as non-EU companies operating in the EU being captured by the other criteria.
- The Japanese government has set up a panel on human rights in business supply chains. It aims to publish guidelines for companies in mid-2022, and will consider passing a law.

<sup>3</sup> Text - H.R.1155 - 117th Congress (2021-2022): Uyghur Forced Labor Prevention Act | Congress.gov | Library of Congress

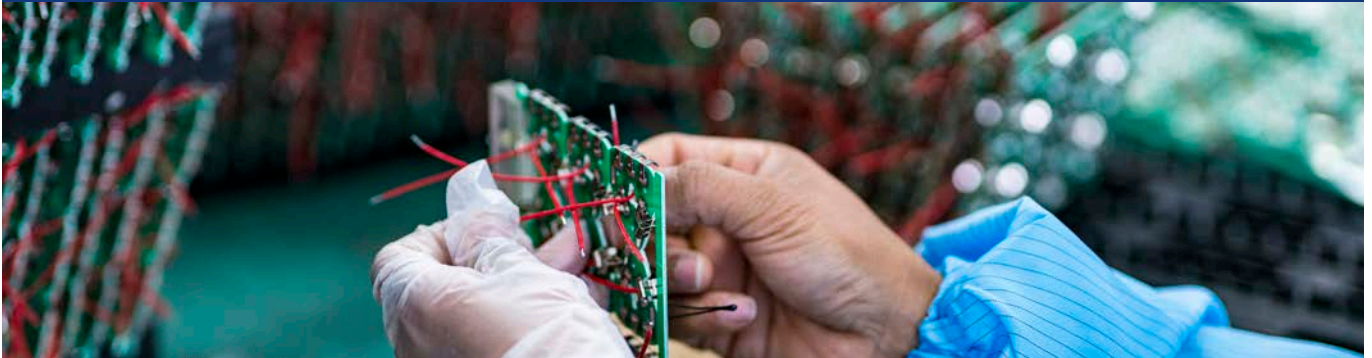
<sup>4</sup> Corporate sustainability due diligence (europa.eu)

<sup>5</sup> 8a8db7dc09e844bcb841c20adb00089.phpmcknw7 (onraport.com)





## Hon Hai



**We have engaged with Taiwanese electronics manufacturer Hon Hai – also known as Foxconn – since 2014 on a wide range of labour issues, including long hours and monotonous work. For example, we expressed our concern in 2017 following media reports that students aged 17-19 were working long hours and overtime, violating local law.**

In engagement, the company acknowledged that there were operational oversight issues. We discussed responsible remedial actions including the termination of the existing student worker programme and raising the working age to the international labour standard of 18, rather than adhering to the local Chinese standard of 16. The company subsequently developed a labour strategy, approved by the board in 2020, which prevented students under the age of 18 from working in production.

We continued to engage on other labour issues, discussing these with the head of investor relations in July 2020. Despite employing over one million people globally, Hon Hai did not have a human capital management strategy. It recognised that staff turnover was high, with most of its human resources work focused on administration, and it was unclear to what extent the issue was on the board's agenda. The company was aware that it needed to adapt to local circumstances. In India, for example, it encountered challenges as the local workforce did not want to reside in factory dormitories.

### Tracking and disclosure

We introduced several human capital management frameworks and metrics for tracking and disclosure and asked to discuss these with the chief people officer. The company already measured some of these metrics and had some good internal practices, but was concerned about disclosure. It was eager to learn about good practice, however, and we shared the relevant information.

In 2021 we asked the company about the risk of forced labour in and from the Xinjiang Uyghur Autonomous Region (XUAR). It shared a public statement saying that: "... at no time has Foxconn ever had employees in its workforce in any market who have not voluntarily joined our firm. Any allegations to the contrary are categorically false".

The company added that it had carried out an investigation and found some Uyghur ethnic minority workers at its Zhengzhou campus in China, but they had been there for over a decade. It added that it fully complied with the relevant laws and regulations in its code of conduct, which it had recently updated to keep up with good practice. It had asked the Responsible Business Alliance to conduct a Validated Audit Process, which published a report in October 2020 indicating that no workers from XUAR were employed at the time of the audit. The chair made a further statement in May 2021 that the company was committed to promoting and protecting the rights of each worker.

In 2022 there were news reports of worker protests at an Indian site due to food poisoning. We discussed this with the company and were pleased to learn of the quick response to address these concerns and the introduction of an anonymised grievance system. We discussed the importance of building trust so that grievances are raised and asked for more proactive disclosure of the working conditions assessments carried out by Hon Hai's teams, and of the third-party verification.

In May 2022 we were pleased to receive the company's new long-term social goals, which include milestones to 2025 and beyond, including some metrics. The plan addresses important aspects of a human capital management strategy, including human rights and labour standards, opportunities for employee feedback, and inclusion and diversity. Overall, this shows significant progress, and we remain committed to following up with the company on implementation.

## What can investors do?

Responsible investors should align with the UNGPs and develop a strong policy commitment, plus governance and leadership mechanisms to ensure that salient human rights risks are investigated, and appropriate due diligence is implemented. This should involve engagement with identified high risk companies or sectors. The Principles for Responsible Investment (PRI) has developed useful guidance on how to do this<sup>6</sup> and institutional investors will be able to collaborate through its new Advance initiative to address human rights and social issues.<sup>7</sup>

Investors should take a holistic approach to engaging with companies on these issues. For example, a US company may perform poorly in terms of providing decent work to employees in its supply chain, but a Taiwanese company in the same chain may face challenges with its direct employee base.

## Our engagement approach

Our engagement with companies focuses on their responsibility to respect human rights as outlined by the UNGPs. This begins with aspects such as policy and governance, but also encourages companies to do more to document effective human rights due diligence that has identified supply chain impacts and provided remedy. We engage on how a company can provide meaningful grievance mechanisms that allow affected workers to be heard, and provide feedback for solutions.

**We encourage companies to use their leverage and collaborate with each other, recognising that transformative change requires collective action.**

We also encourage companies to move beyond the relatively standard process of auditing supply chains - which may identify concerns but not provide remedy - to consider how

their own actions may be exacerbating poor working conditions, and how to address this. Falling under the umbrella term of purchasing practices,<sup>8</sup> this challenges the common approach of pushing much of the burden for improving working conditions on to suppliers alone.

For modern slavery and child labour in a high-risk sector, or if the company has identified modern slavery as a salient risk, we engage on how companies can implement tailored due diligence. This should focus on how to identify the ILO's forced labour indicators<sup>9</sup> or use the Children's Rights and Business Principles.<sup>10</sup> We believe that companies in high-risk sectors should "find it, fix it and prevent it"<sup>11</sup> given the prevalence of modern slavery and child labour in some sectors.<sup>12</sup>

Companies should also use their leverage and collaborate with each other, recognising that transformative change requires collective action. Examples include:

- The Global Platform for Sustainable Natural Rubber<sup>13</sup> has brought industry participants together, spanning smallholder farmers, processors, traders and end-product manufacturers, alongside civil society. The initiative aims to develop and advance policies, adopt grievance mechanisms and share knowledge, enhancing traceability and building capacity, particularly for smallholders.
- The Responsible Glove Alliance<sup>14</sup> was launched in 2022, following the imposition by US Customs of several Withhold Release Orders during the pandemic.<sup>15</sup> This highlighted some practices of concern within the medical supplies industry in Malaysia. The Alliance's aims are to work with buyers and suppliers to transform recruitment practices through collective influence, recognising that unless buyers are consistent in their desire for higher standards the incentives for forced labour will remain. We have engaged with glove manufacturer Ansell on labour issues (see case study).
- The Responsible Minerals Initiative<sup>16</sup> provides resources for companies seeking to address mineral sourcing issues in their supply chains. It has over 400 corporate members.

<sup>6</sup> Why and how investors should act on human rights | Thought leadership | PRI (unpri.org)

<sup>7</sup> Collaborative stewardship initiative on social issues and human rights (unpri.org)

<sup>8</sup> About Purchasing Practices – Better Buying

<sup>9</sup> ILO indicators of Forced Labour

<sup>10</sup> [https://www.unglobalcompact.org/docs/issues\\_doc/human\\_rights/CRBP/Childrens\\_Rights\\_and\\_Business\\_Principles.pdf](https://www.unglobalcompact.org/docs/issues_doc/human_rights/CRBP/Childrens_Rights_and_Business_Principles.pdf)

<sup>11</sup> Find It, Fix It, Prevent It: Annual Report | CCLA Modern Slavery (modernslaveryccla.co.uk)

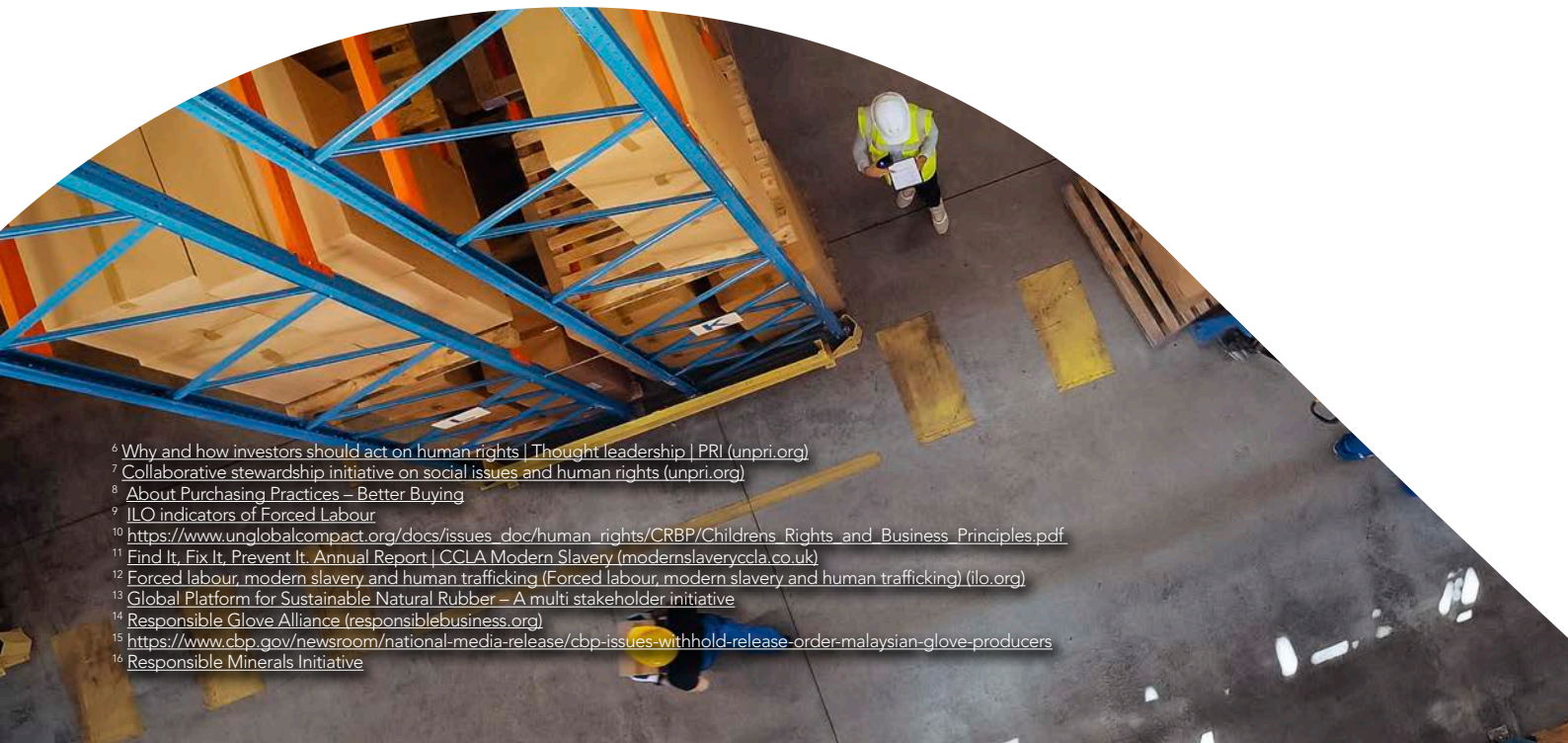
<sup>12</sup> Forced labour, modern slavery and human trafficking (Forced labour, modern slavery and human trafficking) (ilo.org)

<sup>13</sup> Global Platform for Sustainable Natural Rubber – A multi stakeholder initiative

<sup>14</sup> Responsible Glove Alliance (responsiblebusiness.org)

<sup>15</sup> <https://www.cbp.gov/newsroom/national-media-release/cbp-issues-withhold-release-order-malaysian-glove-producers>

<sup>16</sup> Responsible Minerals Initiative





## Ansell



**We engaged with Australian personal protective equipment company Ansell in 2021 and Q1 2022. Labour conditions in its single-use glove supply chain, which is 80% outsourced, were among the topics we discussed. Suppliers are under pressure to improve their treatment of workers – mainly migrants – due to US law enforcement and the associated pressure on buyers.**

The company's view, similar to our argument for engagement, was that it could make a bigger impact by remaining in a position of influence. Ansell relies on independent inspectors to visit its suppliers, typically every 12-18 months. Although this was disrupted by Covid-19, the frequency of visits is rising, and the company has acknowledged the limitations of such audits.

A small number of Ansell's suppliers were affected by US import bans in relation to alleged forced labour

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practices, including Top Glove, the world's largest manufacturer of latex gloves.<sup>17</sup> The ban was later lifted following improvements.<sup>18</sup>

In response to the greater focus on labour standards, Ansell committed to ensuring that no fees are levied for recruitment. It will reimburse fees paid by some migrant workers to home country agents, and revamp its supplier management framework. Ansell is also one of seven founding members of the Responsible Glove Alliance.

This is a positive development given the need for cross-industry action to address the sector's pervasive forced labour issues.

### Living wages

We also discussed low wages, as these can be an underlying factor in human rights abuses. The company pays a "locally-appropriate living wage", and wages are above the legal minimums even at its outsourced suppliers. Excessive overtime has been a bigger problem recently given product scarcity against the backdrop of the pandemic.

Ansell undertook a living wage gap analysis for its own employees in 2021, with the support of global consultancy Mercer. While most of its plants were already paying above the defined living wage, a few gaps were identified at its Southeast Asia plants, which Ansell said it would address by the end of 2023.

A living wage gap will persist for some indirect workers, but Ansell does not set the terms and conditions of employment for its suppliers' operations. The allegations around modern slavery are illustrative of the challenges in enforcing standards in supply chains, and demonstrate the need for a collective multi-stakeholder response on living wages by outsourced suppliers. The Responsible Glove Alliance may provide the platform for such an initiative.



**Will Pomroy**  
**Head of Impact Engagement –**  
**Equities**  
[will.pomroy@hermes-investment.com](mailto:will.pomroy@hermes-investment.com)

<sup>17</sup> <https://www.reuters.com/world/asia-pacific/us-customs-determines-forced-labour-malaysias-top-glove-seize-gloves-2021-03-30/>

<sup>18</sup> <https://www.reuters.com/business/malaysias-top-glove-says-cleared-resume-business-with-us-2021-09-10/>





## CASE STUDY

## Baidu



**We raised our concerns about working conditions and employee wellbeing at Chinese technology company Baidu in 2018, due to some significant employee turnover. In May 2019, we intensified our engagement on human capital management after the departure of several senior executives, including the chief operating officer.**

We communicated our concerns about the accelerated outflow of Baidu's technology talent, which was heightened by growing competition from within the technology industry and banks seeking to build digital offerings. Baidu said this phenomenon was not a new one in the Chinese technology sector and its attrition rate was not higher than historical levels. We urged Baidu to disclose relevant human capital management indicators and its talent retention efforts.

In February 2020, we wrote to the combined chair/CEO with a proposal to discuss our human capital management framework and the new standards from the International Organization for Standardization, to support improved disclosure and measurement.

After another meeting with the company in March 2020, we sent a letter asking Baidu to:

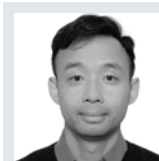
- Enhance its disclosure of its governance structure for human capital management and provide a contextual explanation of how it is linked to Baidu's core values and culture.
- Disclose time-series data (if possible) on turnover, retention rates and employee engagement.
- Disclose diversity and inclusion data quantitatively and qualitatively.
- Make disclosures on employee wellbeing, including mental health.

Following the release of Baidu's 2019 ESG report, we provided written feedback to the company in June 2020, welcoming the improved disclosure and pressing for the disclosure of retention and turnover rates.

In 2020, the company released a human rights policy, aligned to the Universal Declaration of Human Rights, the UNGPs and the ILO Declaration on Fundamental Principles and Rights at Work, one of the few Chinese companies to do so. In March 2021, the company issued a special report on how it was delivering its human rights policy, incorporating employee feedback and enhanced disclosure.

To read the full case study, go to:

<https://www.hermes-investment.com/ukw/eos-insight/eos/baidu-case-study-2022/>



**Kenny Tsang**  
Sector co-lead:  
Consumer Goods

[kenny.tsang@hermes-investment.com](mailto:kenny.tsang@hermes-investment.com)

## Outlook

During 2022, we will increase our engagement focus on how companies can develop a clear understanding of the salient human rights issues in their operations and supply chains. We will examine whether effective and proportionate controls are in place to identify, mitigate and remedy these issues.

We will also participate in the PRI's Advance initiative, collaborating with institutional investors

and other stewardship service providers to accelerate change on human rights and social issues. Companies targeted by the initiative will be asked to fully implement the UNGPs, align their political engagement with their responsibility to respect human rights, and deepen their progress on the most severe human rights issues in their operations and across their supply chains.

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