

REVIEW SYMPOSIUM

On Richard M. Locke, *The Promise and Limits of Private Power: Promoting Labor Standards in a Global Economy*, New York, Cambridge University Press, 2013.

Keywords: corporate social responsibility, governance, industrial relations, inequality, internationalization, multinational firms

JEL classification: J50 labor-management relations, trade unions, and collective bargaining, M14 corporate culture, social responsibility; P16 political economy

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The emergence of huge new cohorts of workers and consumers in the fastest growing developing economies, together with ever more rapid innovations in technology and business models in the advanced countries, are producing vertiginous changes in the organization of global supply chains and the conditions of work in the developing country factories they link to world markets. No one has searched more insistently, ingeniously and broadly—in industries from apparel and electronics to sugar cane—nor looked so high and low—from corporate data bases on supplier compliance with labor standards, to hundreds of interviews with workers, managers and NGOs active in supplier factories the world over—than Richard Locke. In a series of articles over the last decade, often with his then graduate students at MIT, in the recently published *The Promise and Limits of Private Power*, which synthesizes much of that work, and in a new unpublished paper, “Does Lean Capability Building Improve Labor Standards? Evidence from the Nike Supply Chain,” with Greg Distelhorst and Jens Hainmueller (LDH), Locke has somehow managed not only to stay abreast of these changes, but to use his deep understanding of them to explain the successes and failures of repeated efforts by NGOs, corporations themselves and (on occasion) national governments to improve conditions of those who work in the factories that make so much of our material world (Locke, 2013; Locke et. al., 2013; Locke et. al., 2007a; Locke et. al., 2007b; Locke et. al., 2009; Locke et. al., 2012; Locke and Coslovsky, 2013; Locke et. al., 2013).

1. Traffic on the High Road: Lessons from Richard Locke's Recent Work

What emerges is a good news, bad news story, with the double twist that the bad news—the failure of traditional forms of compliance monitoring—comes first and the good news—improbable changes in the organization of supply chains that open new possibilities for improved labor conditions and worker empowerment—may well prove incomparably better than the bad. Both by the failures that it documents and the possibilities that it brings sharply into focus, the work of Locke and his co-authors will set the agenda for debate about labor standards and how to improve them, and by extension the debate about effective regulation, domestic and international, in other domains as well. That the work reframes, but leaves unanswered many familiar questions about labor conditions, while raising new ones, is just another way of saying the same thing.

The somber news is quickly told. Beginning in the mid-1990s, in response to public outrage at reports of widespread violations of minimum standards of decent working conditions in global supply chains, transnational firms with valuable reputations to protect pledged themselves, and obligated their suppliers to adhere to codes of good conduct, policed by third-party (often NGO) standard setters/auditors (in the case of Levi-Strauss, for example), or by internal, corporate auditing units (the case of Nike). These private auditing systems entailed substantial costs—“years of effort and significant investments by global corporations in developing evermore comprehensive monitoring tools, hiring growing numbers of internal compliance specialists, conducting thousands of factory audits, and working with external consultants and NGOs.” Despite the certainty of inspection and the possibility of significant sanctions, including the loss of business, they did not work either as a significant deterrent to violations in general, or even to distinguish a substantial group of good actors, willing to comply with code terms for reasons of their own, from the sharp operators intent on getting away with whatever they can. In *The Promise and Limits of Private Power*, after careful analysis of grades assigned to supplier factories by Nike auditors in successive inspections, Locke finds that while there has been some improvement in areas such as health and safety, there was none in others, such as freedom of association or excessive working hours; and, crucially, “these improvements appear to be unstable in the sense that many factories cycle in and out of compliance over time.” Despite the nuance the conclusion is unequivocal: “After more than a decade of concerted efforts by global brands and labor rights NGOs alike, private compliance programs appear unable to deliver on their promise of enforcing labor standards in today’s new centers of global production.”

The news is all the more sobering because it is unlikely that a public or NGO-based system of labor inspection, at least one focused, as these corporate ones are, on deterrence through the imposition of penalties, would have done much better. Of course public authorities or NGO inspectors might be less constrained in the imposition of penalties than corporate auditors, subordinate as they are to the higher authorities in the firm who will be tempted to give otherwise reliable suppliers a pass on (all but the worst) labor violations. But this increased autonomy is offset by other limitations—for instance, the impossibility of auditing firms with anything like the regularity that is routine for corporate inspectors, and the corresponding loss of detailed knowledge about individual factories. In theory deterrence works if the fine imposed for a violation, discounted for the probability that the violation will be detected and sanctioned, is greater than the benefit of the wrongdoing. It is hard to see how any realistically resourced public authority or NGO could achieve a more effective combination of detection and sanctions than the corporate auditors, and therefore reasonable to see Locke’s findings as sapping the little confidence that remains in deterrence, promoted by public, private or civil society actors, as an effective means of improving labor conditions.

But the story does not end here, and it is in the sequel, hinted at in the book but told largely in LDH, that the good news starts. Even as the auditing program continued to expand, Nike began experimenting with a second, “capacity building” approach to supplier relations. The core of this approach, as Locke explains, is that suppliers are not seen as “immoral agents motivated by a desire to cheat their way through inspections,” but rather “as willing partners who simply lack certain organizational skills for effective code of conduct enforcement.” In a private capacity-building system the buyer provides (often for a price) the training the supplier needs to acquire the skills to comply with their obligations.

In fact Nike’s capacity-building program is a particularly demanding and transformative variant of capacity building: it aims to shift supplier firms from manufacturing systems based on mass production by unskilled workers to lean production systems in which buffer inventories are removed to make sources of disruption (unreliable machines, erratic material flows) conspicuous, and line workers and supervisors collaborate to continuously improve production by identifying the underlying or root causes of such disruptions and successively eliminating them. It is thus an example of what was called, in an older vocabulary, a shift from the low to the high road of production. On the low road (as in the prototypical case of the sweat shop) the firm has only variable costs (the factory building is rented, as are all production machines, and workers are paid by the piece), and the owners therefore have no

reason to invest in training or decent conditions for the workers—in fact, neglect of the facilities and the brutal “driving” of labor are profit-maximizing strategies. But once firms move to the high road by making investments in equipment or organizational routines that require a skilled and stable workforce as complements, increases in productivity and profits go hand in hand, in theory, with improvements in at least some aspects of labor conditions, especially training.

In LDH’s terse account, Nike approached this high-road variant of the capacity-building strategy cautiously (could developing country suppliers master the techniques at acceptable rates and costs? would conditions in the footwear and apparel industries make such investments worthwhile?), but meticulously and with great tenacity. Responding to problems both in workplace conditions and in product quality in the late 1990s, Nike, with the help of a consultant, first adapted lean production to footwear manufacturing: footwear suppliers are typically large firms and thus more likely than many of Nike’s smaller apparel suppliers to already possess many of the managerial capacities needed for lean. By 2004, Nike had obtained commitments from long-term footwear suppliers to shift to the new system, and established a center in Vietnam to train both factory managers and Nike staff. By May 2011, 80 percent of Nike’s footwear manufacturers had at least taken the first steps towards the transformation of their production set up.

According to Nike the program increased productivity, decreased defect rates, and reduced the time needed to replenish customers with existing models and to introduce new ones. Taken together, as a general assertion that lean production is good for suppliers and good for Nike, the claims seem credible; in any case Nike acted as though it is, extending the program to its far-flung apparel supply chain, including hundreds of factories. The pattern of adoption was the same as in footwear: Lead suppliers—members of Nike’s Apparel Management Leadership Forum—were invited or urged to commit to reorganization. In 2009 a dedicated school for teaching lean techniques in apparel production was created, this time in Sri Lanka.

The program is rigorous. Managers spend three months at the school, much of it in a teaching factory that allows them to observe lean principles applied in context and to test their understanding in practice. Their employer pays tuition costs. Upon completion of the program the trainees together with a Nike manager develop a “proliferation” strategy for their home factories, starting with particular elements in a pilot line and adding more until the shift is stabilized.

LDH provide the details of Nike's definition of a lean line to leave no doubt as to just how precise and demanding it is. To count as lean for Nike, a supplier's assembly line must be part of a manufacturing process that adds significant value to the product (no Potemkin villages); eliminates inventory buffers so that upstream production is triggered or pulled by an explicit signal from a downstream station; allows line workers to stop production by pulling Andon cords in case of urgent problems; keeps track of relevant measures of quality, cost, on-time delivery and safety; standardizes good practices; inspects work as it occurs, station by station, not at the end of the production line (when repair is costly and the root causes of problems harder to identify); keeps production orderly (with parts easily identified in bins and tools displayed to facilitate use), and arranged so that disorder—machine breakdowns or disruptions in flow—are conspicuous; and ensures that value-adding processes are well coordinated. When suppliers believe that one or more lines qualify under this standard, they request Nike to certify that it has.

This is to all intents and purposes a supplier qualification program, and a demanding, transformative one. Nike sourcing managers today nominate participants to the program; presumably only the most promising are selected. To "graduate" from the program suppliers must demonstrate to a Nike inspector, production line by production, that their factory organization meets the criteria of lean. What is learned, and how well, is subject to constant scrutiny. Trust or long-term commitments on both sides may play some role in establishing eligibility; moreover, once suppliers have demonstrated the new capacities, the costs to Nike to switching to other, less proven ones is high—so a long-term relation (and the kind of trust that continued exchange easily generates) may be the outcome of the qualification process, even if it is not the precondition or foundation. But performance, continuously monitored, not the character of the prior relation, is decisive.

This kind of supplier qualification program is well established among top-tier suppliers and multinational firms in the auto, agricultural implements and machinery sectors in advanced countries, with the important difference that suppliers are typically expected to do much more of the learning on their own. The important novelty here is the combination of a supplier grading system and the use of tightly organized capacity building by the buyer to spread lean production methods to low-skill parts of global supply chains, where it seemed that the prevailing combination of high volumes, fashion and price sensitivity (generating contradictory pressures for rapid model changes and rigid cost control) might

create so much volatility in factory conditions that re-organization—even re-organization that makes it easier to respond to volatility—would not be feasible.

2. Lean and Labor Conditions

But, still assuming that Nike would not put the entire apparel supply chain at risk and unless the program benefited it and participating suppliers, is this also a high-road solution, improving conditions for workers in lean factories as well? The extraordinarily good news in Locke's story is that it is. In LDH Locke and his co-authors examine the results of Nike labor standards audits in 300 factories in 11 countries (principally China, India, Malaysia, Sri Lanka and Vietnam) from 2009 until the present, as lean-production lines are being introduced. They use the incremental implementation of lean to construct standard fixed-effect regressions that control for unobserved particularities of individual factories; to check the robustness of their model they look for improvements in labor conditions in the years before lean is actually introduced—when managers may have acted in anticipation of the ultimate effects of reorganization—and report no such placebo effects.

The findings regarding the effect of lean on factory conditions are, with two qualifications, striking. Nike's grading system for labor conditions ranges from A to D, with scores of C and below associated with serious violations of labor standards, such as sub-minimum wages, systematic abuse of overtime, and employment of underage labor. The introduction of lean reduces the probability of receiving a C grade or less by 15 percentage points, from 40 percent to 25 percent. LDH speculate that the improvement may have resulted from a combination of enhanced managerial skills (better record keeping, including better records on work hours), investment in worker skills (and the forms of workplace participation this can entail) and changes in the relation between buyer and supplier that reduce volatility inside the factory.

But in *The Promise and Limits of Private Power*, Locke presents a case study of a Mexican lean supplier of T-shirts to Nike that offers a better glimpse of how the new form of organization transforms working conditions: Operators in the lean plant worked in teams, learned to work at many machines (and said in interviews that they valued job rotation), did routine maintenance, set production targets in consultation with supervisors and reviewed production set-ups jointly with them as well. Their wages and productivity levels were also higher than those of workers in a comparable Mexican supplier to Nike using traditional manufacturing methods. So at the very least a large-scale shift to lean production

defined and certified as Nike does opens possibilities for worker participation and empowerment inconceivable on the low road.

Now to the qualifications. The first is that the introduction of lean does not lead to corresponding improvements in health, safety and environmental conditions at the workplace. LDH have a ready and convincing explanation: restructuring focuses on production lines, so regulatory infractions—broken ventilators, blocked emergency exits, missing environmental permits or licenses for hazardous materials—are likely to escape the attention of such initiatives. These problems will have to be addressed in other ways.

Second, and more disquietingly, the study finds important country effects: the lean program has no effect on labor conditions in China (where half of the factories in the sample are located) and Sri Lanka. In part this is, LDH show, because factories in these countries are much slower to adopt lean than their counterparts in the others. But why is that? One possibility is that turnover rates in Chinese factories, to take the overwhelmingly important case, are so high that the workforce does not stay in place long enough to accumulate the skills that underpin lean production. (LDH note that one goal of the program was to reduce turnover rates, but they do not report the results for China or elsewhere.) The turnover rates in the Mexican suppliers, lean and traditional, that Locke studied were in the range of 8 to 10 percent per year. Reputable suppliers in China can have monthly turnover rates in that range. The astronomical turnover rates appear to result from disappointed expectations—the realization by the new labor market cohorts that they can neither return to rural homes nor advance past their dead-end factory jobs—and the harsh living conditions in dormitories often built and controlled by municipalities, not their employers. Even if these conditions are regional, not national—lean production seems to be well established in much of the machinery and other metal-working industries in the traditional industrial heartland of Northeast China (Herrigel, 2013)—they will be hard to change where they have become entrenched. Will Nike and other transnational buyers move, say to Vietnam, where lean is quickly implemented and wages are, to boot, lower than in China? Or is it just a matter of time before the diffusion of lean reaches a threshold level at which increases in productivity, quality and responsiveness lead to substantial improvements in working conditions and wages, further stabilizing the workforce and setting of a more robustly self-reinforcing cycle of change?

2. What induced Nike to experiment?

Questions like these about conditions in the supplier economies prompt complementary ones about the strategy of Nike and other transnational organizers of global supply chains. What induced Nike to experiment with and above to persist in efforts to develop a lean capacity-building system? Increasing problems with defects and on-time delivery as models became more complex and markets more changeable? The promise of large productivity gains? Or, most likely, some compelling combination of these? What lessons has Nike learned from the successes and limits of its program about the possibilities of capacity building in developing countries, and the most effective ways to organize a supplier-development program? Has Nike begun to integrate decisions about sourcing with a (revamped) system for checking and fostering compliance with labor standards? Or, as the pieces of the story reported in Locke's work seem to imply, are the two units still worlds apart, with sourcing having, in the end, the real say?

We know that Nike is not alone in pursuing this kind of strategy. Locke mentions the well-documented case of IKEA's highly developed and successful program of building supplier capacity (Ivarsson and Alvstam, 2010); and in *The Promise and Limits of Private Power* he presents a compact case study of the extraordinary capacity-building assistance provided by ABC corporation—a global apparel producer—to Sula Shirts, a Honduran supplier, to enable Sula to master quick-turnaround techniques to rapidly replenish the US market after the expiration of the Multifiber Agreement in 2005 exposed the firm to low-wage Asian competition. But Nike's efforts are on an entirely different scale; learning why the firm did what it did and what it has learned by doing it will undoubtedly shed light on the direction of development of many important supply chains.

If we accept Locke's conclusion that real improvement in labor conditions depends on capacity building for pervasive organizational change—the turn to the high road—questions such as these are of urgent practical significance. The more we know about the conditions under which transnational firms and developing country suppliers in traditionally low-skill industries are discovering mutual interests in shifting to lean in Nike's precise and demanding sense, the more we know about the situations in which the problem of labor standards is likely to become more tractable, even if—keeping in mind the first qualification, regarding the limits to the transformative character of lean—the problem will not solve itself. Put the other way around, the more we know about the conditions under which upgrading to lean is likely to occur spontaneously, as a reaction to market conditions, the more we can focus on the harder

cases—the firms that don't qualify for the supplier development programs—where some kind of intervention, presumably public, is needed.

Note that investigation of these hard cases is likely to lead away from familiar debates about labor standards and towards development economics—especially industrial policy, the quintessential province of capacity-building efforts at many scales in developing economies. And high time: Development economists have devoted much effort in recent years to debating whether industrial policies—in precisely the sense of deliberate efforts at capacity building—are worthwhile or not, with the consensus in the World Bank and elsewhere shifting in favor of their advisability and even necessity (Greenwald and Stiglitz, forthcoming). But deplorably little effort has gone toward understanding how, institutionally, these policies succeed when they do. Participants in the labor standards debate have, for their part, too often treated respect for workers as a necessary side constraint on growth, not a condition for it. Locke's discovery of significant traffic on the high road suggests that, in the parlance of contemporary politics, it is time for these two groups to have a conversation.

But even within the “easy” domain of mutually beneficial capacity building Locke's findings raise questions that are hard enough. Freedom of association, understood as freedom to organize unions and bargain collectively, is one of the ILO's four, core labor standards, and it is echoed in all labor codes (though of course in some countries, such as China, the state reserves the right to license a single, monopoly union). Yet the kind of workplace empowerment that seems to develop naturally with the shift to lean production does not lead in any straightforward way to the formation of association across and outside workplaces. How should we think about this? In a world of increasing economic polarization, in both developing and advanced countries, it is hard to imagine a vital civil society without active unions. But it is also true that unions in advanced countries have struggled for decades, with meager results, to find a way to accommodate the decentralization of decision making within firms, and the direct worker empowerment associated with it, with traditional and (often much more) centralized forms of bargaining over wages and work conditions. If you still have some faith in the cunning of reason, or the moral arc of history, you may hope that the spread of lean, workplace empowerment in settings without established, workable unions may offer the labor movement another chance at rebirth. But in any case the relation between lean and the freedom of association remains a crucial open question (Barrientos and Visser, 2012; Barrientos et. al., 2012). Given the limits of the spill-over effects

of lean—its inattention to environmental and health and safety issues above all—analogous questions can be raised about new forms of regulation addressing these issues.

Even if questions abound it is clear that through dogged investigation and dispassionate insight Locke has shown us how to see amidst a jumble of sad facts—to many, and understandably, no more than the ruins of a decent system for protecting labor conditions, and of failed efforts to reconstruct it—pieces of a puzzle that figures a new regime. Following his lead, we need to bend our efforts to finding and fitting more pieces to the solution, and above all thinking hard about remaking the ones that don't mesh so they do.

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