PRODUCTIVITY: THE KEY TO FUNDING LIVING WAGES?

POSSIBILITIES, LIMITATIONS AND ALTERNATIVES ALONG THE APPAREL VALUE CHAIN

A discussion paper by Fair Wear Foundation

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Fair Wear Foundation (FWF) is an international multi-stakeholder non-profit organisation that works with clothing companies –and their supply chains– to improve working conditions in the garment industry. By becoming a member of FWF, a company commits to implementing the FWF Code of Labour Practices throughout its supply chain. Currently over 130 brands have joined FWF. FWF strives to increase awareness about working conditions and workers' rights in textile factories.
For more information, please visit www.fairwear.org.

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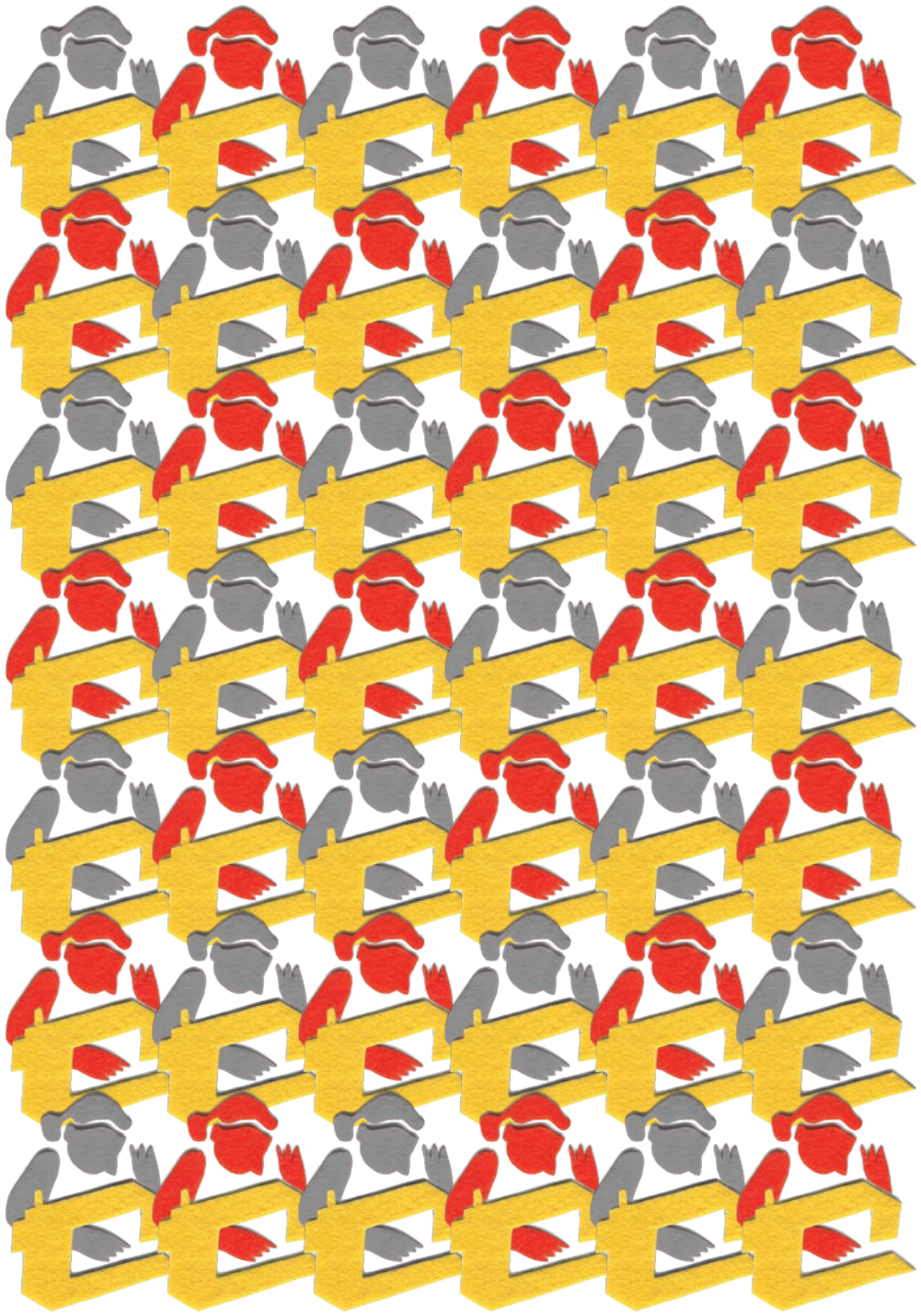


INTRODUCTION

After many years of debate on how to define a living wage in garment-producing countries, attention is starting to turn to questions of how to implement better wages. One of the most pressing questions for many industry stakeholders is how to offset the cost of higher wages.

The work of Fair Wear Foundation and others to date has found that labour comprises a very small part of the retail cost of garments, meaning that significant wage increases will not necessarily require major price increases to retail customers.[1] Nonetheless, efforts to implement living wages do need to address questions of where to find the money in supply chains to offset the costs of higher wages.

Stakeholders working with FWF often identify productivity or efficiency increases at factories as 'the solution' to living wages: if factory productivity is increased, there will be enough money to improve wages. Many brands also question whether paying more to support wages without addressing productivity issues is the equivalent of rewarding the poor efficiency of factories.

This discussion paper is designed to explore the relationships between productivity, efficiency and living wages, and to locate productivity and efficiency gains within the larger universe of options for funding living wages. It begins with a basic overview of how productivity and efficiency interact in the garment industry. It then outlines the potential effects of productivity drives on both costs and workers, and discusses the importance of negotiating with workers on how to manage the potential negative impacts of productivity increases.

This paper is written for a variety of readers who are involved with work on living wages, but who may not normally deal with productivity, efficiency or product pricing as part of their everyday work, including CSR managers, trade unionists, government policymakers or NGO staff, for example.

This paper was published as part of FWF's Living Wage Incubator programme, under the Strategic Partnership for Garment Supply Chain Transformation.

1 See FWF's reports Climbing the Ladder to Living Wages, Living Wage Engineering and Living Wages: An Explorer's Guide.

PART 1
PRODUCTIVITY, EFFICIENCY AND WAGES IN GARMENT SUPPLY CHAINS

In discussions around costs, prices and wages, you will sooner or later come across the widely used terms *productivity* and *efficiency*. These are often used interchangeably, but both terms describe similar things – though seen from different perspectives.

PRODUCTIVITY

Productivity is a way of explaining how much output (e.g. number of shirts) can be made from a given amount of input (work time, machines, etc.). The general formula for productivity is:

OUTPUT ÷ INPUT = PRODUCTIVITY, but there are several specific productivity measures that are commonly used in the apparel industry. They often describe the relationship between a defined period of time (e.g. 1 hour) and the number of units that can be produced during that time (e.g. 100 shirts). Common measures include:

LABOUR PRODUCTIVITY =
The output that a given number of workers can make in a given time frame.

For example, the number of shirts made per hour by a production line of 22 workers.

THE NUMBER OF SHIRTS MADE BY 22 WORKERS IN 60 MINUTES

MACHINE PRODUCTIVITY =
The output per machine in a given time frame.

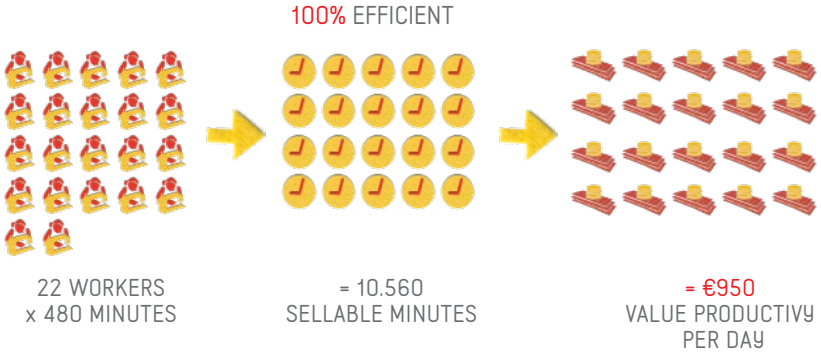
For example number of t-shirts than can be screen-printed in an hour by one machine.

THE NUMBER OF SHIRTS WORKED BY A MACHINE IN 60 MINUTES

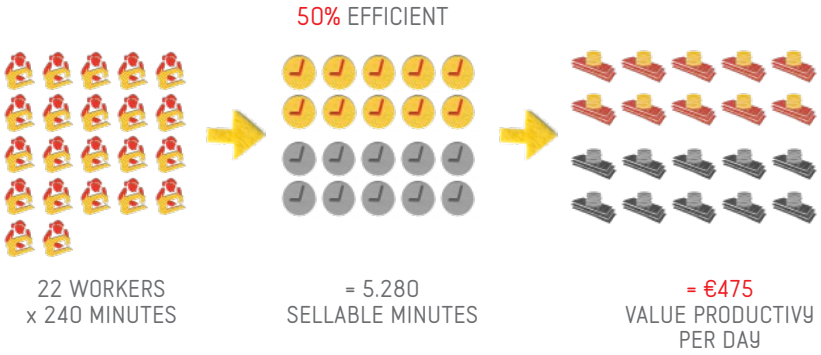
VALUE PRODUCTIVITY =

The total value of output in a given time frame.

This measure is commonly used by factory management to determine how many minutes' worth of production time they will be able to sell to their buyers.



For example, 22 sewing workers each working 480 minutes = 10 560 capacity minutes that the factory can 'sell'. At a working minute price (a concept described later) of €0.09 euro per minute this production line would have a value productivity of €950 value per day or €23 750 per month (with 25 working days).



However, the efficiency of that production line has a major effect on the value productivity. If the same line is only 50% efficient, the factory will only have 5 250 'sellable' minutes per day, with a value productivity of €475 value per day or €11 880 per month (with 25 working days).

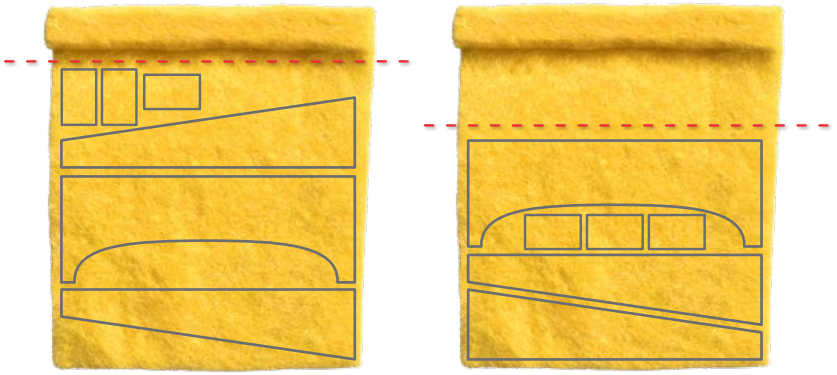
Obviously, efficiency and specifically *line efficiency* is an important concept, and it is covered in the next section.

EFFICIENCY

Efficiency can be defined as finding the optimum way to do things in a factory. Efficiency relates to *how well a goal is accomplished*, generally by measuring the quantity of resources used, and waste generated in comparison to the goods manufactured. This is often expressed as a percentage. As with productivity, efficiency measures can also focus on labour, machines or a number of other resources. And because all of those resources represent expenses, the efficiency with which they are used has a direct impact on a factory's production costs.

For example, there are more and less efficient ways to lay out the pattern for a garment on a piece of fabric; the amount of waste is known as marker efficiency. It shows the pieces which need to be cut out to make a shirt.

In this example, the layout of the shirt in pattern 1 is 85% efficient (15% of the fabric is thrown away), but the layout for the same shirt in pattern 2 is 90% efficient (only 10% of the fabric is thrown away). Higher marker efficiency means less fabric is thrown away, and results in a lower cost per product.



85% EFFICIENT

90% EFFICIENT

In apparel, one of the other most important and common measures of efficiency is line efficiency.

The technical definition of **LINE EFFICIENCY** is:

$$\text{LINE EFFICIENCY} = \frac{\text{TOTAL MINUTES PRODUCED BY THE LINE} * 100}{\text{TOTAL MINUTES ATTENDED BY ALL OPERATORS}}$$

More generally line efficiency refers to the ability of an assembly line to achieve a set production target. Targets are commonly measured relative to 'Standard Allowed Minutes' (SAM) or Standard Minute Values, the amount of time it should take to make a garment. For example, a t-shirt can have a SAM of eight minutes which means that under ideal conditions, it should take eight minutes to sew the garment together.

Factories, for a variety of reasons, often take much longer than the Standard Allowed Minutes to make a given garment. It is not unusual for a garment factory to operate at 50% efficiency or less. At 50% efficiency it would take 16 minutes to make our example eight-minute shirt. There are many possible reasons for low efficiency: poor factory layout, unergonomic work-stations, low morale, poorly-trained workers, poorly-trained managers, worker exhaustion from chronic overtime, power outages, on-going delays in fabric delivery and many other issues. Factories operating 100% of SAM benchmarks are extremely rare. It is worth noting that in today's industry, factories operating at 85% of SAM are considered to be performing well.

Let us imagine that buyer and supplier agree on a price to make a t-shirt with a SAM at eight minutes (e.g. in a 100% efficient factory, it should take eight minutes to pass from the cutting room to inspection):

In our example factory, however, several issues slow down the production process. A combination of regular power outages, low worker morale caused by verbally abusive and poorly-trained line supervisors and an inefficient factory layout, mean that on average it takes 16 minutes for the production line to make the t-shirt. The line efficiency is then 50% (e.g. the factory is half as efficient as a factory that could make the garment in eight minutes under ideal conditions).

In any consideration of productivity, and indeed in any well-run price negotiations between brands and factories, discussions should revolve around three main concepts which have been introduced in this section: time, cost and efficiency. Those three concepts are measured using the following terms:

Time in Standard Allow Minutes (SAM): *SAM defines how many minutes it should take to make a particular garment.* These benchmarks are generated by a number of specialist companies and organisations (e.g. General Sewing Data, Sew Easy and REFA). Not all factories use the same method. Most factories work with some type of time calculations; however the methods are not standardised and are often developed by the factories themselves, which also makes comparisons between factories difficult.

Working Minute Cost: *The per-minute cost of operating the factory.* (This is calculated by adding up the total annual cost of all salaries, rent, electricity etc. and dividing it across the total number of sewing minutes the factory operates during the year.) See FWF's Labour Minute Costing for more details.

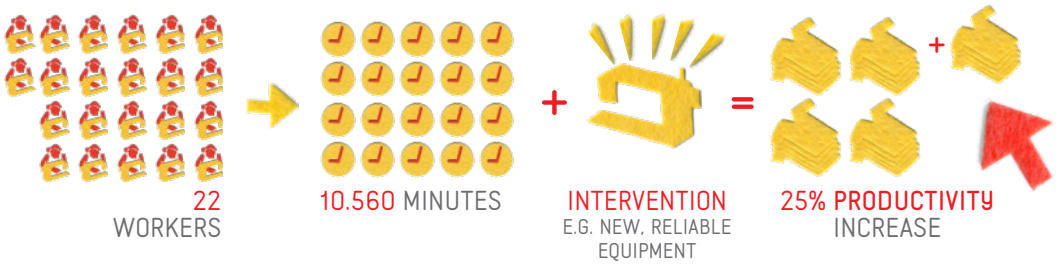
Efficiency Factor: *How long it takes the factory to actually make a garment, compared to SAM.* It is normally expressed as a percentage. Some factories already include the efficiency factor in their SAM quotes, so it is important for customers to understand whether this is the case.
In the following section, we will see how these three components interact.

THE IMPACT OF PRODUCTIVITY AND EFFICIENCY CHANGES

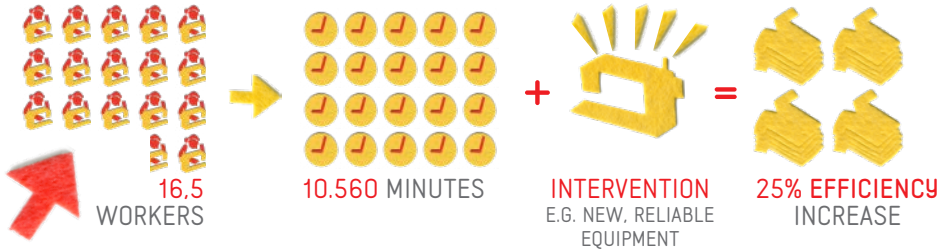
As is clear from these examples, productivity and efficiency levels are closely related, and a factory may focus on improving either or both.

Improvements in productivity and/or efficiency are linked to manufacturing costs in supply chains because they influence the cost per garment. In an apparel factory, one might aim to produce more garments with the same amount of resources – a *productivity increase* – based on an assumption that customers will purchase the additional garments being made. Or a factory could produce the same amount of garments with less resource input – an *efficiency increase*. In both scenarios the cost per piece will drop, because the share of the factory's fixed costs per garment will be lower. The resulting cost savings can then be used in a number of ways: to increase wages, to lower prices to customers, to reinvest into the factory or to raise profits.

PRODUCTIVITY INCREASE = more garments for the same inputs
(time, number of workers, fabric, etc.)

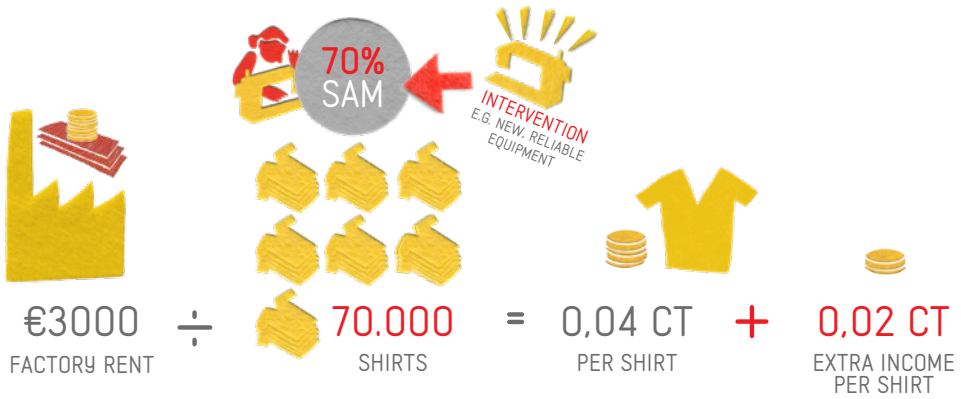


EFFICIENCY INCREASE = same number of garments using less input
(faster, less workers, less fabric, etc.)



The cost implications of low efficiency are significant. The idea of Working Minute Cost – the per-minute cost of running a factory – was introduced earlier, and returns here. Some parts of a factory's Working Minute Costs are fixed, such as rent, utilities, loan payments on equipment, etc., and cost the same amount in total whether a factory is making 50 garments or 100 garments. Increases in productivity or efficiency mean those fixed costs are spread over more garments. To give a simple example:
If a factory's rent is €3,000 per month, and it makes 50,000 shirts at 50% efficiency, the factory must charge €0.06 per shirt to cover the cost of rent.

If the factory increases efficiency to 70%, however, it can make 70,000 shirts per month, and only has to charge €0.04 per shirt to cover the cost of rent. The factory can use the 2 cents per shirt different to lower prices, improve profits or, in theory, improve wages.



This same general principle would apply to all the fixed parts of a factory's Working Minute Cost. When it comes to labour, which is often treated as a flexible cost, the situation is more complicated.

As we noted earlier, *line efficiency* is the most common area of focus for efficiency improvements, and those efforts are mainly focused on improving labour efficiency, e.g. decreasing the amount of time it takes a group of workers on a production line to make a garment.

For example, take a production line with 12 workers that operates at 50% efficiency. They need eight hours to make 30 jackets, at 16 minutes per jacket. The factory redesigns the line and retrains managers and workers, and is able to improve efficiency to 75%, so now it only takes workers 12 minutes to make the same jacket.

The factory then has a choice of what to do with that efficiency improvement. It could translate the efficiency improvement into a productivity increase – it can use the same number of workers and same amount of time to make 40 jackets – a 25% productivity improvement. The price per jacket will be lower relative to fixed costs like rent and labour, and the factory could either pay workers more or increase profits, among other choices.

However, the factory could also just keep making the same number of garments if, for example, it has no customers for additional jackets. In that case, there will be an impact on the amount of workers' time needed to produce 30 jackets. The two simplest options are to either cut hours, so each of the 12 employees only works six hours per day; or to lay off workers, as the line would only need **nine** workers for eight hours to make 30 jackets. (In reality the effects are more complicated, but the general principle remains true: increased efficiency means less worker time is needed to create a given number of products.) The production cost per

jacket would be lower, but if the factory could still sell each jacket for the same amount, the remaining worker could potentially be paid more per hour.

As layoffs and/or reduction in hours are a potential consequence of efficiency increases, the way to manage these effects need to be negotiated with workers, a point covered in the next sections.

PART 2
WHY ARE EFFICIENCY AND PRODUCTIVITY SO LOW IN APPAREL FACTORIES?

By this point in the discussion, an obvious question emerges: Why are productivity and efficiency so poor in so many factories? There are many direct causes which have been identified,such as:

Problems with the factory's physical plant: poor design, inadequate infrastructure (e.g. roads and electricity supply), poor equipment maintenance.

Problems with production processes: inefficient processes and workflow, poor line setup and balancing, too much down time, poor planning processes, product quality problems, no or poor-quality time studies, inefficient flow of materials to and from production lines.

Problems with business and human resource management: inadequate training of managers and workers, failure to address morale and worker turnover, reliance on excessive overtime, reliance on temporary workers.
It is worth reiterating here that labour is only one of many factors involved in questions of productivity and efficiency. None of these issues are individually insurmountable. So why then do so many factories struggle with low productivity?
It can, in part, be a question of the skill and knowledge levels of the factory managers; in some cases factories are run by owners with little business education, and they may not have the knowledge to run a factory at optimal efficiency. However, all of these issues – including having well-educated factory managers – require investments. And the dynamics and structure of the garment industry tend not to support investments.

The outsourcing of manufacturing to countries with 'low-cost' labour has led to fragmented global supply chains based largely on the best possible access to lower production costs. Low wages are a major component of lower production costs, but as the discussion above has shown, the lack of investment in training, processes and factory physical plants also reduce costs. The same lack of investment, in turn, drives both lower efficiency and productivity, as well as a wide range of human rights violations, from health and safety problems, to excessive overtime and even sexual harassment.

FWF's research into preventing gender-based violence at work illustrates the relationship between low productivity and the treatment of workers. Initial research in India and Bangladesh, supported by the UN Trust Fund to End Violence against Women, found that poorly-trained male line supervisors – the first level of management, who directly supervise production lines – were identified as a major source of verbal and physical abuse by women workers. A subsequent pilot conducted with Indian NGOs SAVE and CIVIDEP, and supported by the EU, was designed to train male and female line supervisors with the skills needed to manage without resorting to abusive behaviour. Initial findings from the pilots indicate that absenteeism and production mistakes – two significant contributors to low productivity – were markedly lower in lines managed by supervisors who had completed the training.[2]

Global access to manufacturing capacities, and the lack of factory ownership, has decreased the pressure on many brands to collaborate with their manufacturing suppliers to increase efficiency and productivity in the long term. For many brands, moving to another, cheaper factory or country is quicker and easier. Chasing cheaper factories is often associated with the risk of poorer quality, higher human rights risks and the additional transaction costs of more monitoring and management resources. Despite the risks, the strategy has proved to be attractive enough for many brands to accept the trade-off.

Factory responses to brand behaviours vary. Many factories continue to provide low-cost and low-productivity assembly, lacking the skills, investment funds and/or ability to raise prices necessary to implement improvements. Others have already implemented productivity improvements, and some have upgraded from purely selling production minutes to capturing more value in the 'chain' by providing more services. Some bigger manufacturers have realised the benefits of productivity improvements, and are constantly working towards improving efficiency to generate more profit and maintain their competitiveness. Experience has shown, however, that such gains have been mainly used to improve return on capital investment, shareholder value and/or maintain reduced prices, rather than to improve working conditions and wages for workers.

Factory decisions to upgrade or to improve productivity may happen quite independently of their customers, while others have been drawn into collaborative ventures with brands. Experience has shown that brands may invest in factories when product quality and stable suppliers are more important than a pure low-cost approach; when they come under pressure from campaign groups; or when they have made public commitments to deliver better wages and working conditions to the workers in their supply chains.

The fact of the matter remains, however, that efficiencies in global apparel manufacturing generally remain rather low and still show a high potential and opportunity for improvement.

2 A summary of the project's findings is planned for 2019. For more information on the relationship between gender-based violence and productivity, consult the FWF-ILOITC Gender-based violence in global supply chains resource kit.

PART 3
EFFICIENCY AND OTHER HUMAN RIGHTS RISKS

While the main focus of this paper is on the relationship between efficiency/productivity improvements and the living wage question, it is worth noting there are many other ways in which efficiency affects human rights. Awareness of the relationship between the real state of a factory's efficiency and productivity and what factories agree to in negotiations, should form part of any brand's human rights due diligence process.

Risks can emerge if, for example:

- The working minute price quoted by the factory does not accurately reflect the real costs of the factory
- The factory does not actually know what its per-minute production costs are
- The SAM – e.g. the number of minutes agreed upon to produce each garment is unrealistic – given the actual conditions at the factory
- The factory does not actually have enough production time available to complete the work without resorting to subcontracting or excessive overtime

These risks may emerge in negotiations because factories fear losing a contract to a more efficient factory, or because they quote prices based on rough estimates or what competitors charge, rather than on a calculation of their costs and efficiency, or because their operational management skills are not adequate to properly calculate efficiency and costs. FWF and other organisations working in the industry hear many anecdotal stories of these types of negotiations, which were also documented in a 2014 ETI Norway report.[3] The report illustrates how severe these risks can be: more than half of surveyed factories go so far as to accept orders below production costs, out of fear of losing orders in the future, or to competitors. A recent ILO report[4] examining supply chain operations across a variety of industries, including apparel, echoed these findings.

When efficiency issues are not properly factored into negotiations, factory managers commonly resort to a number of common strategies to cope with these time and cost pressures, including the following:

- Requiring workers to work (excessive) overtime to meet the target
- Subcontracting all or part of the order (often without the knowledge of the buyer) to another factory with more capacity or lower costs (and often worse working conditions)
- Employing temporary workers without legal contracts: e.g. children, migrants without working papers and other vulnerable workers, often at less than legal minimum wage
- Resorting to aggressive or verbally and physically abusive supervision to get results

All these responses remain endemic in the industry today, and all raise significant human rights risks to workers, and due diligence risks to brands. And all have the potential to undermine living wage efforts. It is, for example, impossible to make real progress on living wages if half of a factory's production is subcontracted to a factory that pays less than legal minimum wage.

Given these risks, brands cannot afford to ignore the efficiency levels of their suppliers. Efficiency issues must be factored into the price that they pay for their garments. And this requires a shift in negotiating tactics on the part of brands. Under normal conditions, customers don't worry about whether the price they are quoted for something is reasonable – that is

3 Gunelie Winum and Katrine Karlsen 2014 Supplier Speak up. How Responsible Purchasing Practices Can Improve. Working Conditions in Global Supply Chains. A Practical Guide. IEH Norway.

4 ILO INWORK Issue Brief 2017:, Purchasing practices and working conditions in global supply chains: Global survey results.

the seller's concern. However, in the garment industry the lack of regulation and the enormous power imbalance between brands and factories means that the garment industry does not operate under 'normal' conditions, as the UN Guiding Principles and OECD guidelines make clear.

Consequently, it is an important and pragmatic due diligence step to make an allowance for efficiency in existing product costing calculations. This is first and foremost the responsibility of the supplier, but buyers should have an understanding of standard times for the garments they sell and the allowances that need to be taken into account to compensate for the actual conditions and capabilities within the factory. This is perhaps most easily accomplished under 'open costing' agreements, but to some degree should be possible under other forms of negotiation.

It is worth noting that adding a realistic efficiency calculation agreement between buyer and factory should increase the CMT price paid, as the price is a better reflection of the actual time and cost needed by the factory to make the garment. But paying a realistic price for production can also can help to significantly reduce the risks of the kind of labour rights violations outlined in this paper.

Brands with long-standing relationships with suppliers will generally show a keen interest in a factory's efficiency. This will be a matter of negotiation as it is also in the factory's interest to consider its true operating efficiency. Those factories using more sophisticated systems, like Coats-GSD, Sew-Easy or REFA for costing purposes should normally account for efficiency in the standard allowed minute times calculations quoted to buyers.

PART 4
SOCIAL DIALOGUE:
THE ROLE OF WORKERS IN IMPLEMENTING PRODUCTIVITY AND EFFICIENCY IMPROVEMENTS

In the efficiency example described in Part 1, there is likely to be a significant impact on workers. In a worst-case scenario from the workers' perspective, either all 12 workers will need to take a 25% cut in hours, or three workers on the production line will be laid off. If layoffs or reduction in working hours were to be the ultimate outcome of an efficiency increase, good management practice would be to inform, consult and negotiate with the worker representatives to mitigate the impact of such changes on the workers.

Layoffs and work reductions are not an automatic outcome of efficiency drives, however. It is entirely possible to convert efficiency improvements into outcomes that benefit both workers and management. Consulting with workers through a social dialogue process dramatically increases the chances of their success. Two examples are provided for illustration:

> According to the ILO, social dialogue refers to all types of negotiation, consultation and exchange of information between, or among, representatives of governments, employers and workers on issues of common interest . FWF uses this broad definition of social dialogue while maintaining that collective bargaining with trade unions, in an environment that respects Freedom of Association, is the preferred form of social dialogue for dealing with issues which arise in the workplace around efficiency and productivity.

For example, if the factory can secure more orders from brands, and has or can create spare capacity (e.g. extra production lines) to which the redundant workers could be moved, management can convert the effi-

ciency increase into a productivity increase, which benefits both workers and the factory. For brands who are cooperating with suppliers on efficiency drives, one of the main support steps they can take is to increase their orders to ensure the extra capacity is used.

Efficiency drives also present an opportunity to reduce the chronic excessive overtime found in many factories. In many factories the reality is workers work 12 to 15 hours a day. If efficiency increases allows production to go from 12 to eight hours a day, there are potential benefits for workers (such as having a reasonable workweek), and for factories (which can lower their overhead costs by operating for fewer hours). There are two main challenges: one is that low-paid workers often rely on overtime pay to survive; so if hours are decreased, wages need to rise. The second issue is that overtime is often not only used to compensate for poor productivity, but also to deal with irregular order flow from brands.

Either of these changes, as major adjustments to workplace conditions, require a social dialogue process with workers. Factories and brands involved in promoting efficiency drives should be aware of the following:

- There is some evidence that productivity and efficiency improvements result from a more holistic approach being taken by management to the overall function of the factory
- The principles underlying existing efficiency programs are essentially benign, in that they address such issues as continuous improvement or eradicating waste of resources, which any business requires in order to be successful
- Nevertheless, adjustments to productivity or efficiency can raise the risk of increased work pressure; programmes leading to higher production targets for workers need to be realistic and negotiated

WHAT DOES SOCIAL DIALOGUE ABOUT PRODUCTIVITY ENTAIL?

There are a number of social dialogue mechanisms which can be used to engage with workers in implementing productivity and efficiency improvements at a factory level.

Historically the most common form of social dialogue for dealing with productivity has been the process of collective bargaining between enterprises and recognised trade unions. Procedural agreements have regulated how workplace changes should occur, from the introduction of new machines to the changing of standard times. Substantive collective bargaining agreements have sought to determine bonus arrangements for workers where incentive schemes have been introduced.

More recently there have been initiatives to introduce productivity discussions at workgroup level – from the original Japanese quality circles, to workgroup-based Productivity Improvement Circles or Kaizen. These have looked at the whole area of continuous productivity improvement, not just quality. Even more recently we have seen the introduction in a number of apparel producing countries of enterprise level Performance Improvement Consultative Committees (PICCs) developed under the ILO Better Work Programme.

Where such committees have elected worker representatives, as is the case in Vietnam and Bangladesh, there is the opportunity to develop democracy at work, improve worker leadership skills, workplace morale and technical competence.

The general objectives of these types of factory-level social dialogue are to contribute to the productivity, stability and growth of the enterprise and ideally to make the factory a better place to work in. Such developments are of interest to workers, employers and to their apparel

brand customers. Care must be taken, however, that these committees are not used to block to the exercise of freedom of association or the establishment of workplace trade union structures at the factory level.

THE ROLE OF BRANDS IN SOCIAL DIALOGUE

As the above examples illustrate, there is an important role for brands to play in ensuring that workers share the benefits of efficiency and productivity improvements. Factories can only achieve efficiency improvements when they have a full order book, and stable, predictable orders from customers. Brands' production calendars, therefore, can have an enormous impact on working conditions, particularly excessive overtime. There is an emerging acknowledgement that brands also have an important role in effective social dialogue in the industry. The lack of direct factory ownership and the fact that most factories have many (foreign) customers, mean that traditional factory-level social dialogue structures cannot easily cope with the inclusion of brands. But the development of initiatives like the Action Collaboration Transformation initiative (ACT), the Indonesian Freedom of Association Protocol and the Bangladesh Accord, all provide models for what a future of social dialogue with brand involvement might look like. Productivity questions are likely to loom large in any such negotiations, especially on living wages.

PART 5
CONCLUSION: SHOULD LIVING WAGES BE FUNDED BY PRODUCTIVITY IMPROVEMENTS?

Given all of these considerations, we are left with the question posed by many brands: should living wages be funded by factory-level productivity increases?

Although improving productivity is probably part of the solution, FWF believes that it is not a 'magic bullet', or the entire solution. There are several issues to consider, starting with the oft-quoted idea that living wages can only be implemented *after* productivity increases.

GETTING THE SEQUENCE RIGHT

FWF's viewpoint has always been that living wages are a fundamental right and should never be conditional on productivity improvements. The correct sequencing is to first accept that workers have a right to a living wage, and then to figure out how to pay for it.

The sequence described here is one that the industry deals with all the time. If the price of oil or cotton goes up or currencies fluctuate, then brands and factories find ways to offset those cost increases, through higher prices, design changes, improved productivity or other cost savings, often at different points in the supply chain. The 'compliance cost' of living wages can be thought of in a similar way, as a cost of doing business that needs to be covered.

FWF often hears arguments that wages can only improve *after* factory productivity increases. However, FWF believes this line of thinking incorrectly describes how living wages should be thought about.

'Normal' wage levels and wage growth are indeed linked to productivity, e.g. the more productive a company is, the more money it can make, and the more it can pay workers.

Living wages are something else, however; they describe, in essence, how much legal minimum wages should be. A living wage should be thought of as a floor wage which is set at a level that actually does what a legal minimum wage *should* do – provide a basic, decent quality of life for citizens.

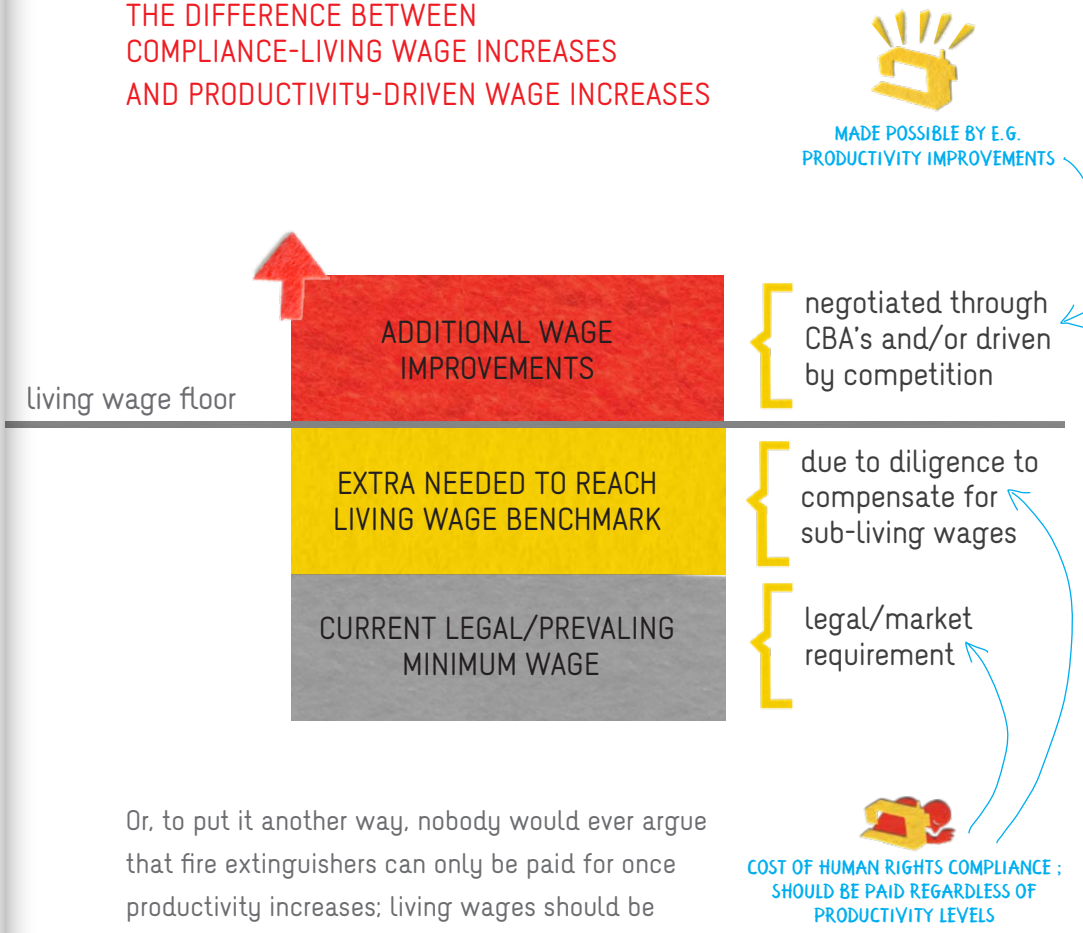
DUE DILIGENCE, LIVING WAGES AND PRODUCTIVITY

The UN Guiding Principles clearly state that companies have a responsibility to respect human rights in their supply chains, even if governments fail to do so. Government unwillingness to set legal minimum wages at a liveable level, often out of fear of losing business to competing low-cost countries, is an example of such a failure. But it is a failure driven in large part by the behaviour of an industry that has been willing to jump from country to country in search of lower costs.

FWF believes that making living wages dependent on productivity is a fundamentally flawed idea. Living wages need to be thought of as a cost of human rights compliance in the same way that building safety and social security are. Costing for a living wage can be thought of as the due diligence cost of operating in a country where the minimum wage does not cover basic needs and provide for a discretionary amount of income. Even though there is not yet consensus regarding living wage benchmarks, there is widespread acknowledgement that in most garment-producing countries legal minimums are nowhere near a living wage level .

Wage increases *beyond* a living wage – beyond basic compliance – can then be financed by increased productivity. And, like other due diligence requirements, the lead firms in supply chains, clothing brands, have a clear role to play in ensuring that living wages are paid. This figure illustrates the difference.

THE DIFFERENCE BETWEEN
COMPLIANCE-LIVING WAGE INCREASES
AND PRODUCTIVITY-DRIVEN WAGE INCREASES



Or, to put it another way, nobody would ever argue that fire extinguishers can only be paid for once productivity increases; living wages should be thought of in the same way.

SHARING THE GAINS

There is another risk associated with making living wage increases dependent on productivity increases: the temptation of factories (or

brands) to want a 'cut' of the money generated by productivity increases. Where such initiatives have been used as the basis of living wage increases, they have tended to result in small increases in pay. Such increases will usually be realised through a productivity bonus rather than increasing the basic rate for the workers. Money created by productivity increases can be used for anything, and there will always be pressures to divert it away from wages unless the commitment to better wages comes first.

EFFICIENCY AND PRODUCTIVITY IMPROVEMENTS ARE NOT FREE

As noted earlier, much of the low productivity in the industry can be linked back to lack of investment in skills, processes and a factory's physical plant. Retraining of management and staff, new equipment, new production processes and any of the other tools that lead to better efficiency all require investment. Whatever gains are made from efficiency improvements need to take these up-front costs into account, along with the question of who will – or can – pay for the necessary investments.

SEPARATING PAY FROM OTHER BENEFITS FOR WORKERS

There may be other gains for workers, e.g. upgrading following retraining/upskilling of workers. Such wage gains achieved on the basis of efficiency drives should be treated separately from any living wage uplift in pay structures.

PART OF THE SOLUTION

As the work of FWF and others have noted, factories only control a small portion of the value in supply chains, and labour costs are often only a few percent of the total retail cost of a garment. When one considers the vast array of opportunities along a supply chain for financing decent wages for garment workers, concentrating only at factory level (and especially on labour productivity), does not seem like the most logical approach, given the distribution of margins and profits throughout the industry.

LIVING WAGES ARE NOT A BONUS

Some past attempts to improve wages have treated wage improvements as 'bonus' payments. While this was understandable in terms of testing out how funds could be distributed, going forward any living wage efforts should focus on integrating a living wage increase on to the basic rate of pay. Any productivity improvements can then be rewarded by a performance related bonus payment *in addition to the basic living wage level.*

NEXT STEPS

This paper has laid out the problems and risks inherent in attempting to solve the living wage issue by focusing solely on productivity and efficiency gains. It has also outlined the flaws and risks posed by making living wage improvements contingent on productivity and efficiency improvements.

In some cases, well-designed and properly negotiated productivity and efficiency improvements may well play a role in freeing up resources to support better wages, But there are many other options which may prove easier to implement and less problematic from a rights perspective. The next FWF document in this series will examine the range of options available to pay for living wages up and down the supply chains, and what brands, factories, trade unions and policymakers need to know about these options in order to facilitate productive social dialogue.

ACKNOWLEDGEMENTS

Doug Miller has a background in academic industrial relations. Between 2000 and 2008 he was seconded to the then International Garment and Leather Workers Federation (now part of IndustriALL). Following the conclusion of an international framework agreement between the ITGLWF and the Spanish multinational Inditex, Doug took up a jointly sponsored chair in Worker Rights in Fashion at the University of Northumbria. Since 2012 Doug is Emeritus Professor and has been working with various organisations principally on the question of how to implement a living wage.

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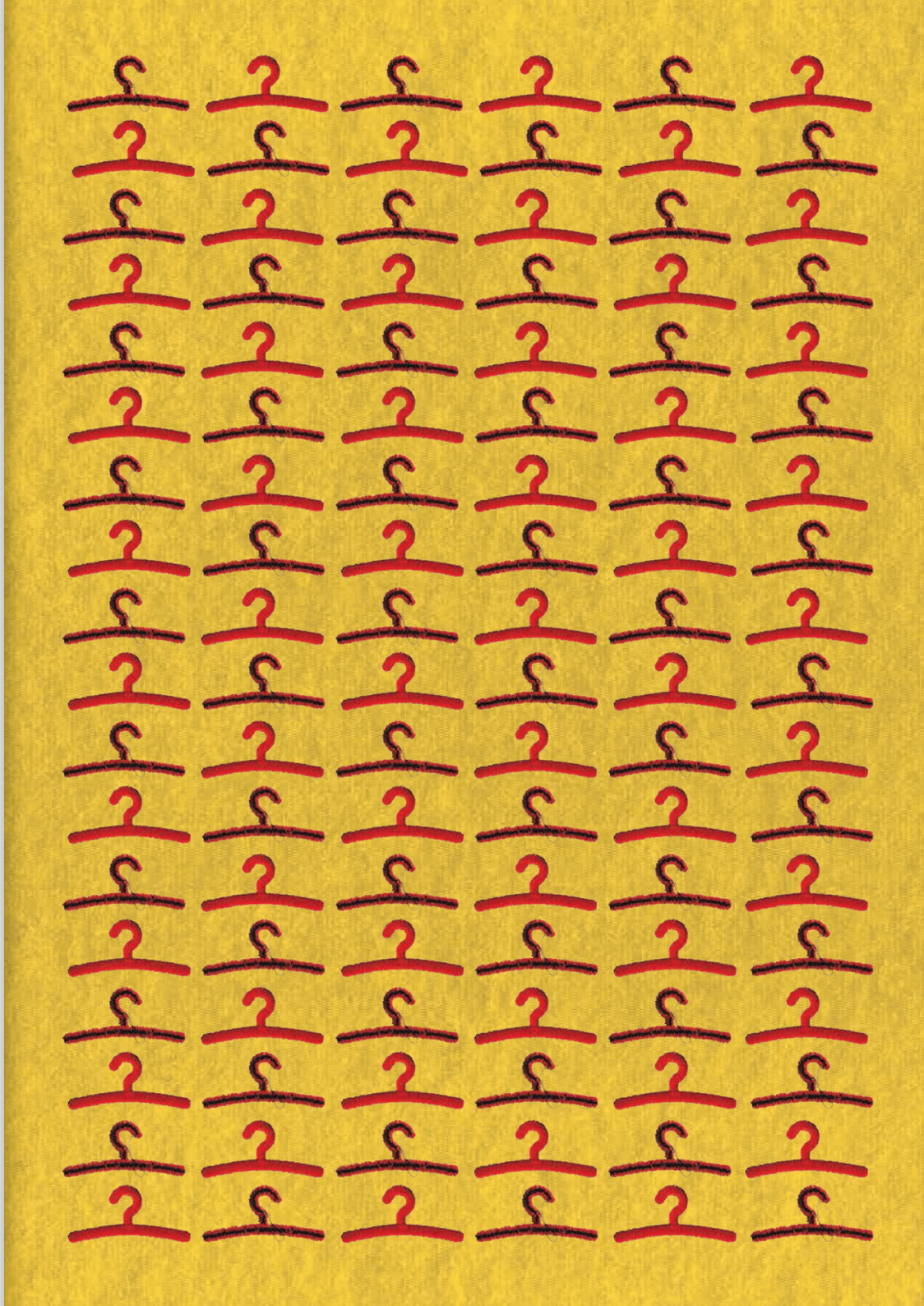

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