



LIVING WAGE ENGINEERING

A study by Fair Wear Foundation - with initial observations about the links between outdoor industry brand practices, wages, pricing, and the cost to consumers

ABOUT THIS PROJECT AND ANTITRUST / COMPETITION LAW

FWF conducted this project as a pilot study into FWF member companies' compliance practices with a special focus on wages. Part of this work reviewed labour costs and other production costs, as well as supply chain pricing practices in an effort to support payment of a living wage.

FWF and the companies participating in this study recognize that the antitrust and competition laws of the United States, the European Union, and other applicable jurisdictions are intended to promote and protect free and open competition and, prior to and throughout the study, took appropriate steps to ensure that their conduct and discussions in furtherance of this study would at all times be consistent with these laws.

Please contact Fair Wear Foundation if you require further information pertaining to this project's adherence with competition and anti-trust laws.

FAIR WEAR FOUNDATION

This report was written by Anne Lally with Ivo Spauwen, who managed the FWF-EOG collaboration and conducted the data calculations and analysis that informed this report. FWF is grateful to the European Outdoor Group and the companies that participated in this study in an effort to move forward on living wages.

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INTRODUCTION

There is not one garment industry.

Most of us think of the garment industry in terms of what is often called 'fast fashion' and the business practices that accompany it, including: (sub)seasonal collections driven by ever-changing trends, short lead times, long supplier lists, limited supplier leverage, non-committal buyer-supplier relationships, and severe price competition.

Often, such factors and practices create a less than stable business environment, making it difficult to achieve lasting changes in workplace conditions.

Indeed, as FWF seeks to answer some of the most persistent questions standing in the way of living wage implementation – e.g. How do we measure it? How much does it cost? How do we ensure increases reach workers? – we are constantly reminded of the importance of stable business relationships as a prerequisite for progress and improvement in this area.

Other 'garment industries,' such as those producing outdoor clothing, work wear, or technical/safety apparel, are less prone to such highly fluid business practices.

For this reason, FWF partnered with the European Outdoor Group to explore living wage implementation. FWF has observed that its members that produce outdoor clothing (hereafter 'outdoor companies') tend to have long-term brand-supplier relationships – some up to 20 years. We also see a tendency towards longer lead times, better planning, and consolidated supply chains in the outdoor industry. Some FWF outdoor brands own their production facilities and/or have invested significantly in their suppliers.

Such stable business practices are not always the rule in making outdoor garments, of course. Outdoor companies can also engage in highly changeable relationships and other practices that can undermine workplace conditions. And factories producing outdoor garments are far from immune from violations of workplace standards.

In the context of seeking solutions on living wages, however, this tendency towards greater stability makes the outdoor garment industry (hereafter 'outdoor industry') an interesting and instructive context in which to investigate, and eventually experiment with, the challenging issue of living wages.

A. About this report

FWF is the sole author of this report. In what follows we look at several aspects of living wages. We first look at current wage levels and compare them to available living wage benchmarks. How much would labour costs need to increase in order to ensure that base wages align with living wage benchmarks? We then consider the implications of wage increases for product costs, both for brands and consumers. How much will the price of some sample outdoor products rise if living wages are paid?

In the process of seeking initial answers to such questions, this study helps to advance FWF's methodology for measuring what we have dubbed the 'living wage factor.' It also enhances our understanding of the impact of living wage increases for FOB (i.e. freight on board, or the per product price paid to factories) and retail prices.

Part of the study included a review of project participants' purchasing practices, transparency, and auditing and remediation. This review of member performance checks and FWF factory audits, which are overviewed in section 1, provide a broader context for our findings on wages and pricing.

In the fourth section, we offer some thoughts on the reasons why some of the behaviours we observed in this review could potentially support future improvements with regard to living wages and other labour standards.

The final section of the report summarises lessons learned and suggests steps forward.

B. Data collected in this study

Six FWF member brands – Deuter, Haglöfs, Kjus, Mountain Force, Odlo, and Vaude – and one FWF member factory – KTC – participated in the project on a voluntary basis.

Five factories (one in China; four in Vietnam) that supply outdoor products to the six brands agreed to accommodate the level of scrutiny required for participation in the study.

According to the terms of project participation, companies agreed to provide all information typically required of FWF members during FWF audits and member performance checks, as well as wage and product pricing data at both the factory and brand level for seventeen outdoor products made in the five factories. Such information is usually confidential and closely guarded by garment brands and factories. As a result, all company-specific pricing data was shared on a bilateral basis only with selected FWF staff in accordance with FWF's confidentiality policy. Companies did not have access to the pricing data of other project participants.

In order to address confidentiality and competition concerns, FWF generated six hypothetical model products, which represented a composite of the 17 products. These products were the source of cost projections generated by the study.

As part of the study, FWF also conducted audits in the five participating factories. Audits took place in all five factories in 2011 and 2012, and follow up audits in three factories took place in 2013. Information about company business practices is based on FWF performance checks of the seven member companies, which took place during in 2012 and 2013.

1. FINDINGS FROM FWF PERFORMANCE CHECKS AND AUDITS

A. Performance Checks

FWF conducts annual brand performance checks for each member company. These checks are published online and assess members' performance with regard to systems for monitoring and remediation; complaints handling; training and capacity building; information management; and the two areas of most interest to this study, purchasing practices and transparency.

For the purposes of this project, between June 2012 and July 2013, we reviewed the outcome of performance checks conducted for the six brands (Deuter, Haglöfs, Kjus, Mountain Force, Odlo, and Vaude) and the one factory (KTC) that took part in the study. Performance checks can be found online on www.fairwear.org

PURCHASING PRACTICES

With regard to purchasing practices, performance indicators include:

- Percentage of supplier base where affiliates have leverage (i.e. the brand purchases 10% or more of a supplier's production)
- Percentage of supplier base dedicated to long-term buying relationships (i.e. five years or more)
- How social compliance is incorporated into selection of new suppliers
- On-time payment to suppliers

In keeping with FWF's previous observations about outdoor companies, findings from the performance checks of participating companies indicated business practices that align with more stable business relationships.

Among the six brands, nearly 90% of production volume was sourced from factories with which the brand had a relationship for five or more years. The brands also had fewer suppliers than many other garment companies. In several cases, brands sourced from only one or two suppliers. Most of the brands had also initiated discussions, and/or invested in technology, to support clear production planning with suppliers.

In various factories, the brands also had a fair degree of leverage. We estimate that the brands purchased 10% or more of a factory's production volume in around half of the production units where participating brands sourced.

We also found considerable overlap among these brands' suppliers. So in many cases, the brands shared audits and corrective actions. In 2012, an estimated one in three audits undertaken by FWF member outdoor companies was shared between one or more companies. Such overlap is also conducive to collaboration around shared activities and remediation of problems, such as workplace training or projects like this one.

TRANSPARENCY

For 2012, FWF received social reports, as required by FWF membership, for six of the seven participants.¹ Generally the companies tended to evidence a relatively high level of transparency. For instance, KTC, a factory affiliate for FWF, has published its audit reports on its website, and Vaude included detailed wage ladders in its social report.

Nevertheless, FWF sees some room for improvement. The names/locations of the factories producing for this group of brands are still not published. Although not a FWF requirement, FWF encourages its affiliates to publish all factory lists and audit findings in order to support accountability and shared social compliance resources in supply chains.

GENERAL PERFORMANCE

In general the outdoor companies met most of FWF's management system requirements. Five of the six brands in the project had met their monitoring requirement, with one brand falling just short of the 60% required of companies in their second year of FWF membership.

Recommendations for improvement were made to all seven brands in two main areas. All participants could do more to support better social dialogue between workers and managers at their suppliers. Worker knowledge about their rights and the Fair Wear Foundation Code of Labour Practices could also be improved. FWF's Workplace Education Programme is designed to address both of these issues.

B. Factory Audits

Factory audits of the five factories provided wage data needed for the study. They also give a sense of the workplace conditions in these facilities. Because audits had already been conducted in three of the factories prior to the study, FWF conducted follow up audits in those facilities as part of the study.

Audits indicate that, in many ways, conditions at the five factories were above average. Factory infrastructure was in generally good condition, and in at least two cases factories had benefited from some form of investment from the brands participating in the study.

There were indications in two factories that participating brands had also encouraged some form of communication and training in the factory about FWF and/or labour standards. Here, though, we saw real potential for improvement across the factories. All factory populations had low worker awareness about labour standards.

There were no findings pertaining to child labour, forced labour, or discrimination based on gender, religion race, etc in the five factories. Worker interviews and document reviews in all five factories confirmed the provision of legal permanent contracts for workers. State benefits and other requirements for workers had been documented as paid.

¹ Mountain Force joined FWF in 2011 and was therefore not required to publish a 2012 report.

While all factories needed to improve systems to support health and safety, there were no egregious health and safety violations reported.

Audit findings also indicated, however, that these factories had some key issues in common with many other garment factories. Perhaps not surprisingly, excessive overtime – among the most common problems in any part of the garment industry – was found in four of the five factories. In follow-up visits to three of these factories the following year, auditors also reported that excessive overtime was ongoing in two of the three facilities. Still, even in those factories, some improvement was evident: while excessive overtime had not been eradicated in the factories, findings showed that very long working hours had been limited to certain departments. The number of overtime hours in excess of the legal limit had also decreased.

According to brands involved in the project, this is one area where leverage is vital. If a brand's production volume is small relative to other buyers, the ability to effect real change can be limited.

The location of the factories in China and Vietnam also meant noncompliance with freedom of association standards due to legal limitations placed on this human right in both countries. As might be expected, all four factories in Vietnam had state-sanctioned trade unions present and CBAs in place. In two facilities, however, workers were not able to name their trade union representatives, and in all four factories – even where there was some form of trade union election – workers preferred working through their supervisors or management, rather than the trade union, to redress issues.

There were still signs of worker organizing in at least some of the factories, however. In the months prior to two of the audits, workers had organized strikes. Auditors reported that pay raises and other improvements resulted from these actions. There were no reports of retaliation against strike organizers.

No independently elected trade union was present in the Chinese factory either. The factory did have in place a worker committee of 60-70 representatives from all factory departments, headed by the director of personnel. Workers had received training about the committee, which management noted included a clear message that committee membership was not required and was free of charge. The manager in the Chinese factory communicated his support for continued improvement in the factory with regard to social dialogue.

Finally, as is the case in nearly all other garment factories, none of the five factories complied with the living wage standard. We will discuss wage levels in greater detail in the next section, but here it is worth noting that wages across the board exceeded legal minimum wage levels – sometimes significantly. Overtime was paid in accordance with the law and tended to bring take-home wages closer to living wage levels.²

When taken together, the performance checks and audit reports indicate there is still plenty of space for improvement among all seven companies and their factories, particularly with regard to freedom of association, hours of work, and workplace education.

Nevertheless, these companies have made progress in developing their compliance programmes. We see potential for all of these companies to be leaders or even pioneers in this field.

² FWF often finds that garment workers' wages may roughly align with living wage benchmarks only once overtime pay (often for very long hours of work) is included in calculations. Here, as elsewhere, we see a clear connection between the common garment industry practice of overtime and low wages. Yet the causality is worth further exploration: Do low wage levels lead workers to seek overtime? And/or does the common practice of long working hours inhibit payment of a living wage for regular working hours? These are important questions worthy of further study.

2. CURRENT WAGE LEVELS

Our study of living wages starts with an analysis of current wages in the five factories and the ways in which they compare to relevant living wage benchmarks.

A. Measuring current wages

To provide a simple yet representative picture of wages in these factories, we charted the 'regular wage with benefits' from the sewing department of each factory as a gauge of current wage levels in each factory. Overtime was not included.³

FWF's Wage Ladder tool is used below to illustrate these wage levels, charted in relation to other relevant wage benchmarks, depending on location.

WHY MEASURE WAGES IN THE SEWING DEPARTMENT?

The sewing process stands at the centre of the Cut-Make-Trim process, so nearly all CMT factories have sewing departments. Sewing departments tend to be amongst the largest departments in factories, and usually employ largely female workers. Sewing departments tend to be where most of the lowest paid workers are employed.

WHY INCLUDE BENEFITS IN THE CALCULATION?

During FWF audits, auditors estimated the value of any relevant housing, food, and/or electricity provided at no cost to workers at the five factories. These benefits represent a form of payment and are part of living wage calculations.

B. The living wage benchmarks used

The wage ladders, in section C below, contain a number of wage benchmarks to offer perspectives on current wage levels in the five participating factories. There is one wage ladder for the Chinese factory, while the four factories in Vietnam are divided between two wage ladders: one is for a factory based in a class 3 wage region (i.e. relatively far from urban centres), while the other charts wages for three factories based in class 1 wage regions (i.e. Hanoi and Ho Chi Minh City).

³ FWF audit reports contain more detailed wage ladders, which provide wage data across various departments, and offer views of regular wages, fringe benefits, and overtime. We did not incorporate these metrics into this study's wage calculations primarily because living wages are based on normal working hours. Taking a simple approach also supports the development of a model of measurement that will be easy to replicate in many other factories.

The wage ladder for the Chinese factory, KTC, includes 2011 local minimum wage levels for Heshan, the city where the factory is located; the living wage benchmark of the Asia Floor Wage (AFW) benchmark for China; and the living wage estimate developed by Zhongshan University in collaboration with FWF.

The wage ladders in Vietnam include 2011 and 2013 measurements of the regional minimum wage and basic needs measurement developed by the VGLC trade union and the AFW benchmark for Vietnam.

In order to compare current wages to living wages (in section D), this study used the Asia Floor Wage (AFW) benchmarks for China and Vietnam. It is important to note FWF does not endorse any particular living wage benchmark. Instead FWF's open-source wage ladder is designed to embrace and cite a range of efforts at the local level to reliably assess local living costs across garment producing countries. The benchmarks that result from these efforts almost always illustrate that legal minimum wage does not allow workers to meet their basic needs.

FWF chose, however, to use the AFW living wage estimates for China and Vietnam in this study for a number of reasons. AFW is based on purchasing power parity (PPP) calculations, which allows for comparisons of the standard of living between countries, regardless of the national currency. Given our work in two distinct countries, this benchmark offered a clear methodological benefit.

What's more, the alternative living wage benchmark for Vietnam, which is the basic needs measurement provided by trade union VGCL, was being revised at the time we were collecting and analysing wage data. It therefore would not offer a reliable level against which to benchmark factory wages.

The Zhongshan University benchmark is included on the Chinese wage ladder to offer further perspective on wage levels there. The benchmark is higher than the AFW estimate. It is worth noting that the benchmark was calculated using living costs in the city of Guangzhou, which is the provincial capital of Guangdong and a major trade hub in southern China. KTC is located in Heshan, which is also a city in Guangdong province, but located about 60 km southwest of Guangzhou. Heshan is said to have lower living costs.

THE NEED FOR IMPROVED LIVING WAGE BENCHMARKS

As part of the project process, we have noted the limited number of living wage benchmarks in Vietnam. While FWF wage ladders for other countries include a range of benchmarks, Vietnam only really has two relevant ones – VGCL and AFW – which vary considerably.

In Vietnam and China, as in many other countries, there is also a need for living wage benchmarks that account for often significant differences in the costs of living among different regions of a single country (see the discussion about Vietnam’s wage regions 1 and 3 in the following section for more).

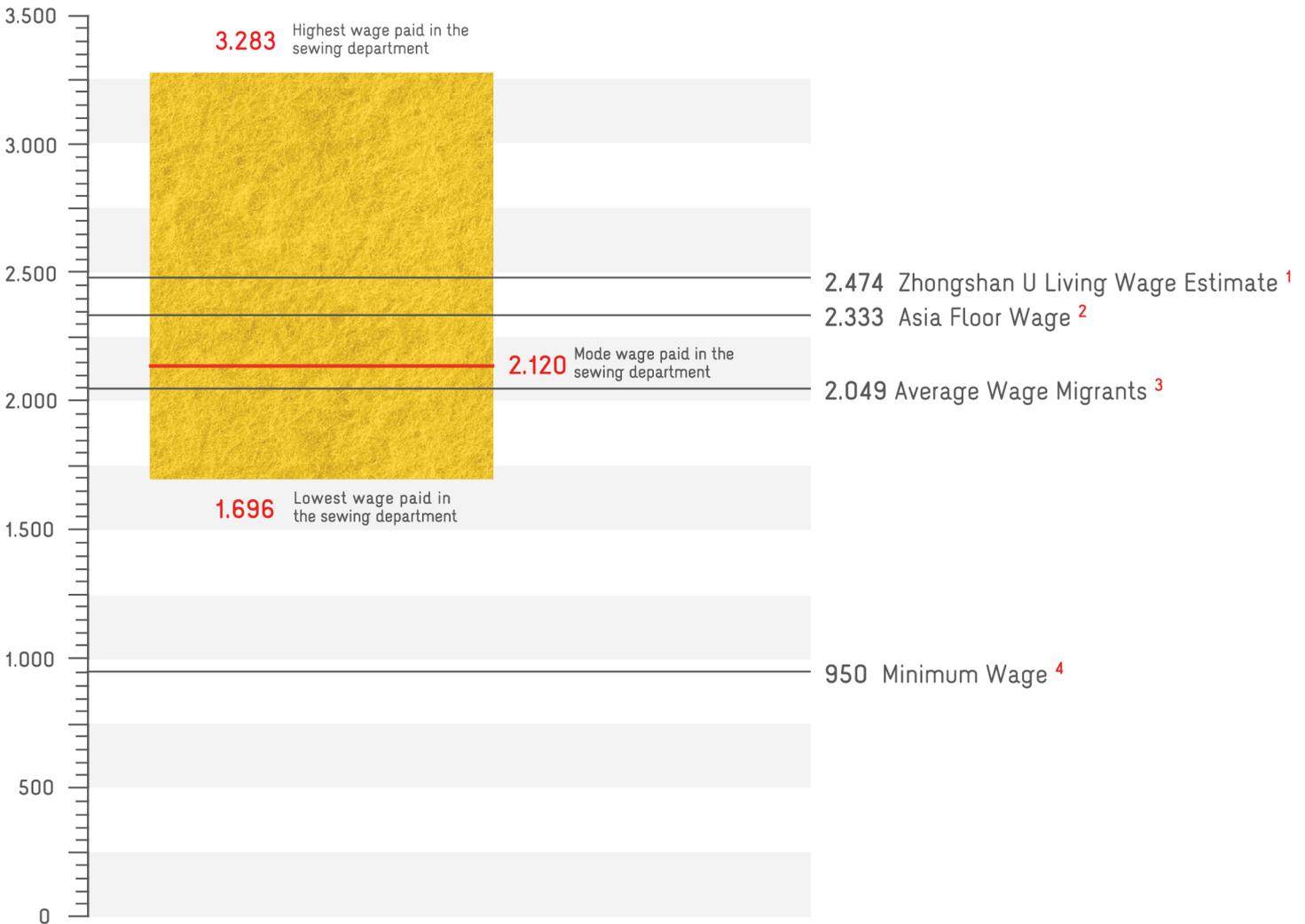
AFW has indicated that it is developing regionally-specific benchmarks. FWF welcomes such efforts.

FWF believes that the ongoing development of reliable and locally-owned benchmarks has an important role to play in improving wages in the garment industry.

C. The wage ladders from the five factories (2012)

WAGES IN FACTORY A (INCLUDING BENEFITS) HESHAN CITY IN GUANGDONG PROVINCE – 2012

amounts in Chinese Yuan (CNY)

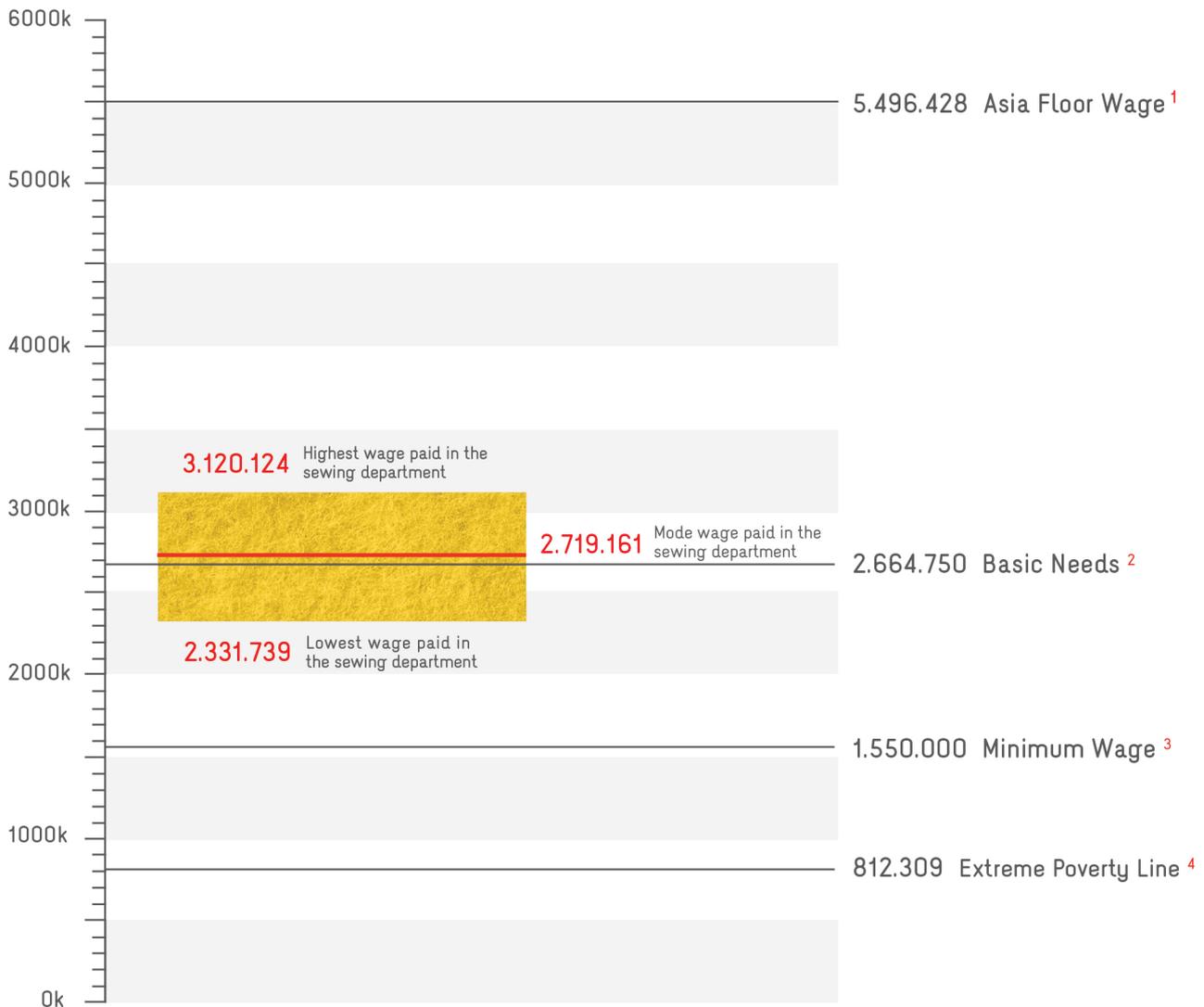


Factory A: Sewing department, regular wages plus estimated value of benefits -- charted against relevant wage benchmarks

- 1 Living Wage estimate by Zhongshan University, as of November 2011
- 2 Asia Floor Wage, as of October 2012
- 3 National Bureau of Statistics of China: National average for 8 hour working day for migrant workers, as of May 2012
- 4 Minimum wage defined by local government, as of March 2011

WAGES IN FACTORY C (INCLUDING BENEFITS) CLASS 3 WAGE REGION IN VIETNAM – 2012

amounts in Dong (VND)

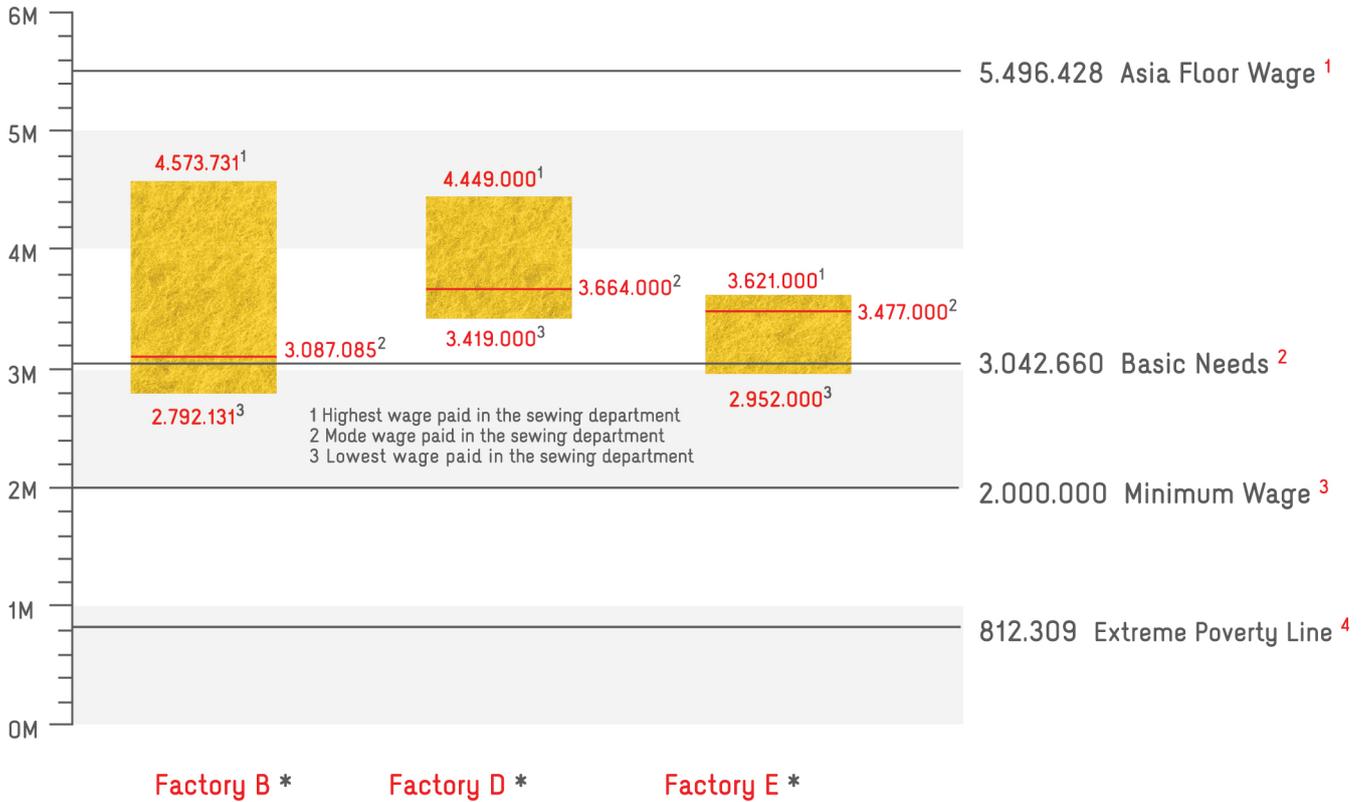


Factory C: Sewing department, regular wages plus estimated value of benefits -- charted against relevant wage benchmarks

- ¹ Asia Floor Wage, as of October 2012
- ² Basic Needs Assessment by VGCL Trade Union, Class 3 Wage Region of Vietnam: Minimum earnings needed to cover food, non-food, and childcare expenses in 2012
- ³ Minimum Wage, Class 3 Wage Region of Vietnam, from October 2011
- ⁴ Extreme Poverty Line, as per World Bank \$1.25/day (corrected for household size of 1.82 earners, monthly income, PPP adapted to 2012 prices), as of October 2012

WAGES IN FACTORY B, D, AND E (INCLUDING BENEFITS) CLASS 1 WAGE REGION IN VIETNAM - 2012

amounts in Dong (VND)



* Sewing department, regular wages plus estimated value of benefits -- charted against relevant wage benchmarks

- 1 Asia Floor Wage, as of October 2012
- 2 Basic Needs Assessment by VGCL Trade Union, Class 1 Wage Region of Vietnam: Minimum earnings needed to cover food, non-food, and childcare expenses in 2012
- 3 Minimum Wage, Class 1 Wage Region of Vietnam, from October 2011
- 4 Extreme Poverty Line, as per World Bank \$1.25/day (corrected for household size of 1.82 earners, monthly income, PPP adapted to 2012 prices), as of October 2012

D. Analysis: Relative wage levels

At the time of data collection, current mode wages⁴ in the sewing departments in all five facilities fell below the Asia Floor Wage (AFW) living wage benchmark. According to our calculations, wages would need to increase from 10% to 102% in order to align with the relevant AFW benchmark for each factory. Wage levels in three of the factories (i.e. Factories B, D, and E) seem to represent similar relevant wage levels – requiring increases of 50% to 78% to reach AFW. Factory A in China is notable in that mode wages in the sewing department would only need to increase by 10%. In Factory C, where wages need to increase by 102%, the picture seems very different.

A variety of factors affect wage levels in factories. These include: factory location; brand practices and price pressures; factory management practices; productivity levels; and skills required for production.

These factors also seem at play in the factories included in this study. For instance, we hold that the relatively low current wages in Factory C in Vietnam, where wages would need to rise by 102% to align with AFW, is largely attributable to its location in what the Vietnamese government has labelled a 'Class 3 wage region.' According to government measurements, the cost of living in such locations is approximately 77% of costs of living in Class 1 cities (i.e. Ho Chi Minh and Hanoi). VGLC's basic needs estimate for Class 3 is 87% of Class 1. If we apply these ratios to the AFW benchmark for Vietnam, the relative wage gap in Factory C generally aligns with the current/living wage gap in the other three Vietnamese factories, i.e. 55% - 77% (For the purposes of this exercise, we used the 102% wage increase to estimate the impact on costs. We wanted to observe the impact of significant wage increases, e.g. nearly doubling wage levels, on costs using our models.)

Higher relative wages in Factory A, on the other hand, may also be partially explained by its location in the centre of the Pearl River Delta, where skilled workers are increasingly sought after. Given what we know of this particular factory, we imagine relatively higher wages may also be attributed to production efficiencies and relatively high skill levels in this factory. (More definitive comparative analyses would be possible if more factories from the region were included in the study.)

Indeed, skill should have some role to play in raising wages in all of these factories producing for outdoor companies. Given the technical nature of many outdoor products, and the relatively complex processes required to produce them, the demand to attract and retain higher skilled workers can at least partially explain why workers receive above minimum wage.

If this is indeed the case, this is a factor that could support the implementation of living wages in the outdoor industry.

⁴ When estimating 'average' current wage levels, FWF opts to measure mode wages, i.e., the wage received by the greatest number of workers in a given department. This approach gives us quick sense of what most workers are earning.

3. THE COST IMPLICATIONS OF PAYING LIVING WAGES

Based on calculations in the previous section, wages in the factories where the six hypothetical products are made would need to increase by as little as 10% and as much as 102% in order to reach the AFW benchmark. If such wage increases were to occur, how would these brands pay to address them? In turn, how does it affect what the consumer pays?

A. How much more do brands pay?

How much garment brands pay to manufacturers for their products is usually summed up by the freight on board (FOB) price. In order to calculate the impact of living wages on FOB price, we accessed factories' costing data to assess the labour costs included in the FOB for each of the 17 products included in this study.⁵ We also accessed the other costs included in the FOB price, e.g. material costs, overhead, factory margin.

We then calculated the amount by which a raise from current wages to living wages would impact staff costs for each product. In order to make this calculation in a simple, straightforward manner, we took the mode regular wages plus benefits for workers in a factory's sewing department (see our reasoning in previous section) and compared it to the relevant AFW living wage benchmark. This generated a percentage that we call the 'living wage factor'. The factor is, in turn, the basis for calculating the per unit production costs for a product if living wages were paid during production.

$$\frac{\text{Living wage benchmark} - \text{Mode wage level of the sewing department (plus benefits)}}{\text{Mode wage level of the sewing department (plus benefits)}} = \text{Percent increase of staff costs (or living wage factor)}$$

⁵ It is worth noting that the labour cost per garment is a complex calculation. Many different workers - sewers, cutters, seam tape machinists, packers, etc - contribute to the creation and assembly of each garment. Any increase in the FOB would need to be divided among various workers in different departments.

IF BASE WAGES IN A FACTORY RISE TO A LIVING WAGE LEVEL, DO ALL WAGES INCREASE?

Yes. Our calculations take into account that nearly all wages among workers in a factory would likely increase if the lowest paid workers receive living wages. It is necessary to maintain incentive structures, reward experience, expertise, etc. Such pay scales can be maintained as long as the current labour costing per product is accurate. We have sought to take an approach that indicates the amount by which total labour costs would increase when living wages replace the factory's current base wages.

We then applied the living wage factor to staff costs for a sample of products included in the study in order to calculate the overall impact of living wages on FOB.

In our sample, when we calculated the impact of a living wage increase where all other costs remained steady, we found FOB increases of 2 to 12 percent.

Divergences in the increases in FOB were in part tied to the size of the living wage factor. For example, for a product where FOB would only rise by 2.2%, living wages would increase staff costs by only 10%. On the other hand, for a different product we tested, a 12.2% rise in FOB was associated with a 78% increase in staff costs.

Yet the size of the discrepancy between current wages and the relevant living wage benchmark (i.e. the living wage factor) was not the only determinant of how much more a brand would pay to realise payment of living wages.

We found, for instance, that the per unit staff time required for a product also greatly influenced the extent to which wage increases affect the FOB price. If staff costs already make up a relatively large proportion of production costs – in the case of one product, staff costs were 60% of the 'cost of making' – it stands to reason that increased wages will have a relatively greater impact on FOB. This, of course, makes sense: simple garments, with only a few parts or using more elementary production processes, take much less time to assemble than complex garments.

B. Avoiding higher factory margins where living wages are paid

When we plugged the new 'living wage' staff costs into the costing models we developed based on the real-life costing sheets provided by factories, we noted that in most cases an increase in staff costs would lead to an increase in factory margins. In other words, if the same models were used in a case where living wages were paid, the factory would also earn more.

While such increases were relatively small (e.g. 2 to 15 percent), the impact was real for FOB. This extra factory margin meant brands were paying an additional 1% to 2% in FOB – above and beyond the cost of wage increases – just for trying to uphold their FWF commitments.

This is not a negligible cost for a company, particularly if it is producing hundreds or thousands of units of a product.

This study proved very valuable for flagging what appears to be a fairly common practice among garment factories (i.e. across various garment industries). FWF's ongoing wage work will need to explore the practice further and identify ways for brands to avoid incurring additional costs by doing the right thing.

C. How much more do consumers pay?

Most discussion around retail costs of living wages has centred on the idea that the living wage factor (i.e. the additional per item cost that would be paid for living wages) would be passed on to the consumer.

In the event that such direct price adjustments were possible in garment supply chains, our calculations showed that retail prices for the hypothetical products in this study would only increase from less than one percent to 7%. This is to say that consumers could cover the cost of living wages by paying several cents to less than \$5 USD more for our hypothetical items, which ranged in price from \$45 to \$1,000.

D. Effect of 'compounding price escalation' on retail prices

Yet these estimates for the costs of living wages do not capture real-life garment supply chains structures and practices. As FWF has stated elsewhere, the dominant sourcing model in the garment industry complicates the simple idea that consumers can pay a bit more to ensure living wages are paid. The fact that most garments reach the consumer by way of various supply chain actors means that a direct transfer of funds to cover increases is more complicated than it might initially seem.

This is what FWF refers to as 'compounding price escalation' (CPE). This essentially amounts to the practice of calculating the price paid at each step in the supply chain relative to the price quoted at the previous step. For example, a selling agent's fee may be calculated as 24% of the FOB. So, if the pre-living wage FOB is \$10, then the agent charges \$2.40 for services. But if living wages bring the FOB price to \$11, it means the agent's fee increases to \$2.64. No matter how big or small, an increase in wages would also spell an increase in agent fees – and, in turn, increases in prices collected by most other actors across the supply chain to VAT.

In the previous section, we also discussed a version of the practice of compounding price escalation at the factory level, when factory gross margins increased simply because wages rose

We used the models we developed from existing product costing sheets to calculate the mark-ups made at each step in supply chains in accordance with common practice. In these cases, we saw retail prices increasing by as much as 15%, instead of a maximum of 7% for those same products if charges by supply chain actors do not increase with wage increases. This meant that in the case of one hypothetical product, the practice of compounding price escalation led to a retail price for consumers that was \$9 USD higher after wage increases, even though living wages only involved a per product increase of \$1.40 USD.

E. The need for an alternative to compounding price escalation

The practice of compounding price escalation is common in garment production. The practice is understandable: it simplifies mark-up calculations along supply chains through which thousands or even millions of products travel daily. Various supply chain actors use this approach – from agents to retailers, brands to shipping companies. Yet it is a major obstacle to living wage implementation.

At FWF, we believe there must be a way for different supply chain actors to earn without inadvertently inhibiting living wage implementation.

The stark numbers above underscore what is perhaps most problematic about compounding price escalation: The large majority of the additional funds laid out by consumers in the name of living wages would actually get directed to others in the supply chain.

Even if a consumer were willing to pay significantly more to ensure living wages were paid, the reality is that he or she would be paying many times more than the worker receives. For example, in the case of one product we examined in the study, the consumer would pay more than \$17 USD extra for the product, with only \$2.75 USD of that reaching the workers.

One of the priorities for FWF's work on wages is exploring practical alternative methods for transferring living wage premiums paid by consumers back to workers in supply chains.



WORKER

WAGE INCREASE



X1.2



MANUFACTURING



X1.2



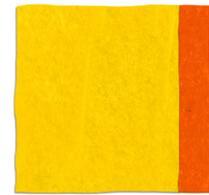
X2



TRANSPORT



X2



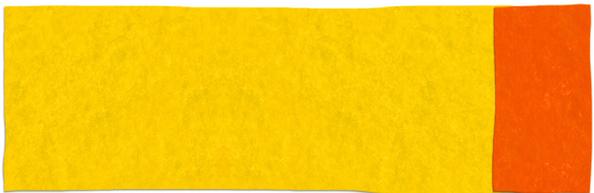
X3



BRAND



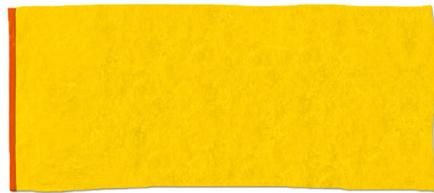
X3



COMPOUNDING PRICE ESCALATION



RETAIL



DIRECT TRANSFER OF LIVING WAGE PREMIUM



CONSUMER

4. LIVING WAGE IMPLEMENTATION AND THE OUTDOOR INDUSTRY

The obvious next step is to try to implement living wages using the tools developed in this study. Is FWF's approach to measuring the 'living wage factor' useful? How accurate are our estimated costs of living wages?

Yet, in doing so, we will need to take into account other features of garment production that can stand as obstacles to living wage implementation.

One such consideration is the amount of leverage a brand has in a factory. For pricing to fully cover the cost of living wages, a significant portion of orders would need to include living wage payments. (We might also look to factories to offset some of the cost of wage increases, and might also consider offsets by way of productivity gains, etc. But for the purposes of this discussion, we focus on the impact of price increases.) So, either a single brand would need to represent a very large portion of production volume, or various brands in a shared factory would need to ensure their pricing was adequate for living wages.

Factory management scepticism is another factor. In a context where production orders are constantly in flux, factory managers often convey substantial hesitance to wage increases – even in cases where brands seek to subsidize higher wages. As some managers have explained, they are looking ahead to a (possibly not so distant) time when current clients decide against paying more to subsidize wages. Or to a time when the pro-living wage brands look to cut costs and consider moving their orders all together. What happens to wages then? What are the ramifications for their factories staying in business?

Such concerns are most effectively allayed through trust and strong, long-term partnerships.

With all of this in mind, FWF recommends that efforts at living wage implementation build on solid foundations in terms of business practices, including: a long-term commitment; sizable per factory production volume; and/or collaboration among brands that share production in a given factory. Again, these are all features more commonly found in the outdoor industry. (They are also areas where FWF checks member performance, as FWF considers them vital to implementation of a host of standards – from building safety to freedom of association.)

It is here that further experimentation on living wages in the outdoor industry or similar other 'garment industries' could prove highly instructive.

5. LESSONS AND NEXT STEPS

This study represents an important step in FWF's step-by-step approach to addressing some of the key questions that stand in the way of living wage implementation. It helped us further clarify our work to measure the cost implications of living wages.

This study also reinforced our view that there are characteristics of the outdoor industry that present real opportunities to improve workplace conditions in important ways. These companies were already willing to go where most other companies have never gone with an initiative like FWF. They have been transparent with their costing data and have encouraged their factories to be transparent too.

While our conclusions from this study are limited by the small sample size, we recognize potential for these companies, and others like them, to become leaders and pioneers on living wages.

FWF has generated important lessons which we will form the foundations of our continuing work on living wages. Going forward, FWF seeks to:

- **Understand pricing across product groups within factories**

While this study gave us real insights into a sample of 17 outdoor products and pricing, it generated new questions about the products that were not included in the study. In order for workers to receive full living wages (i.e. instead of only receiving pay increases for a selection of products they make), we need to develop a strategy that ensures that per unit costs on enough of the products made in a factory will cover the cost of living wages in the factory. To envision how to do this better, we need to understand costing on higher-end and lower-end products, as well as factors such as factory margins. Future studies on the pricing/costing data of complete product lines and/or seasons of production from participating factories and companies are vital here.

- **Access more data and publish more detailed reports**

The findings from this study are based on a small pool of factories and products, which raises questions about how representative the costing data is. The outcomes of this report are not conclusive, and we have intentionally limited the data shared publicly at this time. In future studies we hope to collect much more data in order to test our theories and rules of thumb about wage implementation more rigorously. FWF maintains its commitment to transparency and open-source learning. So with more data, we also hope to be able to publish data-rich reports, particularly to answer the key question more conclusively: 'How much do living wages really cost?'

- **Think differently about living wages**

Until now, most companies think of their living wage commitments as a liability. Instead, we need to support a move towards accepting payment of a living wage as a basic manufacturing cost, alongside material costs and factory margins. The companies in this study and others that have approached FWF for future studies are potential pioneers in this regard.

- **Develop simple tools to support living wage implementation**

We can help support this shift in thinking about wages by developing models and easy-to-use rules of thumb that can help companies quickly ascertain current wage levels, current unit staff costs, and by how much product price would need to increase in order to cover living wages. In this study, we have developed what we hope can be rules of thumb for:

- Gauging current wage levels in a factory (i.e. the mode wage level in the sewing department)
- Determining the amount by which per product staff costs would need to be increased to pay a living wage (i.e. the 'the living wage factor')

With more research, we hope to be able to provide models that can advise companies as to which factories and products should be identified and targeted first to facilitate living wage implementation. The aim is to provide a CEO or product director with the wherewithal to visit a factory and assess its capacity to implement living wages and produce according to her company's needs. Eventually we also hope to develop models that can help a company quickly determine whether its pricing aligns with the commitment to living wage. For instance, we would like to explore the possibility of guidance for wage-to-cost and wage-to-price ratios for certain kinds of products.

- **Find alternative approaches to compounding price escalation in supply chains**

Because compounding price escalation is such an entrenched – and simple – practice in garment supply chains, it will be a difficult one to address. And yet the potential for living wage implementation at any mass level is dependent on wage increases not sending retail prices spiralling upward. We need to find ways to incentivize using alternatives to this practice. This also means involving supply chain actors - such as agents, logistics companies, and retailers - in the living wage discussion.

- **Look beyond individual product pricing to cover increased wages**

When considering the cost of living wages, we have so far focused on the impact on prices for individual products. Excessive focus on individual products, however, misses two important realities of the operation of apparel brands:

- Brands think and evaluate costs and revenue in terms of entire collections, not individual products. Product pricing and margins can vary considerably among garments in a collection for a variety of commercial reasons (e.g. a collection may include a low margin item that creates a lot of publicity for the entire collection). FWF hopes to apply this approach to living wage costing. Can we calculate the total cost of living wage payments for an entire collection? If so, brands have the opportunity to think strategically about covering the cost of living wages. Retail prices on some products may be able to bear increases. Others might not.
- Product cost is not the only cost of doing business for brands. All brands must pay for some mix of product, marketing, advertising, design, and, in some cases, retail operations, rent, etc. All brands construct margins on their product accordingly. If brands do not want to increase prices, there may be possibilities to adjust other expenditures to support living wages.

- **Conduct 'action research'**

Most important at this point is to get out there and do it. There is still a great deal to learn about living wage implementation, and FWF and its members will learn most by way of targeted experiments with increased payments for workers.

We would like next steps to include in-depth studies within selected factories (ideally ones sourcing to committed brands). Studies of supply chains where brands own factories as well as retail locations would be highly instructive. As part of these processes, we will continue to consult with the workers who are affected by the efforts. FWF will also investigate ways to involve retailers and consumers, who are critical to the realization of living wages, more actively in this work.

All of FWF's wage work runs in parallel to our efforts to support and help develop local social dialogue. We believe that functioning industrial relations system represent the fairest, most sustainable, affordable, and scalable method for achieving living wages over the long term.

This study is only an early step in the process to bring living wages into the garment industry, but it is a critical and valuable step. FWF thanks the European Outdoor Group and all involved for their openness and candour in the development and execution of this study.

Please learn more about FWF's broader living wage strategy at fairwear.org.

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