USING DUE DILIGENCE IN LABOUR COSTING TO MEET WAGE COMPLIANCE
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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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SUMMARY

This paper examines the application of human rights due diligence in the area of wages. In order for wage compliance to be achieved and for wages to improve, both a greater transparency in cost price negotiations between apparel buyers and their suppliers, and a precise determination of the labour component must take place.

In the area of labour costing, four main areas require discussion: the mandatory wage elements payable to a worker including employer wage related on-costs; the total of direct and indirect labour costs divided by the available capacity minutes; the standard allowed minutes agreed for the apparel item in question; and a factory’s efficiency. Isolating the labour cost in the form of a minute value establishes the price of labour and, when multiplied by the agreed standard allowed minutes with an allowance for efficiency, allows a determination of the labour part of the cost price—an element which, arguably, has hitherto been missing in garment price negotiations in substantial parts of the industry.

Requesting a supplier to provide this information (a composite of direct and indirect labour costs divided by a factory’s capacity minutes) and comparing this figure with a mandatory labour minute value for the country in question should enable a buyer to exercise due diligence in determining costs, ensuring that mandatory wage elements are covered in the agreed price of labour. Such an approach also enables a supplier to determine the precise amount that needs to be added to projected costs, providing either an increase in the minimum wage or a wage negotiation in a collective agreement.

Where national industry-wide bargaining exists, it should be possible to calculate a baseline labour minute value for the country in question, therefore simplifying the task for buyers. Furthermore, where industry-wide bargaining does not exist, knowing the labour minute value facilitates the introduction of any living wage benchmark for the purposes of determining ongoing manufacturing costs.

While it is possible to create national labour minute value tariffs, as of yet there is no agreed standardised method for generating this. This paper presents a start. Similarly, despite the existence of systematic approaches for determining the time value required on specific garments, there is not yet an agreed industry-wide system, despite the use of the term ‘standard allowed minutes’ (SAMs). Multiplying the SAM for a particular garment by the labour minute value generates its labour cost. If an industry-wide consensus on methodology for determining both the labour minute value and standard allowed minutes existed, efficiency and quality would be the major determinants for buyer discrimination between suppliers. In order for efficiency not to become the driver of work intensification there is a need for union and management capacity building at workplace level on pay and productivity.

BACKGROUND

Following the translation of the UN’s Guiding Principles on Business and Human Rights into a set of due diligence guidelines,1 the global garment industry finds itself in a new regulatory environment. The guiding principles define due diligence as ‘the process through which enterprises can identify, prevent, mitigate and account for how they address their actual and potential adverse impacts’ in their sourcing practices.2 How do such principles translate into the area of wage compliance?

2. UN Guiding Principles on Business and Human Rights p.16
The OECD has provided guidance by stating that this should include both wage compliance with national law and ensuring that wages satisfy the basic needs of workers and their families. Summarising 2014’s Global Dialogue Forum on Wages and Working Conditions in the Textile, Clothing, Leather and Footwear (TCLF) industries held at the ILO, three key points of consensus were identified:

- minimum wage levels in the sector which are generally low and not redistributive
- wage levels which do not fulfil the needs of workers and their families with such levels sometimes only achieved through excessive overtime work
- wage levels which are also influenced by national policies and the price paid by buyers

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- wage levels which do not fulfil the needs of workers and their families with such levels sometimes only achieved through excessive overtime work
- wage levels which are also influenced by national policies and the price paid by buyers

Compliance teams within the industry—whether located within companies, multi-stakeholder initiatives or international agencies—continue to grapple with these major issues, increasingly mindful that the issues are generated largely by the purchasing practices of brands and retailers’ sourcing departments.

There are signs now that the twin straightjackets of competitive national minimum wage policies and the absence of collective bargaining, which have fuelled the race to the bottom, are on the cusp of being loosened. The Action Collaboration Transformation Initiative (ACT), which seeks to develop a sector-wide approach to wage growth (underpinned by buyer commitments to sourcing in key low-wage countries), has prompted member brands to engage in a systematic review of their buying practices. The Better Buying Initiative is giving suppliers the space to anonymously highlight how adverse purchasing practices impact their customers and affect social compliance. Running parallel with these initiatives, Fair Wear Foundation (FWF) has been at the forefront of efforts to open up the traditionally closed world of garment costing by examining how brands and retailers can make their labour costs visible initially to identify the ‘living wage factor’ (as measured against a given benchmark), and then to determine the amount of extra labour cost that would cover a minimum wage increase.Both ACT and FWF’s approaches are geared, among other things, towards strengthening management systems by assisting the development of ‘pricing models, which account for the cost of wages, benefits and investments in decent work.’

5. https://betterbuying.org/ last accessed 28/6/2018
In this paper we present a Fair Wear Foundation pricing model that focuses specifically on the labour component of the manufacturing (CMT) cost. We are conscious that the industry has no standard in determining labour costing because this is fully dependent on transparency—a situation that many buyers crave but that many suppliers are loathe to provide, usually because of the pressure that comes on operational costs and margin that comes from their customers. This paper focuses primarily on the price of labour—the labour minute value. The ‘standard’ allowed minutes or SAMs are the necessary missing variable in determining the actual labour cost. Of course, these vary per garment style and in practice per factory line efficiency. Yet despite the use of the term ‘standard,’ there is no common methodology for determining garment times. This issue deserves a discussion paper on its own right.

Capturing the labour minute value is important in ‘code compliance’ terms since this element within the CMT price must be sufficient enough at least to cover the minimum wage and other statutory wage elements which a manufacturer has to pay. Secondly, once the standard allowed minutes for a particular garment are known, it should then be possible to more accurately pinpoint the upcharge necessary to meet the new wage compliance cost for purchase orders moving forward. Knowing this value should also provide a basis for calculating the extent to which the labour element of a cost price is sufficient to cover a worker’s basic needs and allow for an element of discretionary income against any given living wage benchmarks. Where labour minute values are calculated following an industry-wide collective agreement, this should define the rate for the job – part of the price which alongside the cost of fabric can be inserted into the contract between buyer and supplier. Sourcing decisions should then be based on other indicators—quality, efficiency and social compliance rather than the price of labour.

Since the labour cost is part of an overall cost price which includes fabric, trim, overhead and factory margin, ensuring that it is not offset against these other cost elements will be a major new challenge for buyers since it will essentially shift the focus to the question of how wage increases are to be funded outside of the CMT section of the value chain.

**THE PROBLEM OF A TARGET MARGIN**

Arguably the single biggest element of the buyer-driven nature of the industry lies in the fact that brands fix their target margins at the outset of a cost price negotiation. This, more than anything, sets the parameters for quality and social compliance. The following example illustrates this:

Let’s assume that Brand X, which sells directly to the consumer and sources directly from the factory, sets a target margin of 60% for a specific item of apparel in its negotiation with Supplier Y.

<table>
<thead>
<tr>
<th>OVERALL SELLING PRICE</th>
<th>60% Margin</th>
<th>40% Product Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>70% Material</td>
<td>15% Labour</td>
<td>5% OH</td>
</tr>
</tbody>
</table>

For the supplier, fabric and trim can constitute up to 70% of the manufacturing cost. Let us say labour costs are 15%, overheads are 5% and the factory margin is 10%.

Assuming the brand wishes to maintain its margin but the wages go up as a result of a national minimum wage increase and overhead costs rise in line with inflation, the supplier’s margin will be reduced.

<table>
<thead>
<tr>
<th>40% PRODUCT COST</th>
</tr>
</thead>
<tbody>
<tr>
<td>70% Material</td>
</tr>
</tbody>
</table>

Assuming the brand wishes to maintain its margin but material prices go up as a result of rising commodity prices in line with negative impact of foreign exchange rates but also the supplier wanting to keep his margin abuse of labour cost could occur.

* The ratio between margin and production costs strongly depends on the specific business model being pursued by the buyer. The above graphic is used as an example only.
This means that in terms of the overall projected value of the garment, 40 per cent will be production cost. Of this cost, 70 per cent is taken up by material and trim, labour covers 15 per cent, with overhead and factory margin at five and ten per cent, respectively. Assuming the brand wishes to maintain its target margin, if the minimum wage goes up through a one per cent increase in labour costs and overhead (overhead containing indirect labour costs, etc.), then all other things being equal, the factory margin must decrease if the unit manufacturing price does not increase.

Similarly, if fabric costs increase as a result of a negative exchange rate fluctuation and the factory needs to maintain its margin to sustain in the market, then labour costs must adjust downward accordingly. From a compliance point of view, the issue then becomes how this can be managed without resulting in code violations.

Any supplier wishing to maintain their own margin in circumstances such as this must logically make adjustments to their operating costs. In a full business model (FOB) scenario they may seek to do this by compromising on the quality of the garment, either by finding cheaper fabric or by reducing the workmanship. This is a particular risk as these quality issues can result in cost price reductions and/or fines. Alternatively, suppliers can seek to reduce the cost of labour in some way—either through job cuts, running unpaid overtime, increasing line speed or measured day work targets (always with the possibility of the accompanying threat of physical and/or verbal abuse by line management) or by unauthorised subcontracting. Empirical research suggests that minimum wage non-compliance is often caused by adverse practices on the part of buyers: poor planning, extension of payment schedules or late changes to style.9

A recent ILO study found that one third of suppliers have sold below cost in order to maintain a level of orders from the buyer in question. Moreover, when asked what percentage of buyers was unwilling to increase prices to cover the cost of a minimum wage increase, suppliers reported that 75 per cent of buyers were unwilling to do this.10

There is an undeniable, chronic non-compliance problem, validated by both FWF’s member audit returns and complaints procedure,11 and recent supplier survey results from Better Buying.12 This data tallies with wider regional findings in surveys conducted by the ILO and Better Work, where the findings revealed that an average of 36 per cent of garment workers were underpaid in some form or other, through a failure to pay the minimum wage, overtime, leave entitlements due, or social security payments.13

For buyers seeking greater visibility over labour cost for compliance reasons, there is a need to understand how such costs are derived at factory level. In the next section, a summary of different approaches to garment costs that exist in the sector are presented, explaining how labour costs are calculated. A working model for both determining the mandatory labour minute cost in any given sourcing country and the actual labour minute cost in any given factory is then given. The final section makes an argument for greater supplier transparency on labour cost for wage compliance and highlights some implications for the industry.

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CURRENT COSTING PRACTICES

Because cost price negotiations are highly sensitive commercially, we are not aware of any extensive empirical data as to the range of approaches to determining the cost of labour. These findings are based on data from existing costs sheets, as well as experience in buying and manufacturing (knowledge gained by industry consultants). As we have seen above, supplier experience of cost price negotiations suggests a diversity ranging from tendering to simple face-to-face bargaining to some degree of what is termed “open costing.” However, because “open costing” continues to remain a double-edged sword that generally works to the advantage of the buyer, there would appear to be wide variations in procedures and processes, especially when it comes to transparency in price negotiations.

Our starting point for understanding existing costing practice must be the two principal buying models in the sector: Cut Make and Trim (CMT) and the Full Business Model (aka Free on Board or FOB).

CUT-MAKE-TRIM (CMT)

Under the CMT model, the buyer pays the factory for CMT only, which means the factory is just selling labour. The materials, such as fabric, accessories and trims are sourced and provided by the buyer. In the CMT model, the buyer keeps most of the development process under his control and outsources the labour to CMT factories. Because CMT manufacturers are supplied with the raw materials and are not heavily involved in the development and sourcing part, they tend to have a cost structure with higher direct labour than factories supplying under the full business model. This is because their core strength is in the manufacturing process rather than development and sourcing.

FULL BUSINESS MODEL (FOB)

The Full Business Model (FOB) is an official Incoterm under which the buyer purchases ready-made garments from the factory, meaning that the factory is much more involved in the development and sourcing process. This model demands a much higher skill set and capabilities from the factory’s staff in addition to a certain financial stability and strength to develop, source and pre-finance the necessary materials. Full business factories therefore present a different cost structure when it comes to direct and indirect labour, due to the additional tasks for development, sourcing and purchasing of the needed raw materials.

In both cases, price negotiations can often be quite simple in that the buyer and factory are only discussing one overall figure for the garment in question.

For a T-Shirt, this could be as follows:

CMT PRICE FOR T-SHIRT > $0.95 USD per piece Ex Works

FULL BUSINESS PRICE for T-Shirt > $6.25 USD per piece FOB

14. FOB is an official INCOTERM which indicates that the seller delivers the goods on a designated vessel and that the transportation cost and risk will be transmitted to the other contract party when the goods are loaded on the vessel. There are also other Incoterms, which are commonly used in the apparel industry such as Ex Works (EXW), Cost insurance and Freight (CIF), Delivered Duty Unpaid (DDU), Free Carrier (FCA) and others. The Incoterms therefore determine the point at which the seller takes responsibility for transport cost and risk of the goods purchased or in other words where the buyer takes over the same. Incoterms are published by the International Chamber of Commerce (ICC) to facilitate international and domestic trade transactions cf: https://iccwbo.org/resources-for-business/incoterms-rules/incoterms-rules-2010, last accessed 29/6/2018
This approach to garment costing and negotiation is the least transparent since it does not allow us to see any details about real costs and where these costs are allocated. A conscious buyer would have to assume that these costs are sufficient to cover the factory’s labour costs. A more transparent costing model is where the costs of the product are specified in more detail. The key elements that would normally be opened up are as follows:

- material input > Material cost (fabric cost and consumption, trims, embellishment, accessories...)
- the labour cost
- overhead
- factory Mark-up

**MATERIAL INPUT**

This cost, also known as BOM (Bill of Materials), contains the total material cost including the consumption per garment and a certain percentage for wastage. Both the factory and the brand would normally have detailed knowledge of these costs since they constitute the largest cost component and therefore are very important in the price determination. Moreover, they are important in the design process of choosing the right fabric to reach a target price. Knowledge of fabric cost can also deliver room for negotiation, since changes in fabric price and design input can have a direct impact on product price.

**LABOUR COST**

Simply defined, the labour cost is the price for labour usually expressed as a monetary time value multiplied by the amount of labour time taken to manufacture the garment in question. In Figure 2 above, the labour cost has been quoted. The dominant time value in labour costing has become the ‘sewing or working minute’ with garment styles timed either using work study (whereby the whole assembly is observed and timed...
in factory) or predetermined time and motion studies (a synthetic approach based on the off-site systematic study of manual operations required to make particular garment styles). The required sewing minutes are generally termed the SAM or Standard Allowed Minutes.\textsuperscript{15}

Since it is generally only possible to measure the working time of those workers employed directly on the assembly line, a distinction in manufacturing is made between direct labour costs, which apply to those employees or workers who are directly involved in production of goods or services, and indirect labour costs, which relate to those employees such as supervisors, security, office staff, maintenance who are not directly involved in the production of goods or services, but who make their production possible or more efficient.

\textbf{OVERHEAD}

Overhead costs are costs required to run a business but which cannot be directly linked to any specific product or business activity. There is a diversity in the industry in the way that management defines and therefore allocates indirect labour in the overhead category. Excluding indirect labour, the overhead would normally include such elements as rent, insurance, energy, office supplies and depreciation.

\textbf{THE FACTORY MARGIN}

The factory margin is what the manufacturer retains after all manufacturing costs have been deducted.

Buyers, of course, are interested in this open costing approach—and it is generally only opened up in one direction—namely upstream in the value chain and often for less than benign reasons (i.e. to see where further cuts can be made from the manufacturing cost or the fabric and trim usage). The resulting cat-and-mouse game has created a diversity of approaches in the way costs can be presented.

\textsuperscript{15} The SAM determines how long it takes to manufacture a garment under optimal circumstances taking external factors such as fatigue and, to a certain extent, machine down- or set-up times into consideration. There are different consultancies that offer a range of calculation methods; for example REFA, General Sewing Data (GSD), SewEasy. Not all factories use the same method and many have developed their own internal means for measuring the time it takes to make a garment which obviously makes it complex to compare standard minutes across factories. The use of some of the standardised systems mentioned above would support comparing prices and real competitiveness across factories and even countries.
below shows a further example of an ‘open’ costing where fabric requirements have been specified down to the finest detail, but where labour costs have been hidden, including overhead and factory profit.

**Figure 3** Example of open costing:

![BRAND XYZ GARMENT COST SHEET](image)

below figure shows an example of garment costs, including a working minute cost and its standard allowed minutes.

**Figure 4** Technical fleece shirt
These examples show a range of possibilities in how elements may be presented in a price quotation:

- Total lump sum price for the garment
- Lump sum for labour
- A composite cost covering labour, overhead and profit (calculation with SAM undertaken internally but not revealed)
- A CMT price = working minute cost x SAM
- A CMT quote = working minute price x SAM

The first three examples demonstrate no transparency over the labour cost and therefore have no basis to assess whether or not the price paid covers wage compliance costs.

Our fourth example demonstrates the use of what is known as working minute cost. In calculating the working minute cost of a factory, the entire (annual) operating costs (direct labour, indirect labour and overheads) are taken and divided by the total capacity minutes of the factory. Capacity minutes are calculated based on the number of sewing machine minutes annually available (based on the standard working time of the country in question).

The working minute cost arguably shows the factory’s real manufacturing cost when making a garment and is applied in the discerning the cost by multiplying the working minute cost by the SAM time. This should not be confused with the term working minute price which includes this working minute cost plus the additional mark-up amount from the factory. Where this degree of open costing exists, some variation of working minute cost/price is likely to be quoted within the CMT/FOB manufacturing cost quote.

The working minute cost helps in determining the labour cost of a garment, but we can achieve further clarity by removing the overhead from the calculation, which provides us with a labour minute cost.

**Figure 6** Example using an adult pair of jeans:

<table>
<thead>
<tr>
<th>Fabric type</th>
<th>100% cotton twill solid dyed</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fabric width/GSM</td>
<td>315 GSM</td>
</tr>
<tr>
<td>Main Fabric Cost</td>
<td>$2.09</td>
</tr>
<tr>
<td>Usage</td>
<td>$1.36</td>
</tr>
<tr>
<td>Total Fabric Cost</td>
<td>$2.44</td>
</tr>
<tr>
<td>Trim Cost</td>
<td>$0.75</td>
</tr>
<tr>
<td>P &amp; P Cost</td>
<td>$0.20</td>
</tr>
<tr>
<td>Total</td>
<td>$3.79</td>
</tr>
<tr>
<td>CM Cost</td>
<td>$1.44</td>
</tr>
<tr>
<td>SAMs</td>
<td>16</td>
</tr>
<tr>
<td>Cost per SAM</td>
<td>$0.090</td>
</tr>
<tr>
<td>CM Cost</td>
<td>$1.44</td>
</tr>
<tr>
<td>Other Costs</td>
<td></td>
</tr>
<tr>
<td>Ancillary</td>
<td>$0.17</td>
</tr>
<tr>
<td>Shipping per kg</td>
<td>$0.02</td>
</tr>
<tr>
<td>Shipping Cost</td>
<td>$0.03</td>
</tr>
<tr>
<td>Export Rebate</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>$0.22</td>
</tr>
<tr>
<td>Direct Cost</td>
<td>$5.45</td>
</tr>
<tr>
<td>Overhead</td>
<td>$0.20</td>
</tr>
<tr>
<td>Margin</td>
<td>$0.28</td>
</tr>
<tr>
<td>% age</td>
<td>8.1 %</td>
</tr>
<tr>
<td>Contribution</td>
<td>$0.48</td>
</tr>
<tr>
<td>Supplier Cost</td>
<td>$5.93</td>
</tr>
</tbody>
</table>
Achieving a degree of transparency in how the cost information is presented tells us nothing about whether the values themselves deliver on compliance. In the next section we examine the elements necessary to determine whether a cost is ‘wage compliant’.

ACHIEVING GREATER TRANSPARENCY IN LABOUR COST

In comprehensive labour costing, it is necessary for buyers and suppliers to know all the elements of labour cost. Four key variables need to be opened up:

• the specific elements of the labour cost
• elements of the direct and indirect labour cost expressed as a minute value
• the SAM
• the factory’s efficiency

ELEMENTS OF THE LABOUR COST

There are accepted conventions as to what constitute the elements of compensation. The Fair Labor Association recently engaged in a project to enumerate possible elements of labour cost (see annex). Each country will have a different set of elements that are deemed mandatory as part of national minimum wage legislation. Moreover, each factory will have developed, over and above these mandatory wage elements, bonus schemes and/or extra wage benefits for the purposes of production incentive and to retain labour where local labour markets are volatile. While a formal distinction can be made between mandatory and non-mandatory elements for the purpose of determining statutory wage compliance, in practice non-mandatory wage elements at factory level are necessary to enable a supplier to deliver the product to the buyer.

Members company can demonstrate the link between its buying prices and wage levels in production locations.

<table>
<thead>
<tr>
<th></th>
<th>Max</th>
<th>2</th>
<th>Min</th>
</tr>
</thead>
<tbody>
<tr>
<td>Advanced</td>
<td>4</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Intermediate</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Insufficient</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Member company can demonstrate a clear understanding of the labour cost component of its buying prices. Labour costs are fixed (not negotiable).

Member company can demonstrate some form of open costing and applies a plausibility check to its buying prices.

Member company only knows buying prices. There is no understanding of wage part/labour costs of the product.

Source: FWF Brand Performance Check Indicator Guidelines. 2018 version

In its efforts to foster due diligence on the part of its member companies in the area of wage compliance, Fair Wear Foundation has developed a brand performance benchmark indicator that ‘pushes’ buyers to open up the labour cost in their transactions with suppliers by annually rating their work in this area. This is captured in Performance Indicator 1.8:

At the same time, FWF has begun a project with member factories in Myanmar and Bangladesh to enable suppliers to ‘pull’ their buyers into paying the price increase necessary to cover any rise in the national minimum wage.


Both these approaches require an understanding of mandatory wage elements and employer on-costs of the country in question, and an intimate knowledge of the non-mandatory elements found in factory. Whereas the former should be officially available and most certainly known by the factory, the latter information would normally only be available through the factory audits.

Firstly, a mandatory labour minute value is the basic price for one minute of labour based on the national minimum wage, any other legally required wage elements and associated employer on-costs. A schedule of possible mandatory requirements is contained in Table 2 below:

Table 2: List of possible wage elements

This comprehensive list includes some items such as overtime and incentive premium. Although the overall aim of due diligence in labour costing should be the payment of a decent wage within regular working hours, and without the need for an (incentive) bonus, some allowance should at least be made to accommodate an average amount of overtime worked in the sector in question and therefore should be accounted for within the calculation at the statutory overtime rate. A production bonus by its very nature is difficult to capture and model although we expect this to be included in the direct labour cost element of a supplier’s accounts when they calculate their actual labour minute value (see below).

Once the various elements are known these can be added into an into an EXCEL spreadsheet and relevant values entered to simplify the costing process. In the example in Figure 7 below, we calculate the mandatory labour minute value for Myanmar (as of May 2018, following a minimum wage increase of 33% from $60 to $90 per month) both with and without overtime. Please note the calculation of mandatory labour minute values does need some caution since there are regional/provincial minimum wage rates and in some cases also graded NMW structures that need to be taken into account.
This calculation shows the prevailing labour minute value and the impact on cost of the wage increase with and without overtime. In this instance, labour minute cost quotations from factories in Myanmar, for example, would have to be at least 0.9 of one US cent to meet mandatory requirements including overtime. It shows that the actual cost increase is only 0.21 of one cent per minute in standard working time and 0.31 of one cent when overtime is worked. For a factory including overtime in their calculations, the upcharge per minute would be 0.24 of one cent. In the section on SAMs and efficiency below we calculate the labour cost impact on a number of different garment styles to give an impression of the magnitude of a 33% wage increase in Myanmar and the extra amount a buyer would have to find. Please note that this is the minute value increase for mandatory elements. In the case of Myanmar, factories pay over and above the minimum wage in the form of skill-, attendance- and output bonuses. These values would need to be inserted by the factory management in order to arrive at an actual factory labour minute value. Even when adding these elements, the increase in the labour cost per minute is negligible.
DIRECT AND INDIRECT LABOUR COSTS EXPRESSED AS A MINUTE VALUE

To determine the actual labour minute value to compare with the mandatory labour minute value the supplier would need to take their direct and indirect operating costs for the previous accounting year and divide these by their available annual capacity minutes.

Achieving transparency on actual labour cost for wage compliance will require a supplier to separate out their indirect labour costs from their overhead and add this to direct labour costs for the purposes of establishing the labour minute value.

We expect that such labour costs will include all mandatory and non-mandatory elements, overtime costs, bonuses and other related wage compliance costs such as training expenditures. Note that the factory labour minute cost is a figure that only a supplier can provide since it is based on their own company information and actual operating costs.

How can this be benchmarked against an acceptable compliance wage cost? While this provides greater granularity of labour cost for the purposes of determining a minimum wage upcharge, suppliers need to maintain a separate accounting line for the contracted wage costs of their direct and indirect employees. Hence, following an increase in the minimum wage, suppliers would apply the % increase to this figure and not their overall wage costs.

The supplier thus needs to maintain (as a minimum labour cost) transparency on the following lines:

**LABOUR COST**

- Pay for time worked
- Benefits—monetary and non-monetary
- Labour-related employment on cost
- Standard working week/month

**Total Labour Cost per worker = LMV**

**Capacity minutes**

The above three elements can be further categorised in terms of possible mandatory elements which are either specified in national minimum wage determinations and/or social security/fiscal requirements as laid down in national legislation. We would recommend that sourcing companies request that their suppliers disclose their factory labour minute cost. At this juncture, we are not interested in a breakdown of the direct and indirect labour costs but we need a labour minute value, which is arrived at by dividing the sum of these figures by the available capacity minutes. This factory labour minute value should reflect the prevailing labour minute cost in the factory. The quoted factory labour minute value should at least exceed the national mandatory labour minute value and can be used to verify the plausibility of the factor’s labour pricing in cost price negotiations.
IMPLEMENTING LABOUR COST TRANSPARENCY

The national mandatory labour minute value and can be used to verify the plausibility of the factor’s labour pricing in cost price negotiations.

- establishing whether existing prices are sufficient to meet wage compliance costs. We would suggest that without full open costing this is the most difficult objective to achieve.
- determining the magnitude of price increase necessary to cover a minimum wage increase. This is achievable with partial open costing.
- identifying the ‘wage gap’ between the current prevailing wage and a desired wage based on a given living wage benchmark.
- defining a labour minute value or the price of a labour minute can be the tool by which buyers commit to funding wage increases under industry-wide or multi-employer bargaining.

However, we must remember that the labour ‘price’ is but one part of the labour cost the other key elements being the SAM and the factory’s efficiency. We look at these in turn.

SAMS

In the same way that it is possible to externally generate a mandatory labour minute value for a sourcing country/province, SAMs can be synthetically constructed using predetermined motion and time systems. Although such times have been rigorously assembled and build in allowances for relaxation and downtime, they serve as targets against which actual production can be measured and improved. In factory SAMs will generally be captured using work study although some suppliers have adopted systems such as GSD to generate their target times.

EFFICIENCY

However, to calculate the actual labour cost in the manufacturing of a garment, the real factory efficiency also needs to be taken into consideration since the SAM will only deliver the time needed to produce a garment based on optimal circumstances. Every factory and every line within a factory will have a different production reality and therefore efficiency factor which needs to be taken into consideration. If a factory operates on 50% efficiency, which is not uncommon, then it will take double the SAM target time to produce a garment calculated by the SAM. This extra time needs to be considered in the factory’s costing process, otherwise it cannot sustain in the mid- to long term.

Miscalculations of actual efficiency or failure to include this in the quotation of the working minute cost could lead to excessive overtime in the fulfilment of the buyer’s delivery deadline and/or pressure on workers to meet an unrealistic production target. We must assume that suppliers/factories factor efficiency into their costs/SAMs but given the extent of excessive overtime in the industry we must conclude that this is not done systematically. If buyers are engaging in crude bargaining with little knowledge of a factory’s efficiency, and the factory in turn is failing to build the actual efficiency into its costing, the non-compliances will be
highly likely. This means that there will need to be transparency in costing on the other elements of the manufacturing price which includes the SAM and the efficiency.

In Figure 9 below, we show the impact of the NMW increase in Myanmar on the labour cost of specific garments based on a range of SAMs at 40% efficiency.

This example shows the impact of the 33% NMW increase in Myanmar from $60 to $90 US per month on the labour cost of a number of different garment (SAMs) based on a factory efficiency of 40%. Note that the values here are based on the minimum contracted wage. The same calculation can be carried out based on a median wage or the actual wage costs of a factory. This would obviously lead to a higher but comparatively low value.

However, we must remember that the labour cost is but one part of the overall costing architecture and that for wage compliance to work in a margin-based industry the price of labour has to be fixed and the agreed labour cost must not be offset against other cost elements, i.e. overhead and factory margin. As a principle, in the absence of open costing, we would recommend that where there is a wage increase, the historic CM price remains unaltered and the isolated wage upcharge is added.

Where labour minute values are calculated following an industry-wide collective agreement this should define the rate for the job—part of the price that alongside the cost of fabric can be inserted into the contract between buyer and supplier.

Therefore, if brands and retailers are serious about due diligence in wage compliance, safeguarding labour cost will have implications for buying practices, particularly in relation to the funding of labour cost increases. Sourcing decisions should then be based on other indicators—quality, efficiency, and social compliance rather than the price of labour. Going forward, discussions in cost price negotiations should focus on process optimisation and factory organisation to improve cost competitiveness. When it comes to discussions about efficiency, focus should be placed on working more smartly rather than working harder. In the ‘lean’ world this would be done via continuous improvement and the elimination of waste throughout the entire value chain and not just on the assembly line. Given what we know about added value in the supply chain, there
should be sufficient resources to make this possible and, where there is a relationship of trust between buyer and supplier, open costing should not be an issue.

In conclusion, transparent garment costing will not succeed without know-how and an understanding of the rationale behind it. Both buyers and suppliers will need to invest time and effort into revisiting their respective costing procedures. For factories, this may require a (re)examination of their accounting practices as well as the approach to cost price negotiations. In both cases a clearer understanding of the industrial engineering methodologies underpinning the calculation of SAMs and efficiency will be necessary.

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