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SUPPLY CHAINS TRAPPED AS WESTERN RETAILERS CLOSE THEIR DOORS

FIRST PUBLISHED APRIL 2020

As retailers across Europe and the US have adapted to the crisis brought on by Covid-19, much focus has rightly fallen on their employees as physical shops have closed. Whilst perhaps not front of mind, the situation for workers at the end of the supply chain is just as stark. In the good times, retailers talk of partnership. Is that evident today? Consumers, for whom social issues increasingly matter in spending decisions, will judge companies for their actions today far longer than the spread of this horrendous virus. In November 2019, members of the Research team visited Bangladesh with Rosey Hurst, CEO of ethical trade consultancy Impactt, to assess conditions and challenges within the retail supply chain. As we engage directly with companies today on their response to Covid-19, we spoke to Rosey Hurst to find out where her concerns lie.

ROSEY HURST

Rosey Hurst is the Founder and Director of Impactt, an ethical trade consultancy that looks at labour standards in factories around the world and how workers are treated. She has spoken at our client conferences in the past and contributed to our *Research Journal* on a number of occasions. In addition, the Research team at Walter Scott regularly taps into Rosey's expertise and her network has been instrumental in a number of important research trips aimed at understanding the challenges within the global supply chains that retailer and apparel companies so rely on.

With the world focused on fighting the new coronavirus, there have been suggestions in some quarters that ESG factors could take a back seat as investors nurse heavy losses and look for safe havens. But Walter Scott has always placed ESG at the heart of its investment process, and this crisis provides a stark reminder that ESG remains as important as it ever has been.

No country in the world is immune to the economic and human consequences of the coronavirus but in South Asia, the suppliers of clothing to Western companies are facing financial ruin and a humanitarian disaster is looming.

When Primark announced the closure of all its stores across the world and cancellation of all of its clothing orders in March to protect its staff and business from the impact of the coronavirus, its decision had a devastating impact on the factories in Bangladesh that supply its garments.

Primark is not alone. Western retailers from Nike to Inditex and H&M have closed stores and furloughed staff as almost a third of the world's population has gone into lockdown.

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Bangladesh has been particularly badly hit because its garments and textiles sector accounts for 80% of the country's total export earnings and 20% of its GDP. Order cancellations by Western firms have pushed factories to the brink of insolvency with losses and redundancies mounting on a daily basis. Rubana Huq, President of Bangladesh Garment Manufacturers and Exporters Association (BGMEA), which represents Bangladeshi factory

owners described the situation to the New York Times as “apocalyptic”. Huq said on March 27th that 1,089 garment manufacturers, employing 720,000 people in the country, had reported cancellations or withdrawal of orders worth around \$1.5 billion. That figure is now thought to be closer to \$2.8 billion.

We know that garment factories in Bangladesh are much safer places to work than they were back in 2013 when the Rana Plaza complex collapsed, killing more than 1,100 workers and injuring more than 2,500. The Rana Plaza disaster raised the question of how fast fashion could be responsibly made, and the reputational and financial risk of failure along the supply chain is certainly recognised today.

Primark, which sourced from one of suppliers in Rana Plaza, was among the first retailers to sign the Accord on Fire and Building Safety in Bangladesh and provided \$2m in financial support and food aid immediately following the disaster, a figure that eventually rose to \$12m. “Primark's response to Rana Plaza was impressive, so the commercial decision it has made now to cancel orders risks undermining this approach,” said Rosey Hurst, CEO of ethical trade consultancy Impactt.

Just as Western companies responded to Rana Plaza then, today, they should reflect on how they can limit the damage to their supply chains due to their response to Covid-19. Swedish retailer H&M said on March 30th that it would take and pay for the shipments of goods that had already been manufactured for the company, as well as those currently in production. On March 31st, Inditex, which owns Zara, followed suit, along with Marks & Spencer. The challenge for Primark, one of the largest purchasers of garments in Bangladesh, is that unlike its rivals, it does not sell online so cannot shift stock that is languishing in its now-closed stores, resulting in £650m in lost sales per month.

But while Primark's staff in the UK and other countries receive up to 80% of their monthly wages as part of the government furloughing programmes, such schemes do not exist to the same extent in developing countries. “Bangladesh's garment industry employs five million people in a country where governance is poor, the tax base is small, and there is no social insurance,” said Hurst.

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On March 22nd, Bangladesh Prime Minister Sheikh Hasina Wazed announced a \$590m package to help pay the salaries of workers in export-oriented sectors but more needs to be done.

One option is for Western companies to provide financial support for workers just as they did after Rana Plaza but, as they are nursing losses of their own, there could be less scope to help out further down the supply chain. “Covering the cost of supporting five million workers in its supply chain who are each paid \$150 per month is a big burden for an industry to bear at a time when sales have ground to a halt,” says Hurst. “We're seeing an approach of ‘sauve qui peut’.”

Western companies do not own these facilities nor employ the workers so it is hard for them to provide direct financial support, and any effort to pay the wages of affected workers is challenging in practice. A survey of 103 private companies in Bangladesh, published by the International Finance Corporation (IFC) on March 12th, revealed that

18% cited corruption as the greatest constraint to Bangladesh achieving middle income status.

According to Hurst, investors should engage with Western companies to ensure they are seeking improvements in governance throughout their supply chains. “When it comes to the global supply chain, companies should pay special attention to the ‘G’ in ESG. There are incredibly low standards of governance in some developing countries so even if Western firms did put money in to support, they would not know whether it would get to where it is needed because of high levels of corruption. Governance is the leading indicator in the ESG equation and this is where the work should focus,” says Hurst.

Members of Walter Scott’s Research team visited garment factories in Bangladesh and Vietnam last year and saw at first hand improvements to working conditions. While there was much to be applauded, particularly in Vietnam, where state support is more robust, the team formed a mixed picture.

As well as facing economic hardship, Bangladeshi factory workers are also at risk of contracting the coronavirus because they typically live in close quarters in slums, making social distancing measures difficult to implement. On April 29th, the Bangladeshi government announced the closure of all factories except those making essential personal protection equipment (PPE) to fight the coronavirus. This situation is also playing out in other developing markets such as India, where the imposition of a government lock-down has sparked

a mass exodus by migrant workers to rural areas, which are ill-equipped to deal with the virus. Transport networks are overcrowded, leaving thousands of people to walk hundreds of miles without food or shelter. “This is a humanitarian disaster waiting to happen. There is no social distancing,” adds Hurst.

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In China, which is emerging from lock-down, the impact is still being assessed. Factories closed down in February as part of its New Year celebrations so the immediate impact has been mitigated. However, there are concerns about mass lay-off as the effect of closures by Western retailers plays out.

These retailers know that their long-term economic value comes from adherence to sound ESG principles and practices. The coronavirus crisis is placing financial stress on all companies as they seek first to protect their own staff and balance sheets. There is already a Darwinian struggle for survival on the UK high street, where companies with business models that have been slow to adapt to the surge in online business and e-commerce have failed.

But any steps they can take to preserve their supply chain will produce benefits when they eventually re-open for business. How a company ensures the necessary and appropriate oversight of its supply chain, including outsourced

third parties, has long been an area of conversation for Walter Scott as we engage with company management. Those conversations are perhaps more relevant and important than they have ever been.

Rosey Hurst was interviewed for this article on March 30th 2020.

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