

Factories get more business when they treat workers right

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Workers at a garment factory. Credit: MIT Sloan School of Management

For years, academics have debated if relaxing labor and environmental standards attracts or repels international business. Now a new study finds that manufacturers that adhere to basic labor and environmental

standards saw a 4 percent increase in annual purchases over those that did not.

What's more, the increase is driven almost entirely by manufacturers in the apparel sector, which activists have targeted for decades, demanding better wages and working conditions in factories. Have their efforts paid off?

The study's authors—MIT Sloan professor Greg Distelhorst and Brown University provost and MIT professor emeritus Richard Locke—think so, but caution that the effect of activist work could be limited. "Even within the apparel industry, noncompliance remains the norm," Distelhorst said. "Roughly 80 percent of factories in our sample are rated as noncompliant." While external pressure can make a difference, in the vast majority of cases, the incentive is not strong enough for companies to improve working conditions.

Firms that do comply, though, benefit financially, the study, published in the *American Journal of Political Science*, shows. "This shows that the interests of ethics and profit do align," Distelhorst said.

The race to the bottom

The idea that free trade and foreign investment lowers labor and environmental standards is commonly referred to as the "race to the bottom." It is based on the idea that lowering standards makes countries and firms more competitive.

"Think about the assumptions embedded in that premise," Distelhorst said. With worsening labor conditions, will the best workers stick around? Will people be motivated to work hard?

Distelhorst said that the race-to-the-bottom premise itself was shaky.

Previous researchers had examined the idea at a country level, but Distelhorst and Locke decided to look at the issue at the firm level, and see what happened when individual factories improved working conditions. To that end, they worked with a global sourcing agent—a kind of middleman between retailers in advanced economies and manufacturers in emerging markets. Retailers contacted the sourcing agent with their needs, and the sourcing agent found a factory to produce the product, negotiated the price, and managed the overall relationship.

Distelhorst and Locke examined thousands of audit records and reports kept by the sourcing agent, who graded factories regarding their performance on labor and environmental conditions. It also kept metrics on the value and quality of orders, and if they were delivered on time.

Examining data on more than 2,000 manufacturers in 36 countries over a four-year period, the researchers found that those with improved compliance not only saw an increase in annual purchasing, they were producing better quality products and delivering them on time. In total, they estimated that manufacturers had increased order values of \$110,000 on average—with a range of statistical uncertainty between \$32,000 and \$190,000—when they became more compliant.

Distelhorst and Locke concluded that one of two things was happening: manufacturers were managing to comply with basic labor and environmental standards while maintaining their performance on price, delivery, and product quality; or importers were willing to pay more to work with manufacturers that were compliant.

The anti-sweatshop movement

With the information they had, Distelhorst and Locke could not definitively say which of these was true—that increased compliance did not affect price or importers paid more—but they concluded that these

results were at least partially due to social pressure put on retailers to deal with manufacturers that observe basic labor standards. The fact that they saw the biggest impact at apparel factories is consistent with that.

Since the 1980s, when the anti-sweatshop movement began to gain steam, activists have put pressure on apparel companies to end sweatshop [labor](#) practices. One activist group—United Students Against Sweatshops—uses its influence as students and college apparel buyers to pressure universities to work only with companies that don't use sweatshops. Recently, the group led a campaign to force Nike to let Workers Rights Consortium workers inspect their factories. Its efforts were successful after multiple universities refused to renew their contracts with Nike. "Activists can make it painful to be noncompliant," Distelhorst said.

Among the different types of manufacturers in this study, the [apparel industry](#) is the only industry examined where the effects of compliance were statistically different from zero. That Distelhorst and Locke did not see similar results from other industries supports the assumption that consumer-facing retailers risked losing business if they didn't capitulate to pressure to deal with compliant [factories](#).

Distelhorst doesn't know if other industries will follow suit, but if they are subjected to activist pressure, "I wouldn't be surprised," he said.

More information: Greg Distelhorst et al. Does Compliance Pay? Firm-Level Trade and Social Institutions, *SSRN Electronic Journal* (2017). [DOI: 10.2139/ssrn.2885455](https://doi.org/10.2139/ssrn.2885455)

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