



## FT INVESTIGATION

# Laying a false trail: how Chinese factories dupe western buyers and cheat their staff

Doctored records on working hours and pay are causing problems for consumer multinationals as they source more of their goods in Asia, writes Alexandra Harney

Chinese factories first won international attention for their ability to copy everything from Louis Vuitton handbags to Hollywood films. Now, as they win a growing share of the world's legitimate consumer goods production, the manufacturers are engaged in another kind of deception: creating fake factory records.

Factory managers in China are becoming increasingly sophisticated at falsifying worker time cards and payroll documents to disguise irregularities including underpayment, excessive hours and inadequate health and safety provision. Auditors estimate that more than half of factories they see in China are forging some of their records – meaning that many of the international companies that source from China are learning less about the actual working conditions in the factories they use, even as they step up efforts to monitor them.

The practices also mean that some western groups' assurances that they are abiding by China's labour laws and their own codes of conduct are based on faulty information. The widespread forging of records threatens to undermine the aims of the corporate social responsibility movement, a response by multinationals to the concerns of customers, non-governmental organisations and trades unions about issues including human rights and the environment.

Even the biggest companies that source from China say they are confronted with falsified records at Chinese factories. Beth Keck, director of international affairs at Wal-Mart, says the world's largest retailer is aware of the problem. Nike's 2004 corporate responsibility report, released by the footwear maker this month, says of Chinese factories: "Falsification of information by factories often related to wages and hours of work is common. This extends to the practice of coaching of workers by factory managers trying to deceive compliance auditors."

Daryl Brown, vice-president for ethics and business practices at Liz Claiborne, the New York fashion group, describes the difficulties: "A few years ago, we were able to detect when records were altered by simply interviewing workers. Now, workers are coached. Good auditors can usually tell when the workers have been coached and we also make periodic unannounced audits to combat this. However, there are times when we need to resort to interviewing workers off premises or to surveillance to find out the truth. We also have our direct contact information posted at the factories, which allows workers to contact us confidentially, and on occasion they do."

Compliance executives say the problem occurs elsewhere, citing cases from India, but add that Chinese operations are smartest in their deception. Getting evidence of forgery is therefore difficult. Factory managers are reluctant to explain their methods, while western companies that are trying to persuade them to come clean fear publicity that would damage their reputation. However, the Financial Times has obtained access to a large garment factory that forges some of its documents. The circumstances of the visit require that the name of the factory is withheld, but it is located in the southern province of Guangdong, the industrial hub just north of Hong Kong that produces a big portion of China's exports.

The factory manager said he had assigned a team of six employees to create a paper trail of fake documents for foreign buyers. Some of these workers punched fake time cards to give the impression that the stipulations of buyers were being met. One was charged with creating matching payroll records on the computer. "This is a perfect match for [the buyers'] requirement," the manager said on a recent afternoon, gesturing at forged time cards and payroll records arrayed on the table next to the genuine documents.

Most foreign companies who buy from him see the fake records, he said. The forged documents, nearly indistinguishable from genuine ones, showed shorter working hours, allowing the manager to hide violations of Chinese labour law and western buyers' codes of conduct. "This is a way of surviving," he said. "This is the way of Chinese factories."

Big US and European companies, particularly in the footwear and apparel industries, send staff and third-

party auditors to determine whether their Chinese suppliers are complying with the multinationals' codes of conduct and national labour laws – which for China stipulate a 40-hour working week with a maximum of 36 hours of overtime a month. Auditors talk to factory managers and examine records to check for working hours longer than the legal limit and sweatshop conditions. They tour the factory, looking for everything from under-age workers to exit doors and fire extinguishers to the number of workers sharing factory dormitory rooms.

These audits are a chilling prospect for many Chinese factories. Failing an audit means a potentially crippling loss of business but compliance often requires a costly overhaul. When audits began, "we'd go to the factory, we'd see they did not meet lots of standards", says Steve Li, executive director of Hong Kong-listed Yue Yuen Industrial, the world's largest manufacturer of branded footwear, for customers including Nike, Reebok, Adidas and New Balance. Mr Li adds that improving social compliance is a continuing effort at his factories. "This is a pretty long journey. It's not ended. There's lots of room to improve."

China's laws – which also require workers to be paid at least 1.5 times the normal wage for overtime – are more stringent than in some countries. But factory managers' often cozy relationships with local officials and the rapidly rising number of plants make them easy to disregard. "We rarely find factories that can actually meet the local labour law in terms of hours," says Daniella Gould, China country director for Impactt, a London-based consultancy that helps companies improve labour standards in their supply chains.

Because of the long working hours, most workers do not receive the legal minimum wage, according to auditors and non-governmental organisations that inspect Chinese factories – although some staff want to work beyond legal limits. "In China, it is common for the actual wage to amount to as little as half the legal minimum wage, particularly in industries involving very detailed work, such as handbags and beaded accessories, where workers are paid piece rates," Sanchita Saxena and Franck Wiebe, respectively assistant director and director of the Asia Foundation's economic reform and development programme, wrote in



a report published by the foundation in January on the end of the Multi-Fibre Arrangement, the system that until this year governed the textile trade.

Faced with a choice between losing the business from international buyers or paying the cost of complying, many factories instead cook the books. Ms Gould estimates that a majority of factories in southern China have prepared some forged documents. Gary Beadell, managing director of Level Works, a social compliance auditing group working in China, says that "over 90 per cent" of the factories he sees falsify at least some of their records.

Double bookkeeping is common, say buyers and independent monitors. One Hong Kong-owned toy factory even assigned workers to rubbing falsified time cards in dirt to make them look genuine, according to Parry Leung, a researcher at the Hong Kong Christian Industrial Committee, a non-governmental organisation. Workers who give auditors the impression that a facility is compliant may be rewarded by managers with bonuses, he adds.

Some factories coach their employees ahead of auditors' visits on how to answer their questions. One sign posted in a footwear factory in Guangzhou, the capital of Guangdong province, and obtained by an auditor reminds managers of the various weekly working hours required by different buyers. "Please educate the workers well to avoid telling the client the truth," it says.

A document used in October 2003 to coach workers at a factory in Huizhou, another city in Guangdong, warned staff that the factory had received notice that Liz Claiborne representatives would be coming for an audit the following Tuesday. "All departments and all work places should organise a training for workers to prepare for this," it said, warning that "workers should not be allowed to let the buyers know that we have given prior training

to workers based on the specifics of the workers' interview".

"The falsification of records is a problem, especially in China," says Liz Claiborne's Mr Brown. "When conducting a payroll audit, we become suspicious if the working hours are low.

There still seem to be a few places where you can get a feel for the true working hours, such as reviewing production-related records. However, in some cases, the factory knows to doctor them too. Just being aware of this practice gives us an advantage. We do not necessarily find all of the problems, but we do find a lot."

While persuading most auditors that his records were genuine was not hard, said the Guangdong factory manager observed by the FT, workers were harder to control. "I just stand outside the door and pray to God" during worker interviews, the manager added.

In order to ensure a successful audit, some factories also offer auditors bribes. Ms Keck, at Wal-Mart, says the retailer has fired several employees in China in recent years for requesting or receiving bribes during an audit.

More auditing has not helped the problem. Big companies that buy a lot from China rely on both internal and outside auditors, in order to inspect more of the facilities they use and to show that independent observers had come to their own conclusions about the factories. As the social compliance auditing industry has grown in response to increased demand it has left many auditors with less time to spend at each factory. "I tell auditors that I cannot tell them the truth in relation to some of their questions. They smile and move on to something else," a manager at one large garment factory in Dongguan told CSR Asia, a Hong Kong-based research group. "They are complicit in the deception."

There is no doubt that increased sur-

veillance by foreign buyers has improved working conditions at many factories in China. The best plants now have basketball courts, libraries and internet access for workers. But factory managers and compliance executives say privately that the increasing forgery of records partly reflects the complexity of the challenge facing Chinese plants that supply international companies: meet the customer's requirements for social compliance, pricing and delivery time or lose the business.

"We are under enormous stress, customers place late orders, they change their orders part way through manufacturing and they pay their bills late. At the same time they ask us to provide better training for our staff, better health and safety and better accommodation. We just cannot do it all," the Dongguan manager told CSR Asia.

One executive at a European retailer says falsification of records is the result of common interest between buyers and factories: guaranteeing delivery of goods on tight schedules. "We are sometimes putting them in an impossible situation," the executive says. But Wal-Mart's Ms Keck denies that pressure on prices is a factor. "If we have this kind of contentious relationship [with factories], they're not going to have stability in their workforce to produce good quality goods. What we're looking for is cost efficiency. We're not looking for the lowest cost."

As China continues to increase its share of global manufacturing, however, some observers fear the evasion of labour standards will only get worse. The elimination of the global quota system on textiles is expected to drive a growing share of the world's clothing production to Chinese factories.

"We're rewarding factories that are falsifying records," says one compliance executive. "We are creating a disincentive to really play by the rules and comply."



# Why ethical sourcing means show and tell

Groups such as Nike, Levi Strauss, Wal-Mart and Gap are trying to build on the auditing of labour standards at their supplier factories by introducing programmes to train workers and managers – an initiative known as “capacity building”. Others have stationed full-time compliance executives in important factories or are looking for alternatives to the cat-and-mouse monitoring game.

Though they declined to be identified for fear of damage to their reputation, some companies are trying to persuade Chinese factories to show their real records and sign on to a programme of continuous improvement – even if that means knowingly buying from factories that violate the labour law and the company’s compliance code.

“US businesses are more concerned about China’s labour conditions because they are sourcing there even more than before,” says Mila Rosenthal, director of Amnesty International USA’s business and human rights programme. “The lifting of [textile] quotas has raised the profile of the labour issue and made companies more aware of risk in terms of potential reputational damage. At the same time, they are also consolidating their supply chain.”

Others are trying to work together. The National Retail Federation of the US, the Retail Council of Canada and Reebok, the US shoe company, in January created the Fair Factories

Clearinghouse for companies to share information on factory audits. The FFC is testing a centralised “ethical sourcing” system based on software Reebok uses to monitor its own factories in Asia.

World Monitors, a human rights and business consultancy, obtained a grant from the US State Department to help develop the FFC. Its goal, says Scott Greathead, chief executive of World Monitors, is to “eliminate the inefficiencies and duplication of effort that have made workplace monitoring less effective”.

Pilot FFC software is being tested ahead of a launch expected next week. “It is necessary for us to collaborate with other companies if we are to make the progress we want to make,” says Peter Burrows, Reebok’s chief

information officer. “If you care about protecting your brand and doing the right thing for human rights, the FFC . . . is a very cost-effective solution.”

Elliot Schrage, a senior fellow at the Council on Foreign Relations and an adjunct professor at Columbia Business School, says: “The frustration over deceptive labour practices is fuelling greater collaboration between brands . . . Instead of several companies spending relatively small sums for isolated snapshots of factory conditions, co-operation lets them pool their resources to fund a more comprehensive X-ray.”

However, the FFC project has not yet

gained the support of other industry heavyweights such as Nike and Gap. The FFC “only assists brands in sharing their snapshots of factory conditions; it does little to ensure the snapshots are based on the same standards or have been taken with the level of rigour necessary to uncover possible abuses”, says Mr Schrage, who oversaw Gap’s factory monitoring programme in 2000 and 2001.

Auret van Heerden, president of the Fair Labor Association, a US-based monitoring network, says the main issue is how companies address the root causes of abuse. “Sharing the list of problems, while it helps and hopefully reduces some duplication, only gives us a job list. That is when the real work starts and where we need the collaboration.”

Industry pressure has come from Nike, which in the 1990s endured withering criticism of its labour practices. Last week Nike published its 2004 corporate responsibility report, which for the first time included a list of more than 700 suppliers around the world. “We hope that full disclosure, if also followed by other companies, will lead to more sharing of industry monitoring,” says Hannah Jones, Nike’s vice-president of corporate responsibility. “The current system has to evolve fundamentally to create broad, sustainable change for factory workers. No one company can solve these issues that are endemic to our industry.”

Lauren Foster