



THEMATIC BRIEF

# The Business Benefits of Better Factories Cambodia

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Better Factories Cambodia (BFC) is a partnership between the International Labour Organization (ILO) and the International Finance Corporation (IFC). Since 2001, the programme has engaged with stakeholders at all levels of the Cambodian garment industry to improve working conditions and boost the competitiveness of apparel factories.

The first programme of its kind, BFC marked the first time in which the ILO became involved in direct monitoring of factory compliance with labour standards and public reporting of factory conditions. In factories that have chosen to receive BFC's tailored advisory services, BFC has successfully supported improvements in working conditions and social dialogue through worker-management committees and training, pioneering a unique approach to drive change that has inspired the establishment of the Better Work programme in seven other countries.

This brief highlights the business benefits of BFC that can accrue for employers through improved compliance with international labour standards and national labour legislation. The evidence, based on an array of published and forthcoming research papers, is consistent in showing positive change for the competitiveness of firms, the Cambodian apparel industry and economy at large.



HO HSIN TAI



## The Apparel Industry in Cambodia: Evidence of Progress

Since the late 1990s, the apparel industry in Cambodia has grown rapidly. With the 1999 US-Cambodia Textile and Apparel Trade Agreement (TATA), export quotas were imposed on Cambodian garments, but were made dependent on labour standards clauses. These stipulated that the United States would increase export quotas if Cambodian supplier factories substantially improved working conditions.

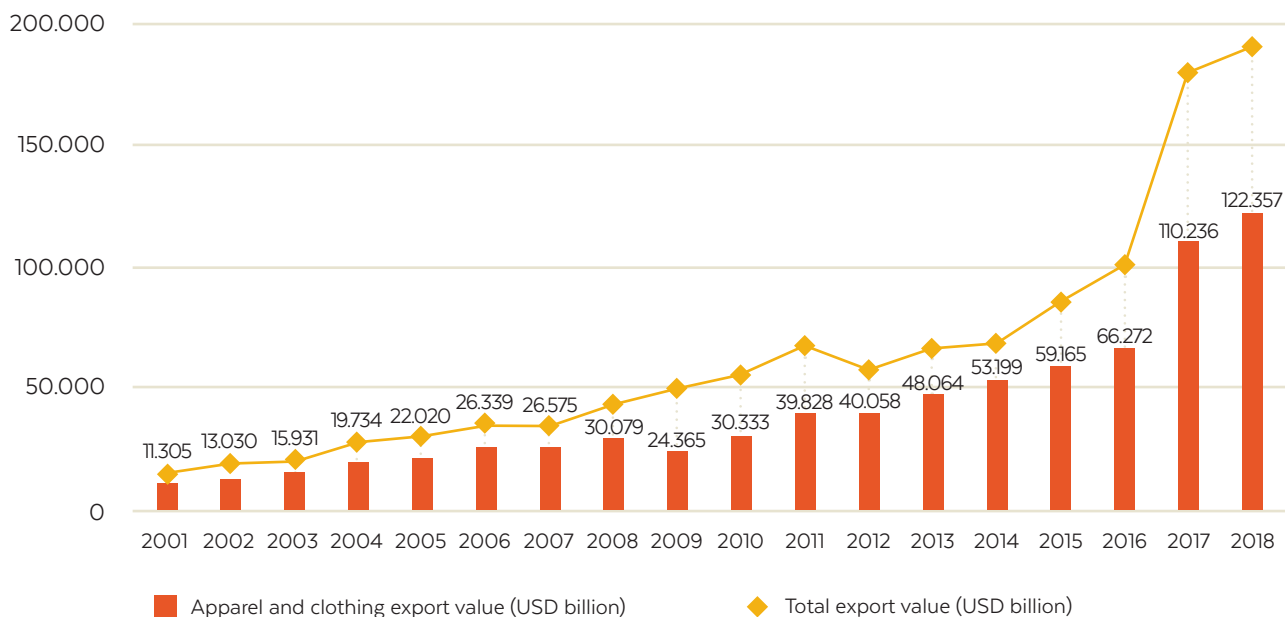
In 2001, BFC was created to ensure the credibility and transparency of the monitoring process, marking it the first time in which the ILO engaged in direct, mandatory monitoring of factory compliance. The opportunity to receive quota bonuses under the trade agreement created a positive incentive for the Cambodian government and factory owners to improve labor conditions in order to obtain the economically valuable increases in export quotas to the US market. BFC provided critical and authoritative information so that these bonus quota decisions could be taken.<sup>1</sup>

When the textile agreement expired in 2004, employers and the government continued to recognize the value of

compliance with labour standards and transparent reporting. Buyer firms rated Cambodia's labour standards higher than those of regional competitors and, in a survey conducted by the World Bank, reported that they would continue to purchase garments from Cambodia if credible monitoring by BFC were to continue.<sup>2</sup>

As shown in Figure 1, despite a more competitive environment, declining prices of products and increasing costs, Cambodian garment firms grew steadily over the past years. With the exception of the global financial crisis of 2008–2009, Cambodia's export share continued to grow, while the export economy became less dependent on the apparel sector, relative to the early 2000s. In 2018, apparel export value reached 122,357 USD million, accounting to over 64 percent of total export value. Research suggests output, value added, profit, employment and labour productivity increased continuously for the average Cambodian firm because of coordination among stakeholders, government policy and improvements in working conditions attributable to BFC.<sup>3</sup>

**FIGURE 1. GROWTH OF CAMBODIAN EXPORTS 2001-2018**



Source: ITC calculations based on UN COMTRADE statistics.



## The Business Returns of Better Factories Cambodia

The development of the Cambodian apparel industry and BFC's monitoring of factory compliance with labour standards have led to important benefits for the Cambodian economy, including the creation of jobs. Under the US-Cambodia textile agreement, BFC's monitoring and transparent reporting has led to quantifiable increases in the quota bonuses due to improved compliance. Since the mid-2000s to date, the risk mitigation that the good labour practices and monitoring provided to buyers has led to their increased sourcing from Cambodia.<sup>4</sup>

Eighteen years on, BFC has demonstrated the positive returns of improved working conditions for firms' productivity and probability of survival, as well as the benefits of human resource management innovations and the reputational gains of transparency about factory working conditions.

### IMPACT ON PRODUCTIVITY

Investing in greater compliance may be costly in the short-term, but it is a smart business choice. Poor working conditions, for instance, increase the probability of fire, serious injuries, and accidents. Improving compliance lowers these risks substantially. In turn, orders from new or existing buyers, especially reputation-conscious ones, may increase when working conditions improve.<sup>5</sup>

Research has demonstrated that working conditions can be linked to firm performance in a number of ways. Compliance with standards that are directly associated with worker effort, such as wage rates for piecework or the availability of first aid, are more likely to be positively correlated with productivity. Other standards aimed at mitigating risk (for example, providing fire safety equipment) may not have an observable effect on factory productivity and performance in the short-run, but yield tangible long-term benefits.<sup>6</sup> Further, higher overall compliance is associated with lower labor turnover, higher incidence of formal training pro-

vision, as well as higher pay for workers.<sup>7</sup>

The impact of BFC on firm productivity has been the subject of recent research. The latest analysis on this dimension comes from a broad sample of factories participating in the programme between 2015-2018. This analysis shows that production efficiency, measured as the time elapsed to achieve hourly and daily production targets reported by workers, rises by about 10 percent after the first year of participation in the programme, and by up to an additional 11 percent after two years. This represents a cumulative effect that ranges between 16 and 21 percent for the average factory. Simultaneously, factories appear to be increasing their production targets as they engage with BFC. Planned production increases by 10 percent, resulting in productivity gains that range between 26 and 31 percent.<sup>8</sup>

### BENEFITS FOR FIRM SURVIVAL

Improvements in labour standards compliance increase the probability of plant survival. Research demonstrates this argument in relation to standards of compensation and social protection, as well as with respect to the negative consequences of the global financial crisis in 2008-2009.<sup>9</sup>

The global financial crisis in particular had a serious impact on Cambodian apparel factories, but findings demonstrate that factories that increased compliance had higher survival rates relative to non-compliant firms. Researchers were also able to isolate the contribution of other factors to firm survival, such as buyer type and credit constraints of firms, from that of greater compliance, ruling out that buyer type and credit constraints were jointly determining compliance and survival. Interestingly, the impact of compliance on closure varies by the compliance category that is considered. Specifically, higher compliance in workplace-communication, occupational safety and health (OSH), including emergency preparedness, and in

wage payments increase survival probabilities.<sup>10</sup> Similarly, higher social protection compliance is associated with a significant reduction in the probability of a factory closing down, equal to over 20 percent for every unit increase in compliance with these standards.<sup>11</sup> Overall, the analysis provides strong indication that advances in worker wellbeing occur while maintaining the competitiveness of firms.

### TRANSPARENCY AND REPUTATION

Since the programme's inception to November 2006, and from 2014 to date, BFC has publicly disclosed factory-level compliance performance as a strategy to drive industry-wide change. Under the bilateral trade agreement with the United States until 2004, US import quotas were directly linked to social and labour clauses. Transparent reporting on industry compliance was indispensable in ensuring sustained increases in orders as a result of better working conditions.

Public disclosure of noncompliance has helped Cambodian firms develop a reputation for humane conditions of work and reduced the risk of free riding by noncompliant firms on the reputation created by firms with better working conditions.<sup>12</sup> The transparent and authoritative information that BFC provided through its reports also allowed governments, firms, trade unions and other stakeholders at national and international levels equal access to the information generated, reinforcing the common interests they shared.<sup>13</sup>

Recent findings suggest the reintegration of public reporting in 2014 has continued to bring benefits for firms. Of all compliance areas monitored by BFC, the 21 issues subject to public reporting (also known as "critical issues") have seen the most dramatic improvements. Changes are focused around the time of the reintroduction of transparency and in those areas that had the lowest prior compliance. These areas include emergency preparedness and compliance with pay bonuses. The results are robust and independent of factory size, association with a reputation-conscious buyer, year, and region of ownership.<sup>14</sup>

In addition, evidence suggests greater compliance with labour standards is a necessary condition for producing for reputation-conscious buyers. Though additional criteria such as price, quality, and delivery time are driving factors of buyers' sourcing decisions and thus factory's capacity to attract them, producing for a certain buyer type and respecting OSH-Welfare standards and fundamental rights increase the supplier's likelihood of retaining buyers, which is critical to the suppliers' competitiveness.<sup>15</sup>

### INNOVATIONS IN HUMAN RESOURCE MANAGEMENT

BFC's monitoring of labour standards compliance, remediation and training activities have induced factories to experiment in human resource management innovations that are both more humane and more efficient. There are two key findings with respect to the benefits of human resource management systems innovations. First, such innovations are positively associated with key measures of performance, specifically productivity and product quality.<sup>16</sup> Second, these innovations decrease the likelihood of falling back into non-compliance, helping ensure the path towards improved compliance is self-sustaining.<sup>17</sup>

When BFC suspended public disclosure of factory-level compliance, independent research demonstrated that factories did slow down their progress towards compliance, but firms did not return to previous rates of non-compliance. When public disclosure was suspended, only BFC and factory managers had access to factory-level compliance reports of firms lacking a reputation sensitive buyer. Despite lower overall compliance, the path towards improved compliance for these firms, did not diverge from that of firms with a buyer that required a certain level of compliance.<sup>18</sup> Transparent information sharing between management and workers and trust between them played a key role, demonstrating that a firm's interest in remaining compliant is not solely driven by a concern for its reputation, but also because it is a smart business choice.



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## Recommendations

Since 2001, BFC has engaged with stakeholders at all levels of the garment industry to improve compliance with labour standards and the competitiveness of Cambodian apparel firms. The evidence presented in this brief demonstrates that employers can reap significant returns when they improve compliance thanks to the BFC service package. Below are the main take-aways for stakeholders' consideration:

- ◆ **Improving working conditions is a win-win solution for workers, employers and the economy at large.** The success of the US-Cambodia textile agreement has proven that public and private interests can be achieved simultaneously when monitoring of labour standards is transparent, independent and reliable.
- ◆ **Improving working conditions is an investment, not a cost.** Findings show that investing in higher OSH-Welfare standards, for instance, decreases the probability of fire, serious injuries, or accidents, therefore mitigating risks and improving workers' productivity. Improvements in working conditions, in turn, have a positive impact on productivity, enabled by higher levels of production and efficiency gains.
- ◆ **Being in compliance increases the probability of firm survival.** Specifically during times of economic downturn such as those incurred during the 2008-2009 financial crisis, factories in compliance with workplace communication, OSH and compensation standards were less likely to face closure.
- ◆ **Transparent reporting drives compliance and competitiveness.** Factories with higher compliance are likely to attract reputation-sensitive buyers and to retain them. Public reporting is effective in fostering greater compliance, increases in orders, as well as industry-wide change.
- ◆ **Innovative human resource management systems are key for workplaces that are more efficient.** Factories are compliant not just out of fear of public reporting or in order to attract responsible buyers, but because being compliant is the smart business choice. When employers shift towards human resource management systems that are more humane, working conditions improve, making workplaces more efficient and more productive.

## END NOTES

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**Better Work Research Briefs** present a summary of the programme's research findings on particular topics.

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