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Highlights

The ownership, management and technology use of subcontractee enterprises (Tier 3) are far behind the enterprises having direct contract (Tier 2).

Limited reinvestment capacity of Tier 3 enterprises constrains even basic advanced and technological upgrading.

Workers are deprived of decent wage and training facility; they are working in an unsafe working environment and are unaware about their rights.

These enterprises have potential to survive and upgrade. Both Tier 1 (brands and buyers) and Tier 2 (direct contractee) enterprises should take joint responsibility for upgrading of Tier 3 enterprises.

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Are Subcontractee Enterprises Able to Upgrade? *Insights from a Case Study*

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Introduction and Objectives

The subcontractee (Tier 3) enterprises have faced severe criticism for their poor compliance standards particularly after the fire disaster in Tazreen Fashions Limited and collapse of Rana Plaza, which caused deaths of thousands of workers. These enterprises produced products for global brands/buyers (Tier 1) under subcontracting arrangements. Various studies show that export-oriented enterprises tend to subcontract or outsource a portion of their orders to the smaller non-compliant enterprises to reduce costs (ILO, 2014; Ethical Corporation, 2013). After the Rana Plaza tragedy, the operation of subcontractee enterprises has come under close scrutiny - Tier 3 enterprises also need to be physically and socially compliant in order to work with brands and buyers. Under this changing circumstance, the question that arises is whether subcontractee enterprises have the capacity to make necessary investment for industrial and social upgrading.

Lack of information about the operation of subcontractee enterprises in the readymade garment (RMG) sector is a major constraint to assess the benchmark condition and capacity of upgrading of these enterprises. It is important to note that subcontractee enterprises are of different types—one type of subcontractee enterprises are members of trade bodies [i.e. Bangladesh Garment Manufacturers and Exporters Association (BGMEA) and Bangladesh Knitwear Manufacturers and Exporters Association (BKMEA)] which work for brands/buyers under an authorised subcontracting arrangement. Another type of subcontractee enterprises are not members of any trade bodies but enlisted with the Department of Inspection for Factories and Establishments (DIFE) and are associated with the monitoring and inspection initiatives undertaken by the National Initiative (NI). There is yet another type of subcontractee enterprises, which are neither members of trade bodies nor listed with DIFE. They are outside the purview of any initiative for improvement of compliance. On principle, all types of subcontractee enterprises need to be registered and operated under the same compliance standards.

This Policy Brief presents a case study of a subcontractee enterprise which is not a member of any trade body but enlisted in the DIFE. The Brief highlights the benchmark level of social compliance and technological standards of this enterprise in order to understand its potentiality in undertaking necessary economic and social upgrading activities to make the enterprise sustainable. The CPD-RMG Study conducted enterprise level survey in nine subcontractee enterprises listed in the DIFE. The selected subcontractee enterprise has been chosen because of its overwhelming dependence on subcontracting activities as well as sharing sufficient information for the analysis. In most cases, the performance of this subcontractee enterprise has been compared with the enterprises having direct export contract (Tier 2). The performance of enterprises with direct contract has been captured from an enterprise-level survey carried out in 226 sample enterprises during 2017–2018 by the Centre for Policy Dialogue (CPD). A pseudo name has been used for the sample enterprise, viz.

Norasmiy Savdo Ltd. (NSL). Norasmiy Savdo is a dialect of Uzbekistan indicating informal trade.

Structure of Ownership and Management of the Subcontractee Enterprise

A Sole Proprietorship-based Company without a Corporate Entity: NSL is a small scale knit garment enterprise which was established in 2016 in Ashulia, Savar—a suburb of Dhaka. The enterprise is operating under sole proprietorship—the owner takes all factory related decisions although two production managers, with nearly 25 years of experience in the sector, work in the factory. There is one accounts manager and 16 non-production staff at NSL. There is no female staff at the management level in this factory, and the management has no plan or policy to appoint female staff at this level in the near future. Overall, the enterprise lacks corporate entity and decentralised management practices unlike those of Tier 2 enterprises.

Small Scale Operation without having Specialised Section: Given its limited scale of operation, the sample factory feels no pressure to set up specialised departments such as industrial engineering, washing, merchandising and compliance assurance. Initially, the factory commenced its operation with only 50 production workers which has now reached at 150. Sixty per cent of these workers are female. The majority of workers are in mid-lower to lower grades (grades 4, 5 and 7). The grade-based composition of workers in this factory is slightly different from that of Tier 2 enterprises. NSL is using basic technologies with the capacity only to produce basic and mass-scale products.

Management Quality is Lagging far behind Compared to Direct Exporting Enterprises: The performance of the management of the NSL is found to be very poor in most of the areas, such as operation management, performance monitoring and tracking, production planning, workforce development, talent management, and target setting. The overall management score of this factory is 1.17 out of 5, which is nearly one-third of the average score (3.4) of Tier 2 enterprises. The NSL management is also found to be compliance-averse in the areas of building safety, occupational health, security, work environment, and labour law. Overall, such poor management practices are likely to adversely affect an enterprise's performance as well as plan for upgrading.

Status of Economic Upgrading of Subcontractee Enterprise

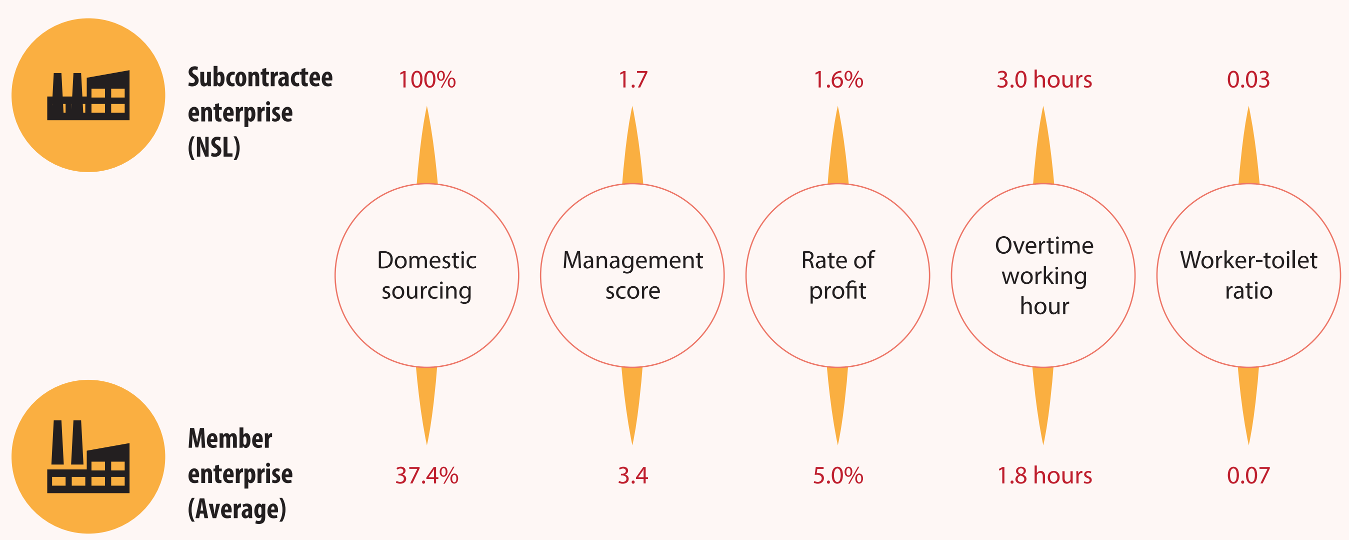
No Indication of Product Upgrading: NSL produces basic knit products such as shirts, T-shirts, trousers and children's wear for different global brands including Polar and Splash, which they obtain through subcontracting from large local enterprises. During 2016, this interprise delivered a total of 1.8 million pieces of products. The factory does not have any capacity for developing designs and products and introducing new technologies which are necessary for functional upgrading.

No Sign of Process Upgrading: Given its structure of production of basic and mass-scale products, NSL uses basic machinery. It has a two-line factory comprising 40 sewing machines in each line. The four types of sewing machines currently used in the factory include single needle lockstitch, overlocking, buttonholing, and flat-bed machine. The quality of machinery (as measured in terms of average price of those machines which is also an indicator of technological upgrading), shows that NSL lags behind compared to Tier 2 enterprises. The average price per machine of the types of sewing machines used in NSL is found to be less than half of the prices of Tier 2 enterprises.

NSL does not have advanced-level machinery such as CAD (computer-aided design) machines which are used for preparing patterns, nor does it have machineries such as auto-cutter, auto-spreader and auto-pocket welding, metal detector and traffic light system, auto-stalker and auto material handling machines. In other words, NSL is yet to upgrade its technological base to reach Tier 2 enterprise level.

NSL sourced all of its raw materials such as fabrics, thread, accessories and chemicals from the domestic market, mainly

Performance of Subcontracting Enterprise



because of not having authorised license for importing raw materials. In contrast, Tier 2 enterprises sourced about 37.4 per cent of their raw materials from domestic market and 62.6 per cent from the international market, CPD-RMG study 2018 shows.

Such a poor technological base and limited production capacity at NSL impedes development of direct contractual relationship with brands and buyers.

Limited Capacity for Reinvestment: The NSL generates 95 per cent of its revenue from subcontracting for the export market and 5 per cent from the domestic market. Its rate of profit per year is only 1.6 per cent, which is very low compared to Tier 2 enterprises (rate of profit is about 5 per cent). Such a low level of profit does not allow to make substantial reinvestment for expansion and remediation related activities for improvement of compliance standards. One positive aspect is that the enterprise does not have any debt, which facilitates at least a limited level of reinvestment.

Status of Social and Gender-related Compliance Standards of Tier 3 Enterprise

Workers are Deprived of Decent Wages: In NSL, a worker's average wage (including overtime) is BDT 7,063, which is 9.8 per cent less compared to that of Tier 2 enterprises. Workers in NSL often do more overtime compared to Tier 2 enterprises (3 hours vs. 1.8 hours) as most of the workers in NSL work during weekends which is rare in other enterprises. Given the poor wage structure, workers of this Tier 3 enterprise have to work extra time to ensure minimum income for their families. Besides, workers of NSL receive attendance and festival bonuses and annual increment. However, they do not receive production bonus and maternity leave with full benefit which a part of Tier 2 enterprise workers receive. Overall, Tier 3 enterprises deprive their workers of entitled benefits and facilities.

Lack of Facility for On-the-job Training: Most of the workers of NSL did not receive any training from this factory, although they received training on fire safety, occupational health safety, and first aid services in their previous jobs. The factory sets a production target for all the workers but did not/does not offer any incentive for fulfilling the targets. The workers said that the target is achievable and there is no punitive measure for failing to meet the target. Despite many limitations, the workers are optimistic about getting promotions if they work hard. This Tier 3 enterprise could not ensure a supportive environment for the improvement of workers' skills and productivity.

Workplace Safety and Security is Weak: The performance of this factory is found to be poor in terms of maintaining safety standards as per requirements. The workers repudiated that there is no safety committee in the factory and the management is reluctant about this issue. Furthermore, the factory has no emergency response team to tackle the emergency situation, which is a matter of great concern for the workers. In addition, no fire drill has been carried out in NSL since its inception and no worker has received any training on fire and electrical safety measures. This Tier 3 enterprise seems to be vulnerable in terms of workplace safety and security, which could cause a disaster in the future. Unlike Tier 2 member-factories, where social benchmark standards improved because of inspection and monitoring under different initiatives, Tier 3 enterprises remain outside the purview of such improvements. NSL factory has not carried out any remediation work since its inauguration and was not inspected by engineers of the NI either. Unless these enterprises are detected by the monitoring and inspection authorities, their operations will continue without making necessary investment for improvement of the safety standards.

Support Facilities are Scant: The support facilities in NSL are either insufficient or absent. The factory could not ensure improved potable water and hygiene to all workers. Lack of safe drinking water and proper sanitation facilities pose great health risks for workers. There are only two toilets (one for men, the other for women) and the worker–toilet ratio is 0.03, which is lower than the average (0.07) of Tier 2 enterprises. There are no primary health care facilities in the NSL such as first aid box, on-site clinic or part-time doctor. To prevent injury, NSL provides protective equipment to the workers but this is not available for all the workers. There is no daycare centre in this factory. No sexual harassment was recorded in NSL and nor is there a concerned person who looks into this issue. The workers expressed their dissatisfaction on account of unavailability of maternity leave, lack of sufficient female toilets, inaccessibility of safe potable water and primary health care and congested work environment. They also complained about not having job certificates and appointment letters, lack of promotion and absence of training facilities. Due to sickness, the workers of NSL took leave for 592 days which is higher than the average leave taken by Tier 2 enterprises. This is certainly a reflection of an unhealthy environment and excessive workload in the factory. Due to tremendous pressure for production orders, the factory operated for more than 10 hours for 296 days in 2016.

Workers have Little Awareness of their Rights: Most of the workers of the NSL are not aware of labour rights. There is no workers' organisation such as participation committee and trade union. Not all the workers have a written contract; in case of the service book, the same situation exists. In other words, workers are largely working under an informal arrangement at NSL. Formalisation of the contractual arrangement is, therefore, one of the most important elements in improving workers' facilities (Labowitz and Baumann-Pauly, 2014).

Limited Prospect for Economic and Social Upgrading

Currently, NSL has a weak benchmark condition both in terms of economic and social upgrading. However, enterprises such as NSL have the potential to survive and upgrade. According to the owner of NSL, "If I want to get direct order from the buyers and leave subcontracting, I have to invest a lot for upgrading which is difficult for me at this moment. Unless I get bank loan without a mortgage, subcontracting is the only option for small entrepreneurs like me." After five years when the scale of production expands, the owner plans to make the factory compliant.

There are no comprehensive and up-to-date databases available on these enterprises, which impedes the planning, monitoring and development of such enterprises. DIFE should take initiative to prepare a comprehensive database of Tier 3 enterprises and make it public. Most importantly, these enterprises need to be made active members of concerned trade bodies such as BGMEA or BKMEA. In case these enterprises do not meet the membership criterea at this stage, they should be made 'associate members' before gradually incorporating them and giving them full membership as they become eligible. DIFE should ensure that no enterprise involved in the export market is unreported, unlisted and uninspected by the concerned public authority.

It is understood that brands and buyers are placing orders to big suppliers (Tier 2) a part of which are handled by Tier 3 enterprises who are not members of any association. Hence, informal system has been in place perilously in subcontracting business. Both Tier 1 and Tier 2 enterprises who subcontract a portion of their production orders, should take joint responsibility to make these factories complaint. A proper guideline for operation of Tier 3 enterprises is necessary to hold concerned parties responsible for compliance. As part of the Sustainability Compact, a draft guideline has been prepared a few years back, but unfortunately, this has not made any progress. In the absence of a proper guideline, the subcontractee enterprises will remain unmonitored and unregulated, and will continue to show reluctance towards making their factories compliant.

Despite various shortcomings, these Tier 3 enterprises appear to have the potential to grow and work directly with brands and buyers in the future. These enterprises need upgrading both in terms of technological and social aspects on a fast-track basis. For that to happen they will need to have access to low-cost credit. Brands and buyers should also extend technical support and take other initiatives in order to upgrade the technological and social compliance standards of subcontractee enterprises.

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