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### What are Buying Companies Doing to Influence Suppliers to Act Sustainable?

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# Sustainability Exchange Governance in the Textile and Apparel Industry –“Why Do the Suppliers Find It Hard to Comply with the Buying Companies Sustainability Requirements?”

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## Abstract

The aim of the paper is to reach a better understanding of which governance structures are applied in the exchanges between buying companies and suppliers in the Textile and Apparel Industry in order to ensure supplier sustainability compliance. Furthermore, an additional aim is to analyze suppliers' perception of and reaction to these different governance structures. The analysis is based on 30 supplier interviews conducted in India, Bangladesh and China. The results of the analysis will lead to a better understanding of *why*, taking into account the governance structures used, suppliers find it difficult to meet and comply with the buying companies' demands for sustainability and might behave in a legitimate opportunistic way.

Key words: Exchange governance, Sustainability, Supplier perspective.

## Introduction

When textile and apparel companies started moving their production from Europe to emerging countries 25-30 years ago, the exchange between the buying companies and the suppliers were mainly built on good relationships - contracts were infrequent in this industry. But at the beginning of the 1990s, stories of bad working conditions and low salaries came to the surface and became the embryo of buying companies' sustainability requirements of their suppliers in the late 1990s (Doorey, 2011). Especially, some of the big retail brands started monitoring their suppliers and made them sign up to and comply with created codes of conduct, which in particular emphasized the social dimension of sustainability.

Today, more than 15 years later almost all companies are increasingly taking actions to make their suppliers act sustainable. Collaborations and other relational ways to govern suppliers' sustainability are being practiced by some companies, but still best practice appears to be the companies' use of codes of conduct combined with monitoring mechanisms (Andersen and Skjoett-Larsen, 2009; Boyd et al., 2007). Despite all these efforts from companies and their attempts to make suppliers comply with their codes of conduct and passing audits - a lot of evidence and empirical studies show that these ways to govern suppliers toward sustainability compliance still do not work (Egels-Zandén, 2007; Egels-Zandén, 2013; Jiang, 2009). Control, certification and enforcement are not giving any guarantees that corporate sustainability is enacted across the whole supply chain (Lueg et al., 2013). The adoption of codes of conduct and auditing may not automatically or easily generate changes (Egels-Zandén, 2007; Spence and Bourlakis, 2009). Moreover, research shows that high monitoring levels may lead to buyer-supplier conflict, with suppliers militating against the trust and commitment integral to successful performance (Boyd et al., 2007). The Transaction Cost Economic (TCE) perspective is the dominant theoretical logic for explaining inter-organizational exchange, and it builds on the assumption that human agents are subject to bounded rationality and opportunism. Bounded rationality could be a reason why this contractual way of governing suppliers in relation to

sustainability is still vulnerable to opportunistic behavior by the suppliers. The opportunistic behavior by suppliers shows through e.g. exploitation of workers in terms of unfair low wages, excessive work hours, double book-keeping and unsafe work environments (Sethi et al., 2010; Jiang, 2009). Still, very little is known about the suppliers' perception of the approaches taken by buying companies to govern supplier sustainability; therefore a broader perspective and an approach based on suppliers is needed (Gimenez and Tachizawa, 2012). On this basis, the purpose of this paper is to address the following research question: "Why do the suppliers find it hard to comply with the buying companies' sustainability requirements?" This paper asks suppliers why sustainability compliance is not widespread – most other research has focused on buying company data. As such it extends on the few authors, who have studied supplier perceptions, for instance Egels-Zandén (2007) who studied the lack of sustainability compliance by asking supplier employees. In this study we ask the owners or managers in the supplier factories about e.g. their perceptions of how buying companies manage the sustainable sourcing process, most notably characterized by the contractual governance approach. The paper is structured as follows. First the conceptual framework is presented. The concept of governance is clarified from a Transaction Cost Economic perspective and contractual governance in parts of the sustainability literature is presented. Following this, the methodological process used in this research is described. Next the findings of the analysis are presented, accompanied by relevant excerpts of the data that reflect emerging concepts. Finally the theoretical concept is discussed together with drawing the findings and conclusions.

## **Conceptual Framework**

*The concept of governance from a Transaction Cost Economic perspective.*

In this article, TCE is used to analyze the exchange governance structures regulated by the buying companies as well as to relate these governance practices to the potential opportunistic behavior displayed by suppliers. In an exchange in particular the costs of planning, adapting and monitoring the transactions need to be considered along with consequently which governance structures should be chosen for which types of transaction, as contractual relations accounting for all possible future states cannot be established (Williamson, 1985). Bounded rationality are in the TCE perspective given to opportunism, which is a condition of self-interest seeking with guile (Williamson, 1985). Williamson (1985:47) describes guile as "*lying, stealing, cheating, and calculated efforts to mislead, distort, disguise obfuscate, or otherwise confuse.*" TCE argues that parties in an exchange have to safeguard against the hazard of opportunism by applying legal contracts, specifying what is acceptable and what is not, with threats of legal enforcement or non-legal retribution (Williamson, 1975). The principal dimensions of exchange hazards with respect to which transactions differ and which necessitate contractual safeguards are asset specificity and uncertainty (Williamson, 1985, 1991). Asset specificity is the most important dimension when interpreting a transaction (Williamson, 1985). It refers to that a particular asset has a higher value in its primary intended application than it would have, if one were to use the asset in a different context. Uncertainty creates information problems in exchange (Williamson, 1985). Primary uncertainty or external uncertainty is caused by market dynamism which makes it more difficult to predict future contingencies (Williamson, 1985; Child, 1972), while secondary uncertainty or internal uncertainty, which is caused by task ambiguity, makes it more difficult to specify outcomes and measure performance (Alchian and Demsetz, 1975). These performance difficulties can result in clauses that may include third party monitoring and requirements of

documents to justify work done (Poppo and Zenger, 2002). This also points to the great importance of the uncertainty dimension within the sustainability area.

### *Contractual governance in the sustainability literature.*

As previous outlined the contractual governance structure in the form of codes of conduct is still best practice in the buying companies efforts to make their suppliers sustainable compliant. Brockhaus et al. (2013) present a clear example of the contractual governance structure when they discuss a *mandated* way of implementing sustainability which is often characterized by dominating buying companies that force strict instructions upon the weaker upstream members. The mandated sustainability initiatives are usually implemented on a formal “here is what we need you to do” -basis, and they are often operationalized using the governance mechanism *codes of conduct*, which companies requires their manufacturer or supplier to sign. With this commitment, the suppliers also often *agree* to be monitored as it is the principal way to ensure the buyers of compliance with the code of conduct (Boyd et al., 2007) and this monitoring procedure often takes the form of audits (Spence and Bourlakis 2009). At the same time monitoring and auditing of suppliers’ compliance with the code of conduct enables the buying firm to use it as a marketing instrument because of the increasing demands and importance of sustainability in the society (Scheiber, 2013). Often the suppliers are seen as passive players with little power to discuss how the audits should take place and what is achievable (Gould, 2005).

In the Textile and Apparel Industry the demands toward suppliers’ sustainability compliance are widely used particularly in emerging countries where a large part of the textile and apparel production is placed. To safeguard against the hazards of opportunism, the buying companies have specified requirements within these codes of conducts especially in terms of social demands and demands concerning working conditions. But due to the strong competition, the price pressure and the increasing demands for higher quality and shorter delivery times, this contractual way of governing the suppliers could be the reason why many suppliers are driven toward opportunistic behavior by cheating to avoid costly changes and losing competitiveness (Lim and Phillips, 2008). This cheating can manifest in double-book keeping regarding work overtime or the suppliers coaching their workers in what to say in audit worker interviews. This audit fraud has developed in a direct counterpart to audit practice, as the suppliers know they have to meet the requirements to keep in business, but haven’t got the resources or the knowledge needed to comply with all the requirements which gives them little choice but to present false data (Gould, 2005). Asset specificity, uncertainty and performance measurement are the principal dimensions of exchange hazards and the higher the degree of these dimensions, the greater the risk of opportunism (Williamson, 1985, 1991). When looking at the sustainability literature we can see that high supplier asset specificity and high customer uncertainty clearly often lead to the aforementioned opportunistic behavior of suppliers. If we look at the supplier asset specificity in the Textile and Apparel Industry it seems medium to high. Suppliers are investing in improvements, new systems and training programs to meet buyers’ individual demands about sustainability - all the time with the risks and uncertainties that the buyers may switch to another supplier if they do not live up to their claims about low cost and short delivery which are the main factors in the industry (Gould, 2005; Jiang, 2009; Locke et al., 2009). Further, apart from meeting the requirements set in the code of conduct, suppliers are often asked to pay for the costs that are associated with specific audits required by the buying company. Audits often results in correction plans, which a supplier must follow before a re-audit is conducted and these costs are

frequently also paid by the supplier (Jiang, 2009). Uncertainty is evident for the buying companies, partly because of the often long distances (Aulakh and Gençtürk, 2008) and the cultural differences in the international exchange, but most of all because of the ambiguity inherent in specifying the outcome and measuring the actual supplier sustainability compliance which results in the buying companies' use of contractual governance structures such as codes of conduct and monitoring activities.

## Research Methodology

A limited part of the existing research within the field of supplier sustainability compliance is focused on the supplier point of view. In this limited part examples of focus has been on how and in which areas the supplier fails to meet the customer's requirements (Egels-Zandén, 2007), the mechanisms that generate compliance and those that do not (Jiang, 2009), and how suppliers make sense of sustainability implementation (Perry et al., 2014). For this study the purpose is to explore *why* the suppliers find it hard to comply with the buying companies requirements regarding sustainability. The research question is exploratory so it requires a methodology that is appropriate for delving deep into how the suppliers react to, perceive, comprehend, and manage the sustainability requirements raised by the buying companies. Grounded theory (Glaser and Strauss, 1967) is an inductive research tradition that can help to show how social actors interpret and act on their environments (Flint and Golicic, 2009). Thirty semi-structured interviews were conducted within the Textile and Apparel Industry in India, Bangladesh, and China. The number of interviews was selected according to accessibility and what was temporally possible. Charmaz (2014) suggests that the aims of a study are the ultimate driver of the project design, and therefore the sample size. The selection of countries was chosen from three of the largest textile and apparel-producing countries exporting to Denmark (Eurostat Database, 2012). A semi-structured interview guide was developed around a number of topics to allow the participating suppliers to express their perspectives of the buying companies' initiatives toward sustainability compliance. In each interview there was also room for discussion of issues that were not covered in the interview protocol, but that the participants nonetheless found relevant (Yin, 2003). To be able to find answers to the research question we interviewed in English, the managers or fabric owners of the various suppliers and each interview was carried out in person and ran for 41 min on average. All interviews were recorded and transcribed verbatim. All the suppliers were promised beforehand that personal names and company names would be kept anonymous. Taking this approach made it possible to gain insights into how the suppliers react to and are affected by the customer driven contractual governance structure aimed at fostering sustainability.

The data analysis was conducted through coding activities (Charmaz, 2014). According to Charmaz (2014), coding should be conducted in at least two phases: initial coding and focused coding. During initial coding, analysis was performed very close to the data and the interview transcriptions were approached without direct consideration of existing theory (Corbin and Strauss, 2008; Charmaz, 2014). The data was broken down to make it more accessible for constant comparisons (Glaser and Strauss, 1967). During the coding process, certain groups of codes with close ties emerged and consequently categories were formed. During the focused coding phase, all codes were reviewed and further generalized (Charmaz, 2006). The most frequently used codes were examined in correlation with the research question for their adequacy and renamed in categories and subcategories if necessary to include higher level concepts. This activity was not carried out in a linear fashion, but instead went back and forth to the data as more abstract concepts emerged (Brockhaus et al., 2013). The contribution of this empirical

research to the Sustainability Supply Chain Literature will be increased understanding of why suppliers find it difficult to comply with the contractual governance inherent in the code of conduct/monitoring approach.

## Findings

Based on the research question "Why the suppliers find it hard to comply with the buying companies' sustainability requirements?" the interviews from the 30 suppliers were coded and analyzed. Categories that could be assigned to the RQ in the analysis were selected and some of the categories were further divided into subcategories. Each time the category or subcategory was expressed, it was counted (see Table 1). The **Financial** category was divided into the two subcategories 'Buying companies not willing to pay higher prices' and 'No financial help from buying companies regarding sustainability related investments'. In the interviews the suppliers were asked if their customers were willing to pay higher prices in the light of the customers' sustainability requirements. In 23 of the interviews the clear answer was *no*, most of the suppliers were actually laughing when saying that. Most of the buying companies do not see or accept the connection between the costs of compliance and the costs of the garment. The customers always want something for free, as one supplier says. The suppliers were also asked whether their customers helped them in any way with 'sustainability related investments', such as more environmentally friendly machines, educations, waste water plants, buildings etc. and to that question 24 suppliers answered *no*. Again many of the suppliers were laughing when answering, saying that the buying companies only demand, they do not help. From interviewing the suppliers and hearing these answers it was easy to trace the suppliers' contempt regarding the buying companies' reluctance to help the suppliers comply with the sustainability demands. Also the fact that the suppliers don't find it easy to make a profit in the exchange with their customers limits their opportunities for sustainability-related investments.

Table 1

<b>Conceivable Categories and subcategories that might influence the ability of supplier sustainability compliance</b>	<b>Expressed in no. of supplier interviews</b>
<b>Financial</b>	
• Buying companies not willing to pay higher prices	23
• No Financial help from buying companies re. sustainability related investments	24
<b>Code of conducts/Standards/Audits</b>	
• Different code of conducts with different requirements	20
• Too many different standards	21
• Third part audits as a problem	16
<b>Cooperation</b>	
• Buying companies don't involve themselves re. requirements of supplier sustainability compliance	16
• The lack of consistency between demands for sustainability and product	10
<b>No perceived fairness regarding buying companies sustainability requirements</b>	18
<b>No requirements re. sustainability from buying companies</b>	6

The ***Codes of conduct/standards/audits*** category was divided into three subcategories, *'Different code of conducts with different requirements'*, *'Too many different standards'* and *'Third part audits as a problem'*. These three subcategories are close related as the codes of conduct and the standards are almost always followed by an audit. In 20 of the interviews the suppliers expressed their frustration at the codes of conduct from the customers, especially the fact that the code of conduct requirements often differ from each other. Small differences are making it hard for the suppliers to comply with each code of conduct. An example could be that one customer requires the supplier to put up a fence at a staircase and the next customer says that the supplier has to remove it. So even though the codes of conduct are similar, the methods and scaling are different, which again makes sustainability compliance difficult. The fact that suppliers are asked to comply with 'too many different standards' was mentioned in 21 interviews. Requirements of standards or certificates in the Textile and Apparel Industry often differ a lot dependent on the country of the buying company. The European countries often ask for the BSCI (Business Social Compliance Initiative) certificate, the UK customers ask for the Sedex (the Supplier Ethical Data Exchange), certificate and the US customers ask for the WRAP (Worldwide Responsible Accredited Production) certificate. According to the suppliers the three certificates are very similar and all contain requirements relating to social conditions, working conditions, health and safety, and environment. In Bangladesh the suppliers are now in addition being asked to comply with either the European Accord Standard or the American Alliance Standard, both similar standards concerning requirements of fire and building safety. Each of the various standards has its own audit, which can result in CAPs (correction action plans) and re-audits. Some suppliers have up to 25 audits per year and some even have 4-5 audits in a single day, all of which requires a lot from the suppliers in terms of both time and costs.

Even though it was *only* 21 of the suppliers who actually mentioned the costs and the trouble with all the standards, all 30 suppliers agreed that it would reduce their time and costs if the Textile and Apparel Industry could agree on a common standard. Some of the 21 suppliers mentioned though, that this will never happen because all the standards make a good business for the third parties. As mentioned the audits are always closely related to either all the code of conducts or the standards and in consequence related to higher supplier costs, but 16 suppliers also mentioned that the 'audit process itself poses a direct problem' for compliance. The third party organizations who conduct the audits are a problem because there are so many different auditors, appointed by the buying companies, coming all with different rules and books to follow. The auditors do not show consideration for the individual supplier. Some suppliers might have better solutions to problems that are not accepted by the auditor because it is not written down in his book. The suppliers sometimes find it difficult to comply with all the requirements because of the auditors' sometimes very bigoted attitudes. Two of the suppliers actually admitted that it is easier to pay of the third party to approve the audit than to make the necessary investments to be able to comply with the requirements of the buying companies.

***Cooperation*** was divided into two subcategories, *'Buying companies don't involve themselves regarding the requirements of suppliers' sustainability compliance'* and *'The lack of consistency between demands for sustainability and products'*. In the interviews, suppliers were asked how the buying companies involved themselves regarding the requirements of sustainability and 16 suppliers says that their customers 'do not involve themselves' in any way. There is no help provided by the buying companies regarding training or education, they might ask the suppliers to attend certain seminars held by third parties, but at the suppliers' own expense. When the



buying companies visit the suppliers it is more of an audit than a mutual work toward compliance and actually most of the 16 suppliers indicated that the buying companies simply demand, they do not help. The second subcategory under the cooperation category concerns the suppliers' frustration regarding the lack of consistency between the requirements of sustainability and the requirements regarding the products or more precisely, the prices of the products, -10 of the suppliers mentioned this. The suppliers feel that they have no one to talk to about the sustainability requirements, -the design teams from the buying companies know nothing and the buyers knows nothing about standards and regulations and therefore not able to help or answer sustainability related questions. Actually the buying companies often don't care about how the suppliers are managing their sustainability or production; they are interested only in getting the lowest prices. These suppliers said that the buyers do not think of certificates or standards when negotiating the price, they only follow their budget and the budget does not include sustainability costs.

Suppliers were asked in general if they find the buying companies fair regarding all the sustainability requirements. The category ***No perceived fairness regarding buying companies' sustainability requirements***, was not divided into further subcategories, as the answers were derived from this question but also inferred from other passages in the interviews. In 18 of the interviews the suppliers indicated unfairness regarding the requirements of sustainability. Actually most of the suppliers found the whole question about sustainability fair, they had no problem seeing why they have to look after the environment or take good care of their workers in social and health matters. Unfairness arose due to the buying companies' lack of comprehension concerning the costs of sustainability compliance. The suppliers are constantly asked about shorter and faster delivery times that often force the suppliers work overtime which is not allowed according to the codes of conduct and standards. The fact that the buying companies often set requirements that go beyond the local laws of the countries is also considered unfair by the suppliers. One supplier says that based on the size of his company he is required by local law to have a doctor employed but the customer insists on his having to have the facilities of a small hospital. In Bangladesh the suppliers are living with the risk of being closed down or customers discontinuing their cooperation if they do not construct new buildings. This is without any thought from the buying companies about the workers, whose lives and families depend on their jobs, or about the financial losses the already strained suppliers are suffering. The suppliers don't think that the buying companies always are aware of the suppliers' situation. As one of the suppliers says: "Yes, these requirements might be fair in an international perspective, but in our situation, it is not fair, and neither is it reasonable".

The last category, ***No requirements regarding sustainability from the buying companies*** is included because it might be an implicit answer to the research question. In the 30 interviews 6 suppliers indicated that they had customers who did not have any requirements regarding sustainability at all. Especially it was suppliers working with small buying companies who experienced this but it does apply to suppliers working with big local buying companies too. One supplier, a tannery was not asked to comply with anything by his customers even though this customer was cooperating with some of the big international brands. These suppliers say that the buying companies simply don't care as long as the price, quality and delivery time are as requested. Finally since examples of the categories were not found in all the 30 interviews (Table 1) there are suppliers who comply with the buying companies requirements even though some of them still find it difficult. There are suppliers who cooperate with the buying companies,



especially those suppliers who's customers are very big international brands and there are suppliers (especially the large ones), who can afford to make the sustainability related investments without help from the buying customers.

## Discussion and Conclusion

The increasing requirements for supplier sustainability compliance in the Textile and Apparel Industry have become a major challenging task for buying companies. Especially to protect themselves against the hazard of measurement ambiguity, the buying companies has taken advantage of contractual governance mechanisms such as codes of conduct and certificates against suppliers when requiring sustainability compliance. We began this paper by asking "Why do the suppliers find it hard to comply with the buying companies' sustainability requirements?" Existing research into supplier sustainability issues has examined if and/or to what extent buying companies use contractual governance in the form of codes of conduct to achieve supplier compliance and how the codes of conduct can influence suppliers. From this qualitative study we still confirm that the contractual governance structure is the dominant way used by buying companies and furthermore that sustainability compliance is not obvious or easy for suppliers. But we also contribute to the literature by providing answers as to *why* the factory owners don't comply. Five conceivable categories of factors that influence the suppliers' sustainability compliance ability were presented in the findings and by asking the factory owners or managers, we unfolded a deeper comprehension of the reasons of the apparent supplier opportunism. Opportunism was actually documented in the interviews by the suppliers telling about the necessity of overtime work because of the buying companies' demands for shorter delivery time and by the fact that the suppliers felt themselves compelled to pay the auditors to pass the audits. The most obvious reason in the categories found, was the suppliers challenges and difficulties with regard to the high costs connected to sustainability compliance, which most of the factors also led back to. Given that we are talking about suppliers from India, Bangladesh and China and that the greater part of them are relatively small, the increasing costs are understandably challenging. At the same time the suppliers constantly live with the fear of losing orders if they do not meet the requirements of low price and short delivery time which again may result in compromising solutions regarding sustainability compliance. This knowledge or comprehension of the supplier situation could be used to an advantage by buying companies especially in relation to small suppliers, to avoid opportunism by evaluating these suppliers' financial position and prospects in relation to achieving sustainability compliance. The findings show that buying companies are frequently not interested in contributing to the suppliers' sustainability compliance even though they themselves are pushing suppliers contractually. We might question whether this buying company behavior is actually leading suppliers to react opportunistic as they can do nothing else, thus it might be a form of legitimate opportunism? The concern in the Transaction Cost Economic approach is opportunism - especially in a high uncertainty context such as global sustainable sourcing, but considering these findings, the problem seems to be rather the interplay between the buying company's governance and how it is implemented, and the supplier which seems to lead to this legitimate opportunism. Supplier behavior must be seen in relation to the buying company's behavior. If the buying company wants compliance and seeks to avoid the threats of opportunism, it has to evaluate its own behavior. Buying companies need to improve their ability to implement and manage the contractual/code of conduct governance. This includes a valuation of the financial situation of the suppliers and a customized sustainability approach. A hybridization of the buying companies' governance structure combining relational norms with the contractual norms (Dyer, 1996) might be preferable.

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