



Guilt by Association – The Importance of Child Labor Due Diligence

Child labor remains a complex and pernicious issue across much of the developing world. A mix of poverty, economic malaise, corruption, and lax enforcement make it a problem that is unlikely to be eradicated in the foreseeable future.

Child labor constitutes a very real risk for investors and multinational corporations with a variety of detrimental implications. Financial institutions and investors would be well-advised to include checks in their existing due diligence and anti-money laundering policies and procedures to prevent involvement in child labor. Failure to do so could result in regulatory or legal action, or perhaps inflict lasting damage to a brand's reputation.

Child Labor Remains a Systemic Risk

Child labor often involves systemic dimensions that make it difficult to eliminate without addressing the underlying issues, including poverty and a lack of educational opportunities for children. Recent news reports demonstrate the prevalence of child labor and its associated risks across the developing world. According to a June 2018 Guardian report, for example, children have been discovered working on tobacco plantations in Asia, Africa and South America.

In Indonesia, there have been recent reports of child laborers on tobacco plantations falling ill during harvest season. Such child laborers are involved in the mixing of fertilizer and the unfurling of tobacco leaves from ovens. The latter process reportedly exposes them to a pungent tobacco smell that can cause nausea and other

symptoms such as an elevated heart rate. Child workers are especially vulnerable to the long-term effects of pesticide and other toxin exposure. These include cancer, learning difficulties, and reproductive health issues, according to a 2014 Human Rights Watch report. Exposure to toxins is a problem in many industries, especially agriculture and garment production.

It is important for investors to understand that child labor also acts as a conspicuous indicator of other legal and regulatory risks that often take a less visible form. In particular, child labor is almost always associated with organized crime and corruption. For example, documentation for underage workers is often forged and bribes paid to facilitate regulatory approvals in the process of child labor recruitment. In part reflecting this unfortunate reality, child labor is categorized by the Financial Action Task Force (an intergovernmental anti-money laundering organization) as a "designated category of money laundering offense."

Case Study: The Rana Plaza Collapse

Though it happened several years ago, the 2013 collapse of the Rana Plaza factory complex in Bangladesh remains a typical – and tragic – example of how corruption, criminal activity, and a lax regulatory environment can unexpectedly impact investors. The catastrophe resulted in the deaths of over 1,000 workers and the injury of around 2,500. The wounded survivors included more than 200 children, but because their employment was illegal and undocumented it is unknown how many of those who perished were underage workers.

In the aftermath of the collapse, the Rana Plaza complex was found to be a substandard structure erected on land acquired illegally, allegedly funded by the proceeds of criminal activity, and lacking in the requisite building permits for an industrial complex. The structure was in no way designed for industrial use, as it had been partially designed by a structural engineer as a shopping mall. Furthermore, corrupt local government officials illegally approved the initial plans for the shopping center and the subsequent plans for additional floors. In the process, they did not review construction blueprints or structural design, and in circumvention of official review processes. As this case demonstrates, child labor may accompany several other compliance problems.

The collapse exposed labor and safety issues within the global fashion industry in general and the ready-made garment industry in Bangladesh in particular. Garment manufacturing has the potential to lift more than four million people out of poverty. However, consumer preference for affordable clothing and Bangladesh's status as the world's cheapest place to manufacture textiles have led to the country's poor labor conditions to remain largely unaddressed – including a lax regulatory environment, extremely low wages, poor safety standards, and child labor.

Western Brands Impacted by Collapse

Clothes with tags from major Western brands were found in the collapsed factory building. Further investigation by law enforcement and an international group of journalists found that large multinational brands produced a number of successful clothing lines both directly with the factories and indirectly through a series of middlemen. The shadow network of middlemen – fashion production houses and supply chain management services – enabled the brands to claim that they had no connection with the Rana Plaza factories and to present a veneer of social responsibility. While this may have allowed these brands to avoid legal liability, however, it did not save them from the reputational impact of having been associated with the Rana Plaza tragedy.

Though the collapse is what exposed the labor and safety issues within the fashion industry to the outside world, an official audit done by a large industrial audit firm had noted the presence of child labor at one of the Rana Plaza factories in 2012, a year before the collapse. The fact that the issue had been discovered prior to the collapse but went unaddressed highlights the degree to which the compliance and due diligence regimes of the associated fashion brands failed.

Measures to Reduce Exposure to Child Labor Risk

In taking measures to avoid involvement in child labor, investors should first know which industries are most prone to this type of risk. These sectors include outsourced manufacturing, agriculture, third-party human resource companies, and diversified logistics companies. All four of these involve sources of labor that are beyond the visibility of the investor and may involve opaque outsourcing to third parties with few or no compliance procedures. Other indicators of potential risk are involvement in complex and opaque transnational supply chains, and investment in nascent or immature and labor-intensive industries in developing countries with lax or immature regulatory frameworks.

Once it is determined that such exposure exists or may exist, it is important to choose a due diligence provider that is able to recognize such exposure and conduct checks to mitigate associated risks. The usual “red flag” searches may be insufficient, particularly for cases in which child labor is a broader, systemic issue that exists across a given industry, though perhaps not in relation to a particular individual or entity.

Some ways to ensure that potential child labor issues are covered in due diligence research are to conduct targeted checks on potentially suspicious facilities, managers, or owners to see whether there are any indications of past involvement in child labor. Checks can also be run to see whether the business in question is involved in local corporate social responsibility and labor standards initiatives. Discreet site visits to a factory can also be a very useful tool to ascertain whether there are any visual indications of child labor at a given facility. However, all these methodologies are predicated on engaging a firm with strong country knowledge that can effectively navigate the local context to make such an assessment.

Child labor is unfortunately an issue that is unlikely to be ended in the near term, and further media exposure can be virtually guaranteed. It is vital that investors take steps to minimize any potential exposure by choosing a provider that understands such issues and includes them in their due diligence scopes. Cutting corners on due diligence or choosing an unqualified provider could prove far more costly in the long term – both to the reputation of your business and to the lives of the workers involved in your supply chain.

Special Contributor to This Article

This article has been written in collaboration with our partner, Liberty Shared.

Liberty Shared aims to prevent human trafficking through legal advocacy, technological interventions, and strategic collaborations with NGOs, corporations, and financial institutions.



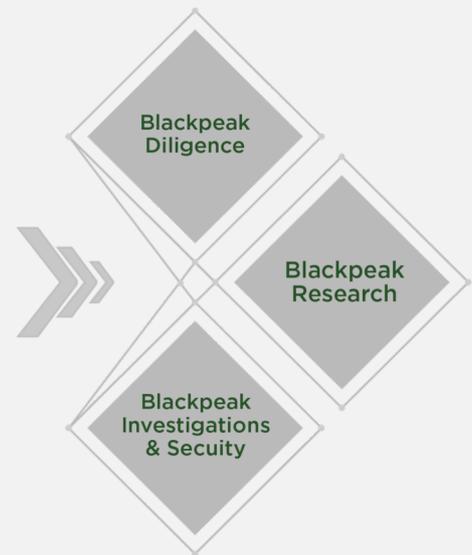
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