



# Responsible Investment Corporate Governance and SRI – Q1 2006

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## Voting profile for Q1 2006

During the quarter, Newton exercised its clients' voting rights at 234 separate General Meetings. Votes were instructed against one or more resolutions at 10.6% of UK meetings and at 19.4% of meetings held outside of the UK. This equated to 21 separate resolutions in the UK and 48 separate resolutions at meetings outside of the UK. 37.5% of all resolutions voted against related to remuneration arrangements or proposals.

Issues included the granting of share-based incentives to non-executive directors and excessive dilution of shareholders' value. When assessing the appropriateness of remuneration arrangements, Newton is aware, especially for small and medium sized companies, of the cost to shareholders of these arrangements and the transfer of value from shareholders to management.

<b>Complete voting summary – Q1 2006</b>	<b>Total</b>	<b>UK</b>	<b>Ex-UK</b>
<b>AGMs</b>			
Voted in favour of all resolutions	121	75	46
Voted against one or more resolutions	27	11	16
Took no action	10	0	10
Abstained	0	0	0
	<b>158</b>	<b>86</b>	<b>72</b>
<b>EGMs</b>			
Voted in favour of all resolutions	67	50	17
Voted against one or more resolutions	6	4	2
Took no action	2	0	2
Abstained	0	0	0
	<b>75</b>	<b>54</b>	<b>21</b>
<b>Court Meetings</b>			
Voted in favour of all resolutions	1	1	0
Voted against one or more resolutions	0	0	0
Took no action	0	0	0
Abstained	0	0	0
	<b>1</b>	<b>1</b>	<b>0</b>
<b>Totals</b>	<b>234</b>	<b>141</b>	<b>93</b>
<b>Voted in favour</b>	<b>189</b>	<b>126</b>	<b>63</b>
<b>Voted against</b>	<b>33</b>	<b>15</b>	<b>18</b>
<b>Took no action</b>	<b>12</b>	<b>0</b>	<b>12</b>
<b>Abstained</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>Totals</b>	<b>234</b>	<b>141</b>	<b>93</b>

## Breakdown of resolutions voted against during Q1 2006



## UK Companies

### Aberdeen Asset Management PLC – AGM – 20/01/2006

Newton instructed votes against a resolution seeking shareholder approval of the company's remuneration report. Newton felt that the high level of cash award made to the CEO, in conjunction with a significant and unexpected increase in Long-term Incentive Plan (LTIP) awards, was not sufficiently explained by the company. It was indicated by the company that LTIP awards would be at a similar level to the previous year. In fact, they were up to seven times greater; raising a concern that this, to some extent, represented compensation for the dissolved share options which had failed to meet performance conditions. There was also concern relating to compensation arrangements in the event of termination of employment, which provide for one year's remuneration to be awarded. This was aggravated by the inclusion of uncapped bonuses within the calculation. A further concern centred on the lack of protection to shareholders' value, given that no dilution limit existed in relation to the granting of share-based incentives. Newton expects dilution to be limited to a maximum of 10% of the company's market capitalisation (5% by way of discretionary participation schemes and 5% to all employees schemes).

### African Diamonds PLC – AGM – 23/01/2006

Newton voted against a resolution that sought approval of "Other Business". The unknown content of this resolution meant that Newton had to exercise a level of prudence by voting against its approval.

### ATH Resources PLC – AGM – 09/01/2006

The company proposed changes to the performance conditions that governed the vesting of share options and long-term incentive awards. In stark contrast to best practice, the changes would be applied to future awards and also, retrospectively, to outstanding awards. Newton was also concerned with the ability of the remuneration committee to appropriately represent shareholders' interests given that a recipient of share-based incentives, the CEO of the company, was a member of the remuneration committee. The effective repricing of share-based incentive awards and the structure of the remuneration committee led to Newton instructing votes against the resolution seeking shareholder approval of the remuneration changes. Votes were also cast against a non-executive director, who was a member of the remuneration committee, seeking re-election to the company's board.

**Cambridge Antibody Tech Group PLC – AGM – 03/02/2006**

The company sought shareholder approval to issue up to 10% of its share capital on a non pre-emptive basis. No immediate investment opportunities or safeguard provisions were provided by the company. Newton considered the potential 10% level of dilution to be excessive and, therefore, instructed votes against this resolution.

**Charter Pan European Trust PLC – AGM – 21/03/2006**

The trust sought shareholder approval to re-issue shares from its treasury account, without first offering any issuances to its existing shareholders. Newton was not satisfied that sufficient protection would be given to existing shareholders' value. The discount to Net Asset Value, which the shares trade at, could be increased with the proposed share issuance. Votes were instructed against the proposal to issue up to 10% of the funds value whilst dis-applying the pre-emption rights of existing shareholders.

**Creative Education Corporation PLC – AGM – 23/02/2006**

The company proposed to increase the number of shares in issue by 48%, while dis-applying existing shareholders' pre-emption rights. Given that the company failed to provide any explanation as to why shareholders' should accept such a level of dilution, Newton instructed votes against the proposal.

**Daily Mail & General Trust PLC – AGM – 08/02/2006**

A resolution was proposed at the company's AGM that sought to amend the Long-Term Incentive Plan. However, within the amendments, the remuneration committee failed to address concerns relating to the re-testing of the performance conditions. Under the existing and proposed plan, if performance conditions are not met after the initial vesting period, the vesting period can be extended for a further two years. The maximum award under the re-testing period would also be enhanced by 50% over the maximum award for the shorter performance period. Furthermore, the CEO has exceptional provisions within his service contract that would increase his notice period to two years should he choose to resign within 60 days of a change in control. Newton considered that these arrangements did not align the interests of management with those of shareholders. Therefore, votes were instructed against the proposed amendments and against the resolution seeking shareholder approval of the remuneration report.

**Diploma PLC – AGM – 11/01/2006**

It was highlighted in the company's remuneration report that its contributions to individuals' pension arrangements would be increased. This would be in compensation for the removal of the company's performance dependent Bonus Share Matching Plan. Newton instructed votes against the remuneration report as it was felt to be inappropriate for the company to replace a performance-based incentive arrangement with a simple cash award in the form of increased pension contributions.

**Electrocomponents PLC – EGM – 01/02/2006**

Two resolutions were proposed for shareholder approval at the company's EGM. Newton considered the structure of the

proposed Long-Term Incentive Plan to be appropriate and instructed votes in favour. However, there was concern over a proposed one-off award of restricted shares by way of an Executive Incentive Plan. Objections to the award included the setting of absolute profit targets as a performance condition. Newton was also suspicious that the award was compensating for underwater share options and, essentially, re-pricing these share options. Structurally, Newton was concerned over the performance condition governing the vesting of awards. In using absolute profit targets, the plan provides an incentive, potentially, for extreme cost cutting over the three-year vesting period. Such a policy may not be sustainable and could significantly hinder the long-term performance of the company.

**GW Pharmaceuticals PLC – AGM – 21/03/2006**

Newton considers share-based incentive awards to non-executive directors limit their ability to exercise independent judgement and safeguard the interests of shareholders. The company has consistently granted share option awards to its non-executive directors. Therefore, votes were instructed against the resolution seeking approval of the remuneration report.

A further resolution was also voted against. The company did not justify its request to dis-apply existing shareholders' pre-emption rights in the event of a new issue of shares, which could be up to 20% of the company's issued share capital. 20% dilution of existing shareholders' value was felt to be excessive where no commitments or comfort was provided to shareholders relating to the company's intended use of any capital raised.

**JP Morgan Fleming Asian Investment Trust PLC – AGM – 03/02/2006**

Two resolutions were proposed at the companies AGM relating to the re-issue of treasury shares and the dis-application of pre-emption rights in the event of these shares being re-issued. Newton felt that existing shareholders' value was not sufficiently protected by the conditions that would be applied to any re-issue of treasury shares. Following the re-issuance of treasury shares, the trading discount to Net Asset Value could be increased.

**Lonrho Africa PLC – EGM – 14/02/2006**

At its EGM, the company sought shareholder approval to grant 1.5 million share options to two of its non-executive directors, who were both members of the audit and remuneration committees. Newton considers the award of share-based incentives to non-executive directors can hinder their ability to exercise independent judgement. Votes were instructed against the proposed incentive arrangement.

**Merrill Lynch World Mining Trust PLC – EGM – 17/03/2006**

The trust sought shareholder approval to allot warrants in its fund. This, in effect, would be a premium-priced rights issue, designed to increase the size of the trust. Newton felt that the trust should have been concentrating on narrowing the shares' discount to Net Asset Value. Other trusts, owned by the same company, have incorporated a mechanism designed to reduce this trading discount. Votes were instructed against both resolutions proposed at the EGM.

#### **Persimmon PLC – EGM – 06/01/2006**

The company convened an EGM to seek shareholder approval of an acquisition and an additional incentive plan for its executive directors. Newton was in favour of the proposed acquisition. However, votes were instructed against the proposed Synergy Incentive Plan. The incentive plan was a transaction-based plan that would reward management for achieving synergy cost savings resulting from the proposed acquisition. Should certain cost savings be realised, the plan would provide for awards to individuals of up to 10x salary. The awards could equate to c.20% of any synergy cost savings achieved. Newton considered this to be excessive and felt that the scheme could encourage radical cost savings that may be to the detriment of the company's long-term performance.

#### **Qvester VCT 4 PLC – AGM – 28/02/2006**

The company provided no rationale in relation to its resolution that sought to issue 10% of its share capital, whilst dis-applying the pre-emption rights enjoyed by existing shareholders. Newton felt that the potential level of dilution was excessive and instructed votes against the resolution.

### **Overseas Companies**

#### **Air Products & Chemicals Inc – AGM – 26/01/2006**

Votes were instructed against the resolution that proposed amendments to the company's Omnibus Stock Option Plan. Newton's concerns centred on the proposed dilution of existing shareholders' value of up to 16% and the inclusion of non-executive directors as recipients of the share-based incentive awards.

#### **Bank of Nova Scotia – AGM – 03/03/2006**

A shareholder requisitioned resolution requested that the company include, in its annual report, the financial statements of its subsidiaries that are domiciled in tax havens. The financial market in Canada is heavily regulated and the company states that it is in full compliance with all national and international laws developed to detect and deter tax evasion, terrorist activity and organised crime. The company also has policies and procedures in place to address any inappropriate activity. Newton understands that countries adopt differing tax regimes in order to attract and retain investment and that companies should be able to take advantage of these regimes when establishing legitimate tax planning strategies. It should also be noted that the company highlights the locations, within its annual report, of all its principle activities. Newton did not consider that this shareholder requisitioned resolution warranted support and, therefore, votes were instructed against the proposal.

Newton voted against a second shareholder proposed resolution. The shareholder sought for the company to prohibit the recruitment of directors if they had been implicated in any judicial proceedings that resulted in a finding of unethical activity or behaviour. The proponent's suggested prohibition policy appeared to be very broad. Individuals would not necessarily need to be named in a case of unethical conduct to

be prohibited from being recruited, but simply have been a director of a company found to be operating unethically. Newton considers that a well structured and well resourced nomination committee is best placed to oversee the recruitment of a company's directors. It should also be noted that the company has certain policies and procedures in place that address ethical conduct.

#### **Banpu Public Company Ltd – AGM – 30/03/2006**

Newton voted against a resolution that sought approval of "Other Business". The unknown content of this resolution suggests that it is foolhardy to proffer support.

#### **Barclays Investment Funds, North American Equity – AGM – 03/01/2006**

#### **Barclays Investment Funds, North American Equity 'A' – AGM – 03/01/2006**

#### **Barclays Investment Funds, Sterling Bond – AGM – 03/01/2006**

Newton voted against the same resolution proposed at the above three funds.

A resolution entitled "Other Business" was put to shareholders for their approval. This would allow the board and shareholders to raise other issues at the AGM. While such requests are routine in certain jurisdictions, there is a possibility that certain items may be raised and approved under this resolution, which may not be in shareholders' best interests.

#### **Canon Inc – AGM – 30/03/2006**

The company requested shareholder approval of retirement bonuses for its executive directors and also for a statutory auditor. Newton considered it inappropriate to award a retirement bonus to the statutory auditor, who had been designated by the company as an independent non-executive director. Votes were instructed against this resolution.

#### **Cooper Companies Inc – AGM – 21/03/2006**

A separate resolution provided detail and sought shareholder approval of an Omnibus Stock Plan for non-executive directors. Newton is fundamentally against the award of share-based incentives to non-executive directors due to the conflicts of interest that can arise. Under the proposal, each non-executive director would be awarded share options on c.\$1 million worth of the company's shares with subsequent annual grants at c.\$55,000 worth of the company's shares. Votes were instructed against this resolution.

#### **D.R.Horton Inc – AGM – 26/01/2006**

Votes were instructed against the resolution that proposed amendments to the company's Omnibus Stock Option Plan. Newton's concerns centred on the proposed dilution to existing shareholders of up to 13.9% and the inclusion of non-executive directors as recipients of share-based incentive awards.

Newton also voted against a resolution that sought approval of "Other Business". The unknown content of this resolution meant that Newton had to exercise a level of prudence by voting against its approval. It cannot be expected that shareholders will blindly approve such resolutions.

**Fast Search & Transfer ASA – EGM – 15/02/2006**

Neither the number or the names of the proposed nominees to the company's board were disclosed to shareholders prior to the EGM. Votes were instructed against the single resolution that requested the approval of shareholders for the appointment of the undisclosed nominees.

**Fortum Oyj – AGM – 16/03/2006**

A shareholder requisitioned resolution, proposed at the company's AGM, sought shareholder approval for the abolition of the company's Supervisory Board and the creation of a Unitary Board structure. There is little empirical evidence to suggest that one board structure is superior to the other. Also, Finnish company law does not dictate the approach that companies should take. Therefore, Newton did not support the resolution.

A second shareholder resolution requested the company to abolish the existing nomination committee and remuneration committee. It was requested that they be replaced with a single committee. The resolution also proposed that the sole constituents of this new committee should be representatives of three major shareholders, together with the company's chairman. Newton believes that it is not in shareholders' best interests to delegate such authority to shareholders, given that they do not owe a fiduciary duty to the other shareholders. Also, it is felt that the appointment of executive board members and key executives should be, in part, the responsibility of the company's CEO. Newton voted against the shareholder proposed resolution.

**Gartmore Sicav, Continental European Smaller – AGM – 09/03/2006****Gartmore Sicav, Luxemburg – AGM – 09/03/2006**

A resolution entitled "Other Business" was proposed at the above two AGMs.

The proposal of "Other Business" was an administrative error by the company. It had not intended to include it as a formal agenda item. However, given that the content of the resolution would be unknown until the day of the meeting, Newton felt it prudent to vote against the resolution.

**Goldrea Resources Corp – AGM – 18/01/2006**

Newton did not consider the proposed amendments to the company's Stock Option Plan to be in shareholders' best interests. Votes were instructed against the proposed amendments, which included provisions for a 6 monthly vesting schedule, dilution of up to 13.3% and the participation in the plan of non-executive directors.

Newton voted against a resolution entitled "Other Business". This was a request to allow the board and shareholders to raise other issues at the AGM. While such requests are often routine in certain jurisdictions, there is a possibility that certain items may be raised and approved under this resolution, which may not be in shareholders' best interests. Until further information and assurances can be provided, Newton will continue to vote against resolutions seeking approval of "other business".

**Island Mountain Gold Mines Ltd – AGM – 16/01/2006**

The company proposed and sought shareholder approval of a new share option plan. It was intended that non-executive directors be included as recipients of share options. Newton believes that this could bring about unnecessary conflicts of interest and hinder the ability of non-executive directors to safeguard shareholders' long-term value. Votes were instructed against the new share option plan. A further resolution was also voted against. This requested shareholder approval for the company to re-price existing share options.

Newton also voted against a resolution that sought approval of "Other Business". The unknown content of this resolution meant that Newton had to exercise a level of prudence by voting against its approval. It cannot be expected that shareholders will blindly approve such resolutions.

**Siam Cement Public Co Ltd – AGM – 22/03/2006**

Despite attempting to seek shareholder approval of its directors' remuneration arrangements, the company failed to provide any detail relating to the structure or even aggregate level of the remuneration of its directors. Votes were instructed against this resolution.

Newton also voted against a resolution that sought approval of "Other Business". The unknown content of this resolution suggests that it is foolhardy to proffer support.

**Skandia Forsakrings AB – EGM – 21/02/2006**

The company did not provide any detail relating to two resolutions that requested shareholder approval for the company to determine the size of its board and the election of directors. At the time of the meeting, the company was in the process of being acquired, which was the reason given for the lack of disclosure. In the interest of prudence, Newton instructed votes against both of these resolutions.

**The Walt Disney Company – AGM – 10/03/2006**

Two shareholder proposed resolutions were voted against.

The first of these proposals sought to limit possible greenmail payments by the company. Last year, Newton, along with a majority of voting shareholders, supported this same proposal. In response to this majority vote, the company amended its Bylaws. According to its Bylaws, the company is now prohibited from purchasing shares at a premium to their market price from any shareholder controlling more than two percent of the issued share capital. Newton considered that the amendments, already undertaken by the company, offered sufficient protection to shareholders in potential greenmail situations.

The second shareholder requisitioned resolution proposed that the company prepare a report disclosing its Chinese suppliers' compliance with its corporate code of conduct, China's labour laws and the core conventions of the International Labour Organisation (ILO). Newton did not feel that this resolution warranted shareholder support. The company has a formal code of conduct based on the ILO standards, has established an International Labour Standards Group and has education programmes in place. The company also uses internal monitors and external auditors, whilst also working with various external parties on this matter.

# Examples of engagement – Corporate Governance Q1 2006

## **UK Media company – January 2006**

**Contacts: Chair of the Remuneration Committee  
Compensations Directors**

The company sought Newton's views on its intention to extend the life of its remuneration arrangements. Newton had various concerns relating to the company's remuneration structure. These concerns had been raised with the company prior to its consultation with shareholders. The company provided some comfort relating to the setting of performance targets that would govern the vesting of share-based awards made under the Long-Term Incentive Plan. However, the company remained insistent in its policy that it would only disclose the actual performance conditions after awards had vested. Newton argued that a suitably wide and stretching range for each performance condition would not constitute commercially sensitive information. Historically, the company has been criticised for rewarding individuals despite poor performance being reported by the company. Of additional concern was the use of Expected Value to determine the size of share-based incentive awards. Given the subjectivity surrounding the calculation of Expected Value, Newton felt that it could lead to excessive awards being granted. Newton stated that it would not support a proposal for the company to extend its remuneration arrangements unless, at the very least, the above concerns were addressed.

## **UK Support Services company – January 2006**

**Contact: Chairman**

The company contacted Newton in relation to a one-off remuneration arrangement it wished to put in place for the proposed new CEO. Newton appreciated the opportunity to comment and question the proposed arrangements. It was felt that the company had carried out appropriate due diligence and afforded itself a level of flexibility that would minimise the cost to shareholders, whilst attracting a suitable candidate for the role. Newton was also mindful of the need to appoint an individual of sufficient calibre to lead the company through its turnaround phase.

## **Korean Technology Hardware & Equipment company – February 2006**

**Contact: Chairman**

Discussions were had with the company relating to resolutions it expected to propose at its 2006 AGM. These centred on the proposed election and re-election of board members. Newton also gained a better understanding of how the company was developing its corporate governance practices in light of changes to the regulatory environment and developments of best practice in South Korea.

## **Luxembourg Unit Trust – February 2006**

**Contact: Company Secretary**

The company requested shareholder approval of directors' remuneration at its AGM. However, this information was not disclosed within any of the published documents. The company stated that there was an error in publication and that this information is usually available. The company provided comfort on the setting of appropriate remuneration arrangements for its board members. Additionally, Newton queried the inclusion of "Other Business" as a resolution item. The company admitted that this was also an administrative error.

## **UK Support Services company – February 2006**

**Contacts: Chair of the Remuneration Committee  
Remuneration Consultant**

Shareholders' views were solicited, by the company, in relation to a proposed new Long-Term Incentive Plan (LTIP). It was intended for the new LTIP to reward the company's senior executives. Newton considered that the Earnings Per Share performance conditions were not sufficiently stretching, given the company's financial position and growth expectations. Following the company's disclosure of high double-digit salary increases for its executive directors, further information was requested as to the policy and process for setting appropriate base salary levels.

#### **UK General Financial company – March 2006**

**Contacts: Chair of the Remuneration Committee  
Remuneration Consultant**

A proposal was made by the company to disband the regular use of its share option scheme and replace it with a nil-cost Performance Share Plan (PSP). Newton requested and received comfort on a number of operational matters connected with the proposed PSP. Before Newton could support the proposal, it was felt that two main points needed to be addressed. The first was the constituent companies included in the proposed comparator group that would be used in calculating Total Shareholder Return performance. Newton proposed two additional companies, which were later incorporated in the comparator group. The second key issue raised by Newton concerned the robustness of the Earnings Per Share (EPS) performance targets. It is believed that other investors had also raised this concern. In a follow-up letter, the company outlined higher EPS performance targets and stated that these targets would be kept under review, on an annual basis, to ensure they are set at an appropriate level.

#### **UK Bank – March 2006**

**Contacts: Chairman  
Company Secretary**

In a meeting with the company, many areas of its corporate governance policies and practices were discussed. Specifically, Newton sought additional information and the chairman's insight on the company's board structure, including the number of constituents, responsibilities of the board members and details surrounding the company's recent board reviews. Further information and insight was also gained relating to the company's internal and external audit, and relevant control functions. Of particular interest was the succession planning process and the company's views on limiting the liability of auditors.

#### **UK Equity Investment Instrument – March 2006**

**Contact: Fund Manager  
Broker**

The company sought to put in place certain provisions that would allow it to issue new shares, whilst potentially dis-applying existing shareholders pre-emption rights. The level of authority sought by the company was almost 6% of its issued share capital. Despite assurances that shares would only be issued when the fund trades at a premium to its Net Asset Value, Newton sought further comfort that the value of holdings in the company would not be significantly diluted in the event of the new shares being issued.

# SRI Focus: Supply Chain Management

## Introduction

### Enhancing margins through efficient sourcing

Supply chain management is the organisation of the value-added chain from the sourcing of raw materials to the delivery of the completed good or service. Efficient management of a supply chain can optimise the quality and price of goods. It can also impact on the speed and reliability of the delivery of the goods by managing the flow of information between production and end distribution. Therefore, efficient supply chain management can reduce costs and enhance margins.

The drive for companies to innovate continuously, in order to gain competitive advantage, has caused companies to look beyond their home country for sourcing opportunities. Sourcing products from developing countries can provide access to cheap labour and resources that may not be abundant in home markets. It can also offer opportunities to access new markets. As companies have moved to take advantage of these opportunities, supply chains have grown increasingly complex. Wal-Mart, for instance, which accounts for approximately 10% of China's total exports to the United States, has over 20,000 suppliers worldwide. Organisation of the flow of goods, paperwork and money among the different partners is a significant task.

### Protecting reputation

Many developing countries do not have well-developed regulatory frameworks, particularly in the areas of human rights and environmental standards. With companies being increasingly held accountable for the practices of their business partners, the working practices of suppliers can give rise to significant operational and reputational risks. A company's image is one of its most valuable assets. Customer attitudes and general goodwill towards a company can directly impact its success. Managing supply chains to maximise flexibility, efficiency and profitability, while upholding commitments to sustainable business practices, can be a substantial challenge.

In recent years, there have been many allegations of violations of labour standards in the supply chains of Western companies. Nike is a notable example. After the company paid US\$1.5 million to settle allegations that it made false claims about how well its workers were treated, it went on to produce a detailed report that described the working conditions of its 705 worldwide factories. The report admitted to widespread problems, particularly in some Asian factories. The company now has approximately one hundred people managing corporate responsibility issues.

Gap is another example of a company that has faced allegations of human rights violations. On May 12, 2004, Gap released a report admitting to less than perfect working conditions in as many as 3,000 of its worldwide supplier factories. The report stated that close to 90% of contract manufacturers failed the company's evaluation of working conditions. The report also stated that between 10% to 25% of the company's factories in China, Taiwan and Saipan Island subject their workers to psychological coercion; 50% of the factories in sub-Saharan Africa use machines that are not equipped with proper safety devices; and many factories regularly demand employees to work in excess of 80 hours per week.

Other global brands that have faced allegations of human rights abuses include Wal-Mart, Adidas, Benetton and Mattel. These types of allegations can be very costly for the reputation of a company.

## Sourcing from the developing world

Supply chains that were once concentrated in the UK and Western Europe now extend into North Africa, Central and Eastern Europe and the Far East. This trend has occurred as companies have realised the benefits of manufacturing in

economies where labour costs are low. Quality and productivity of manufacturing processes in these countries is improving. This has led to rapid growth in global demand for products from these countries. China is a significant beneficiary of this trend.

### CHINA

<b>Population:</b>	1.3 billion (July 2005 est.)
<b>Area:</b>	9.6 million sq km (fourth largest country in the World after Russia, Canada and US);
<b>Government type:</b>	Communist state
<b>Chief of state:</b>	President HU Jintao (since 15 March 2003)
<b>Head of government:</b>	Premier WEN Jiabao (since 16 March 2003)
<b>Cabinet:</b>	State Council appointed by the National People's Congress (NPC)
<b>GDP – real growth rate:</b>	9.2% (official data) (2005 est.)
<b>Unemployment*:</b>	4.2% official registered unemployment in urban areas in 2004; substantial unemployment and underemployment in rural areas; an official Chinese journal estimated overall unemployment, including rural areas, for 2003 at 20% (2004).
<b>Population below poverty line:</b>	10% (2001 est.)
<b>Inflation rate (consumer prices):</b>	1.9% (2005 est.)
<b>Export partners:</b>	US 21.1%, Hong Kong 17%, Japan 12.4%, South Korea 4.7%, Germany 4% (2004)

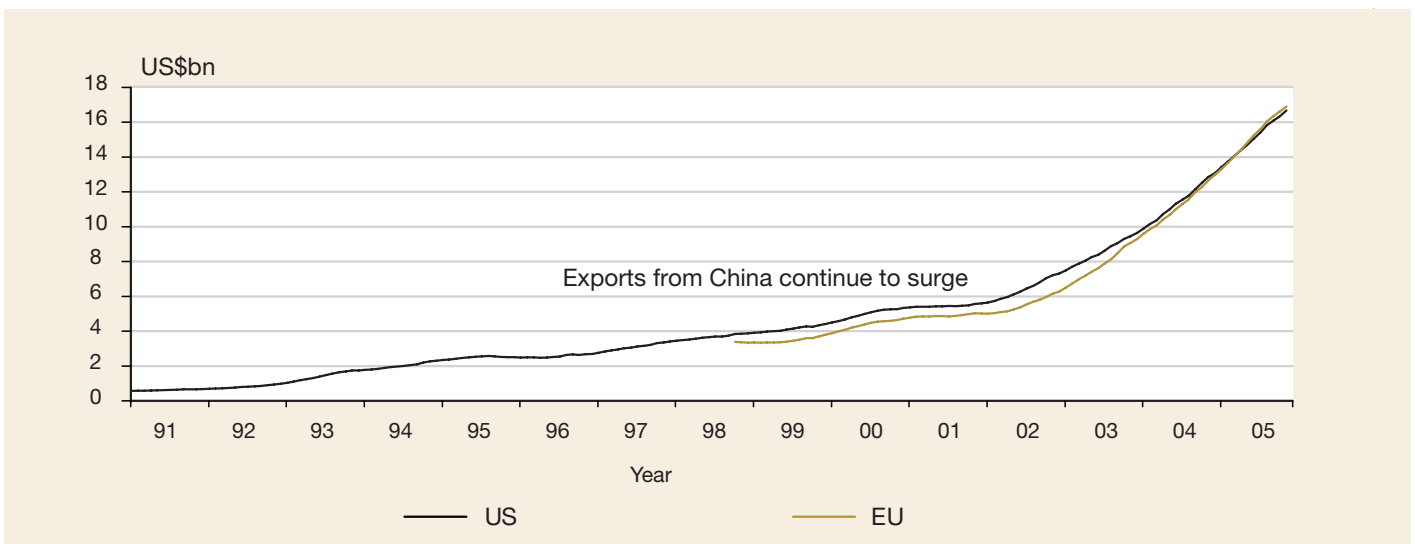
Source: CIO Factbook

\*Unemployment is one of China's greatest problems and sources of insecurity. According to official government statistics, 11.8 million workers lost their jobs in State Owned Enterprises (SOE) in 2002. This occurred as the country restructured, moving away from a centrally controlled labour market, towards a market-oriented system. According to the International Labour Organisation, approximately 26 million people have been laid off because of SOE reform. Rural unemployment and underemployment now combine to affect over 30% of the population.

China is an increasingly significant producer of many manufactured goods for the global economy. Exports from China to the United States and European Union have grown at a substantial rate over the past fifteen years (see Figure 1: Chinese Exports to the US and Europe). The country's capacity to provide a seemingly endless supply of cheap labour is considered one of the most important factors contributing to

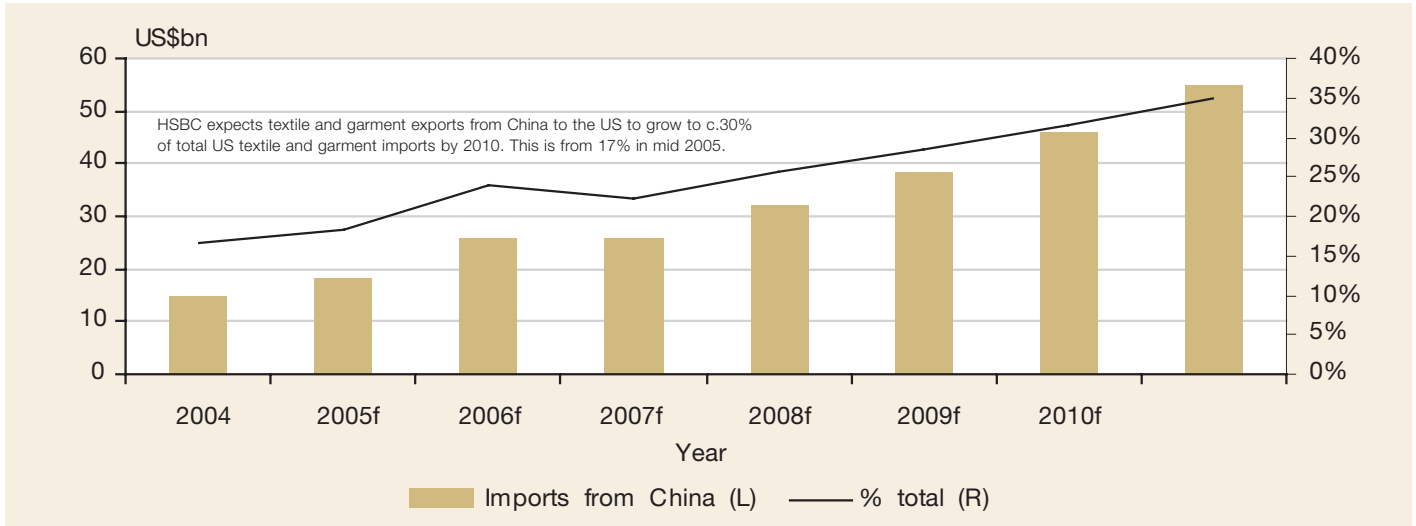
growth in exports. Other attributes such as modern facilities, the Chinese work ethic, strong logistics and organisational ability mean that purchasing companies have confidence that orders are likely to be completed at the right quantity, at the right quality and on time. China's entry into the World Trade Organisation in 2001 has also provided the country with further opportunity to increase exports of labour-intensive goods.

**Figure 1: Chinese Exports to US and Europe (1 Year Moving Ave.)**



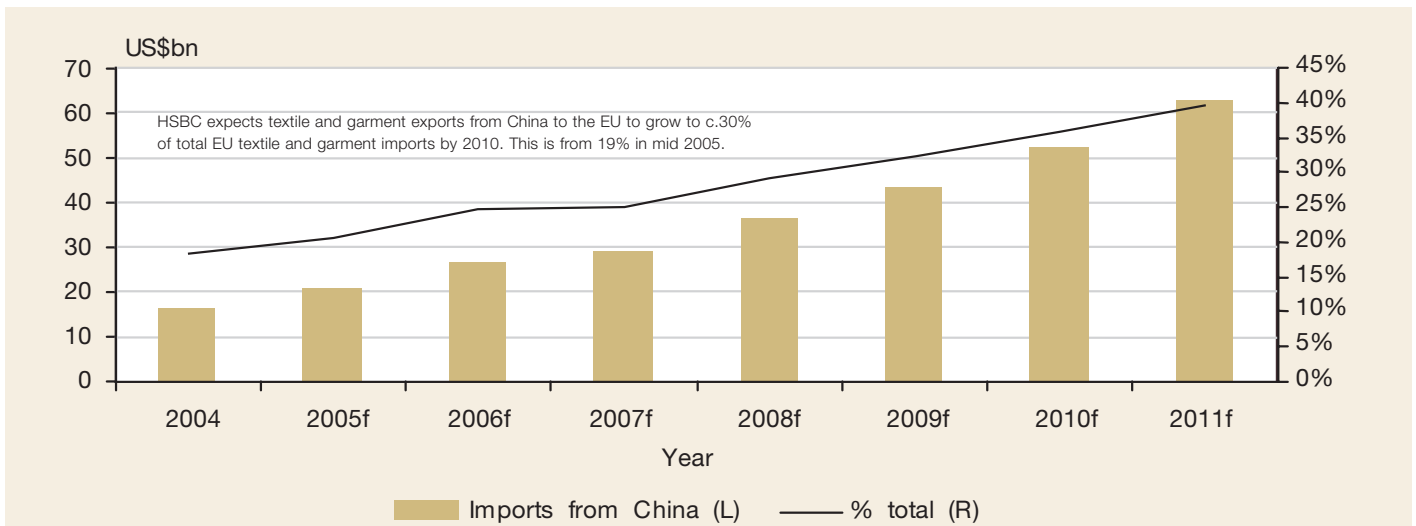
Source: Datastream March '06.

**Figure 2: US textile and garment imports from China.**



Source: HSBC ImportAsian Report, August 2005.

**Figure 3: EU textile and garment imports from China.**



Source: HSBC ImportAsian Report, August 2005.

## Buying practices

Large Western retail companies are attractive customers for suppliers in the developing world due to their tendency to make major purchases and provide a route to large consumer markets. Therefore, suppliers compete to secure major supply contracts.

Current buying practices of Western retailers can put pressure on suppliers. Companies must respond constantly to changes in the market. Consumer behaviour, social trends, new regulations and developing technology will all influence the demands placed on suppliers by retailers. Suppliers need to be able to respond quickly to large new orders. Other pressures suppliers face include:

- **Seasonality.** Consumers expect certain products all year round, for example, fresh produce. This places heavy demands on retailers to find the appropriate stock. The

clothing industry is experiencing shorter fashion seasons with some retailers planning up to twelve seasons per year rather than the traditional four. The effects of seasonal demand means that suppliers must be able to flex production throughout the year, in line with the requirements of the company.

- **Quality demands.** Companies report that customers are now tending to seek the lowest price without compromising product quality. Historically, consumers have been willing to pay more for higher quality.
- **Buying power.** If a company takes a high percentage of a supplier's output or controls the supplier's only route to market, the amount of influence it can have over a supplier can be substantial. This influence can be used when negotiating price reductions.

- **Drive for lower prices.** The downward drive in prices means that a key customer of a supplier could, at any time, decide to move production to a supplier with lower labour costs. This leads suppliers to continually seek ways to cut costs.

There is a potential link between buying pressures and unacceptable behaviour by suppliers. The need to produce goods quickly can lead to excessive working hours in an attempt to meet demand. Issues around flexibility and seasonality can affect a supplier's ability to provide secure and regular employment. The search for lower prices can mean manufacturers want to keep labour costs at a minimum. Cost pressures may also lead to a lack of investment in health and safety measures.

Factories in the developing world have faced widespread criticism in relation to alleged abuse of workers. Some of these criticisms in China include:

- Pay failing to meet the legal minimum requirement;
- Non-payment of overtime wages;
- Long hours over and above that specified by Chinese labour law;
- Discrimination against migrants from different areas of China;
- Poor occupational health and safety standards;
- Poor employee training;
- Physical and verbal abuse;
- Lack of access to trade unions.

Consequently, Chinese factories have been under pressure to improve labour standards. Surprisingly, China's labour law is more comprehensive than that of many members of OECD countries. However, an adequate system of implementation is yet to be developed. A table outlining some relevant articles of the Labour Laws of the People's Republic of China can be found in Appendix 1.

Beyond the government, other international agencies are also active in attempting to improve standards. The International Labour Organisation (ILO) is very active in China and is consistently working with the Ministry of Labour and Social Security, the All China Federation of Unions and the China Enterprise Confederation. The aim of the cooperation is to overcome the challenges in Chinese employment. The ILO continues to provide on-going technical consultation to China on dealing with employment issues.

## **The International Labour Organisation (ILO) Standards**

The ILO is a specialised agency of the United Nations, which seeks the promotion of social justice and internationally recognised human and labour rights. It was founded in 1919 and is the only surviving major creation of the Treaty of Versailles, which brought the League of Nations into being. The ILO became the first specialised agency of the United Nations in 1946.

The ILO formulates international labour standards in the form of conventions and recommendations that set minimum standards of basic labour rights. Some of these rights include: freedom of association, the right to organise, collective bargaining, abolition of forced labour, equality of opportunity and treatment, and other standards regulating conditions across the entire spectrum of work related issues. The ILO also provides technical assistance primarily in the fields of:

- vocational training and rehabilitation;
- working conditions;
- employment policy;
- management development;
- labour administration;
- cooperatives;
- labour law and industrial relations;
- social security;
- labour statistics and occupational safety and health.

The ILO promotes the development of independent employers' and workers' organisations and provides training and advisory services to those organisations. The agency uses a unique tripartite structure while working towards meeting the standards. This involves workers and employers participating as equal partners alongside the government.

By becoming a member of the ILO, a country is formally accepting the obligations of the constitution. Currently there are 178 member countries, including China. There are 184 conventions in total. China has ratified 24 conventions. Currently 21 are in force.

## Benefits of Responsible Sourcing

Many companies acknowledge that they have a responsibility to influence change in the working practices of their suppliers. Alongside protection of a company's brand and reputation, there are other advantages to be gained from responsible sourcing. These include:

- **An increased ability to attract and retain customers.** Allegations of human rights abuses in suppliers' factories can result in adverse publicity and consumer boycotts<sup>1</sup>. Polling data suggests that some customers will avoid products they associate with abusive labour practices or those that are produced in countries tainted with allegations of widespread human rights abuses. Establishing consumer confidence and trust in goods and services, which have been provided without compromising ethical and environmental issues, can help companies to attract and retain customers.
- **An ability to command a price premium for goods produced under fair-labour conditions.** Customers are increasingly using social and ethical criteria in purchasing decisions. There is evidence that consumers are showing support for retailers whose policies give better contract terms to producers from less developed countries. Consumers are willing to pay a premium in order to ensure workers are treated fairly. For example, Transfair USA states that imports of Fair Trade Certified coffee have grown an average of 72% per year since 1999.
- **An increased ability to attract capital.** Positive social performance can improve the ability of companies to attract capital from institutional investors.
- **Benefits from an improved macro environment.** As workplace standards improve, communities can become more stable and prosperous. This, in turn, can create a better base of operation for international business ventures.
- **Protection from liability and litigation risk.** Ensuring that business operations are consistent with human rights principles contained in national and international laws can help companies to avoid legal challenges to their global activities.
- **A reduction in the risk of trade sanctions.** The United States and the European Union have established trade sanctions for countries that are viewed as having widespread human rights violations. Companies can help to ensure that sanctions do not limit their ability to conduct business globally by promoting greater respect for human rights.
- **Enhanced worker productivity.** A growing body of literature links fair workplace practices to improved productivity<sup>2</sup>. One example is a three-year project recently undertaken by supply chain consultancy group, Impactt. Impactt worked with eleven purchasing companies and a group of their Chinese supplier factories. The project set out to understand and to tackle some of the factors that drive high levels of worker overtime in Chinese factories. By providing technical assistance on productivity, human resources management and improving internal communications, the project found that, over time, improvement is possible. Most of the factories achieved reductions in working hours, steady or increasing pay, and reduced worker turnover while productivity was increased<sup>2</sup>.
- **A reduction in operational risks.** Predictability is essential for stable and productive business operations. The denial of basic human rights can lead to social or political disruption. This in turn can cause labour strife, restricted access to goods and services, or delays in the movement of finished products.

<sup>1</sup> Sourcing Standards: Concerns for Investors, Amalgamated Bank et al, September 2004.

<sup>2</sup> Changing Over Time: Tackling supply chain labour issues through business practice; Impactt Limited, September 2005

## Responsible sourcing policies

Many major companies recognise that ethical risk management is an important part of brand management. Some companies are adopting responsible sourcing policies, which aim to meet recognised international labour standards. These can include:

- **Codes of conduct.** A code of conduct can provide a framework from which supply chain partners can begin to address ethical sourcing issues through a common set of principles. A code of conduct usually sets out what a company believes are acceptable minimum standards. A company can devise its own code or may implement one that has been developed by an external organisation, such as SA8000\* or a multi-stakeholder initiative such as the Ethical Trading initiative (ETI)\*. A company's expectations, as well as the repercussions associated with non-compliance, should be communicated to its suppliers.

### Areas typically included in the codes of conduct of companies include:

**Child labour:** Children should not be employed below the legal minimum age and appropriate steps should be put in place to remove children from employment and guide them towards education.

**Discrimination:** On recruitment, remuneration, promotion or training, employers should not discriminate on grounds of ethnicity, gender, caste and union membership.

**Freedom of association:** Workers should have the right to form and join trade unions and to bargain collectively.

**Regular employment:** As far as possible, employees should be given proper and recognised employment contracts. Employers should not try to avoid payment of social security, sick leave and maternity and other benefits through subcontracting or labour-only contracting arrangements.

**Treatment of workers:** There should be no physical, verbal or sexual abuse of workers.

**Wages:** Workers should be paid at least the national minimum wage in their country but preferably a wage that is adequate to sustain an acceptable standard of living. Workers should also receive a payslip and breakdown of their payment.

**Working conditions:** Working environments and materials should meet appropriate health and safety standards.

**Working hours:** Working hours should comply with national laws and should not be more than 48 hours per week plus a maximum of 12 hours overtime. Overtime should be voluntary and agreed in advance.

- **Training.** Employees involved in the buying process can be trained to ensure they are familiar with issues so they can identify any potential problems when establishing a relationship with a supplier. Training on implementation methods of acceptable practice should also be provided to factory managers.
- **Social audits.** Social auditing involves visiting a supplier's production facilities, interviewing management and workers and thereby assessing compliance with the code of conduct. External specialists are often hired to undertake social audits. Some companies may have their own specialist staff that will carry out the social audit procedure.
- **Plans for improvement.** If a supplier is found not to be in full compliance of a code of conduct, an improvement plan can be suggested. Ideally, the buying company works with the suppliers to help them achieve the required standards.
- **Reporting.** Placing supply chain policies and information regarding compliance into the public domain can satisfy stakeholder demands for increased transparency and communication. A consistently applied reporting process also allows a company to establish transparent monitoring and progress records, which can enhance accountability. There are many published guidelines for reporting standards. One example is the Global Reporting Initiative\*, which has specific guidelines for reporting on sustainability issues.
- **Collaborative action.** Collaborative action to improve working conditions is important to ensure that a company is not placed at a potential disadvantage if it acts alone. Improved compliance can mean that operating costs may increase. However, suppliers may be reluctant to take on any additional costs associated with complying to local laws, especially if their competitors do not adopt a similar policy.

Some suppliers are becoming aware that corporate responsibility and improved compliance with international standards could be harnessed as a competitive advantage. This can provide benefits to the supplier through increased production contracts and a motivated workforce.

\* For details of multistakeholders initiatives and guidelines of best practice for labour standards in the work place, see the glossary on page 18.

## **View from Newton's General Retailers analyst: Rosie Bichard**

When analysing retailers, we look at the supply chain as an integral part of their business model. Over the past few years, we have seen Western retailers' supply chains change dramatically as they have recognised the benefits available from sourcing an increasing proportion of their products from cheaper overseas markets. There are many different models adopted; some retailers order direct from factories in China; others use third parties to obtain the best combination of raw materials, assembly and finishing for their particular needs in different markets; and others still use their old suppliers but persuade them to move their factories overseas. In a weak dollar environment, even without strong demand growth, such moves have been highly accretive to retailers' gross margins, though some of the benefit has been passed through to consumers in the form of lower prices. However, there are significant associated risks that we must be aware of, including potential disruption of supply and reputational risks, which could negatively impact sales. Recent news has also indicated that the cost of production is rising in southern China, which is largely due to higher wage settlements. With certain groups seeking to relocate contracts to other areas, flexibility of a company's supply chain is key.

The challenges going forward for retailers will be the effective management of this extended supply chain and to continue to create value from the new sourcing arrangements. This could prove to be difficult given that many others will be trying to do the same thing. However, those that are able to take advantage of the opportunities offered by a global supply chain should outperform their peer group. We look to invest in retailers in this category. More broadly, we can also invest in companies that benefit from the globalisation trend, such as those providing sourcing and chain management solutions.

## **Company contact**

Newton, on behalf of its clients, contacted seven General Retailers in order to gain a better understanding of their respective policies for dealing with suppliers. The companies contacted were: **Body Shop International, DSG International, GUS, Hennes & Mauritz, Inditex, Marks & Spencer** and **Primark** (owned by Associated British Foods).

Disappointingly, and despite repeated requests, at the time this report went to press, Newton was awaiting replies from DSG International, GUS and Inditex.

The table overleaf is a summary of responses received so far.

# Engagement on Supply Chain Management

## Summary of responses

Company	Policy	Responsibility	Approval	Monitoring	Training
<b>Marks &amp; Spencer (M&amp;S)</b>	Global Sourcing Principles (GSP) outline requirements for compliance to local and national laws. The company aims to achieve supplier adherence to the ETI Base Code.	Technical teams develop and manage Quality Management Systems (QMS) through which buyers operate. Ethical trading requirements sit within the QMS and are the responsibility of the Head of Technology (Foods and General Merchandise).	Quality, ethical and financial reviews are undertaken prior to approval of any supplier. All new clothing suppliers, as a minimum, have to pass a 'critical issue' ethical assessment and commit to a timescale to meet the GSP's in full.	Supplier self-assessment audits, backed by a lesser number of M&S independent assessments.	Self-help guides in 11 different languages are distributed. Detailed briefing notes on the employment legislation of 60 countries have been published and distributed. One-day workshops are held with suppliers on requirements in a wide range of countries. Practical tuition on ethical auditing is also provided.
<b>The BodyShop International</b>	Aligned to ETI Base Code.	Chief Executive Officer	Suppliers are required to complete a Supplier Screening Questionnaire and sign the company's code of conduct for suppliers. Ingredient suppliers to The Body Shop are also required to sign an Against Animal Testing declaration annually.  Supplier questionnaires are risk-assessed by the Sourcing Team prior to business being placed with the supplier.  Factory evaluations against the code of conduct are carried out for all suppliers prior to the placement of orders. Where non-compliances are detected, the factory manager is required to commit to rectifying problems within an agreed time frame. A re-auditing process then takes place to verify that the changes have been made.  The Body Shop works with suppliers who are willing to make progress towards the company standards. Where suppliers fall short of the criteria, the company works with them to progress towards full compliance. Disengagement will only occur if suppliers fail to devote consistent effort and fail to improve their performance within a reasonable and agreed time frame.	The ethical performance of suppliers is tracked on a weekly basis. In addition, suppliers are tracked against the following key indicators on a monthly basis:  – On time delivery in full – Quality – Innovation – Ethical standards  In addition to ongoing dialogue, formal bi-annual reviews with suppliers provide an opportunity for mutual feedback. Communication and training on The Body Shop brand values and ethical standards are given to suppliers, agents, professional organisations and employees.	The ethical trade team provides all new suppliers in low and medium risk countries with an introduction to ethical trade standards. In 2006, training with suppliers in high-risk countries on appropriate remediation strategies is planned.
<b>Associated British Foods (in relation to Primark)</b>	The Primark code of conduct incorporates the United Nations Charter, Chapter IX, article 55 <sup>6</sup> .  All suppliers of products to Primark are asked to do so in accordance with this code of conduct.	Company Secretary	Buyers do an initial assessment of the factory operations. Auditors are used to assess compliance with Primark's code of conduct and local and national labour laws.  If either the buyer or auditor discovers any practices that do not comply with Primark's principles, they will go back to the supplier and express their wish for improvement to an acceptable level. An improvement programme is then developed and put into action.	Through use of an independent auditor and through buyer assessment, the company is able to monitor and assess the management and operations of its suppliers. A programme of improvement is developed if either the buyer or auditor find any issue that is deemed to be below industry standard or not compliant with company principles. The company states that it does not walk away from issues that may arise. Instead, it will seek improvements at the individual supplier. However, responsibility for specific supply codes and agreements rests with individual companies.	None
<b>Hennes &amp; Mauritz (H&amp;M)</b>	H&M's code of conduct is partly based on the UN Convention on the Rights of the Child and ILO conventions on working conditions and rights at work. The code includes requirements concerning:  – the working environment; – a ban on child labour; – fire safety; – working hours; – wages; – freedom of association.	Logistics Director	All H&M's suppliers have signed an agreement documenting their intention to abide by H&M's code of conduct. Not all suppliers meet every one of the requirements from the start but they must commit themselves to implementing the changes required to do so in order to be accepted as a longer term supplier. H&M employs full-time staff to carry out regular inspections of suppliers' premises to ensure that they and their subcontractors carry out the necessary improvements. The company also requires that suppliers disclose all the subcontractors that may be used for H&M production, so that they can ensure control over where clothes are produced.  In most violation cases, H&M will work with suppliers on a long-term basis to achieve a sustainable business relationship that can benefit both parties. When serious violations are encountered, the company would terminate a relationship. However, effort is made to terminate the relationship in a responsible manner in order to avoid sudden adverse effects for the workers.	H&M employs full-time staff to carry out regular audits of suppliers' premises. The company has a programme called the "Full Audit Programme (FAP)" which aims to detect compliance issues at an early stage by focusing on why things may be wrong, rather than what is wrong. The FAP allows a system of prioritising suppliers based on who the most important suppliers are and what sort of risk is associated with the country.  The company also employs quality controllers, who visit the factories daily to check the quality of the garments. Their tasks include reporting any breaches of the Code of Conduct that they spot. Controllers follow an inspection protocol containing over 100 points. They interview the company management, inspect all factory premises, check documentation such as payroll reports and time cards and when necessary also interview staff at the factories.	To help suppliers understand the requirements of the code of conduct, opportunities to participate in workshops on codes of conduct and how these are implemented are provided. These workshops are organised by an American organisation, BSR (Business for Social Responsibility), of which H&M is a member.  Sometimes H&M also organises its own workshops for suppliers on topics such as safety, local legislation, labour rights and human rights. The target groups are managers of suppliers and subcontractors.

6. Article 55 of the United Nations Charter states: "With a view to the creation of conditions of stability and well-being which are necessary for peaceful and friendly relations among nations based on respect for the principle of equal rights and self-determination of peoples, the United Nations shall promote:

a. higher standards of living, full employment, and conditions of economic and social progress and development;  
b. solutions on international economic, social, health, and related problems; and international cultural and educational cooperation; and  
c. universal respect for, and observance of, human rights and fundamental freedoms for all without distinction as to race, sex, language, or religion."

	Payment policy	Sourcing countries in 2005	Position in 2000	Initiatives	Technology	Auditors	Adherence to local laws
	Information not given.	UK & Europe 44%; Far East 39%; Indian Subcontinent 17%.	UK & Europe 77%; Far East 11%; Indian Subcontinent 12%.	Joined the ETI in 1999.  Participant in the Multi-Fibre Alliance Forum.	Licensed software to monitor location of merchandise in the supply chain at any point in time, is used.	A variety of assessment techniques for issues such as quality management, hygiene (foods) and social compliance are used. The frequency of audits for each issue reflects assessments of risk. In 2004, 958 assessments were carried out. Of these, 351 were conducted independently. A number of organisations are used, based on experience in specific regions of the world.	Individual country briefing notes detailing employment legislation of 60 countries are published and distributed to suppliers.
	The company has a policy with its principal suppliers to settle the terms of payment when agreeing the terms of each transaction.	China, UK, India, Germany, Korea, France, USA, Taiwan, Italy, Philippines, Japan, Switzerland, Indonesia, South Africa, Turkey, Belgium. Percentages not disclosed.	The number of suppliers based in China has increased since 2000.	Ethical Trading Initiative.  AA1000 Assurance Standard.  Business Leaders Initiative on Human Rights.	SAP Software is used to track the production flow of suppliers.	The Body Shop uses 4 audit bodies to assess its supply base.  – A core team of buyers are trained to do ethical audits – these focus on low risk countries usually with less than 25 workers.  – Eternal auditing services are engaged to undertake ethical audits in all low and medium risk countries.  – The external auditing company, Verite, is engaged to undertake audits of suppliers that The Body Shop works with directly in China.  – The Body Shop's main sourcing agent has an ethical audit team who undertake audits of suppliers engaged through them.  – In low risk countries – i.e. Western Europe and USA – suppliers are audited on a bi-annual basis. Medium and high risk suppliers are audited on an annual basis.	Several external auditing companies are used to assess compliance with local law and the ETI base code.
	Bills are settled promptly. ABF is a signatory to the Better Payment Practice Code.	All major garment producing countries. The company does not source from Myanmar (Burma).	Regional breakdown of supplier locations is constantly changing due to economic and "other" considerations. However, there has been no significant policy shift.	Better Payment Practice Code.  Membership of Ethical Trading Initiative is pending.	Not disclosed.	SGS, an independent company that offers inspection, verification, testing and certification services, is used by the company to perform independent audits.  The company does not disclose the actual number of audits that are undertaken. However, suppliers are audited on a rolling programme with as many as ten audits in progress at any one time.	Suppliers are contractually bound to the Primark code of conduct which specifically refers to local labour laws. Compliance is monitored by buyers and third party auditors (SGS).
	20 days after delivery at the service provider.	Asia ex China: 60% China: 30%  Remainder is mainly Europe with a limited volume coming from Africa and South America.  The company does not source from Myanmar (Burma).	Asia has increased by 10% since 2000.	No answer given.	Legacy systems are developed in-house.	In-house auditors are used. The company states that in 2004, over 2700 audits were undertaken. One third of all audits in Europe and Asia were unannounced. Approximately 70% of the company's auditors work in Asia.	In-house auditors are used.

## Glossary of best practice standards and multi-stakeholder initiatives

- **SA8000**

The SA8000 standard and verification system is a credible, comprehensive and efficient tool for assuring humane workplaces. It is based on the international workplace norms of the International Labour Organisation conventions, the United Nation's Universal Declaration of Human Rights and the Convention on Rights of the Child.

- **The Ethical Trading Initiative**

Founded in 1998, the Ethical Trading Initiative (ETI) is an alliance of businesses, non-governmental organisations and trade unions whose objective is to improve labour standards in supply chains. By signing up, companies agree to conform to high levels of labour standards, including the avoidance of child labour, forced labour, sweatshops, adverse health and safety conditions, and violations of labour rights.

- **Business Leaders' Initiative on Human Rights**

Established in May 2003, the Business Leaders' Initiative on Human Rights is a three-year programme to help lead and develop the corporate response to human rights. The founding members acknowledged that there are some roadblocks that businesses perceive when trying to operationalise human rights. The Initiative aims to help businesses overcome these through developing tools and signposting the work of others.

- **The Global Reporting Initiative**

The Global Reporting Initiative (GRI) is a multi-stakeholder process and an independent institution whose mission is to develop and disseminate globally applicable Sustainability Reporting Guidelines. These Guidelines are for voluntary use by organisations reporting on the economic, environmental, and social dimensions of their activities, products, and services. Started in 1997, GRI became independent in 2002. It is an official collaborating centre of the United Nations Environment Programme (UNEP) and works in cooperation with United Nations Global Compact.

- **The AA1000 Assurance Standard**

The AA1000 Assurance Standard was launched on March 25th 2003. AA1000 is a standard for the measuring and reporting of ethical behaviour in business. The standard effectively deals with qualitative and quantitative data, which highlights sustainability performance. The systems that underpin data and performance are also described. It is designed to complement the GRI Reporting Guidelines. The Standard covers the principles that define a robust and credible assurance process, the essential elements of a public assurance statement, and the independence, impartiality and competency requirements for assurance providers.

- **The OECD Guidelines for Multinational Enterprises**

The Guidelines aim to ensure that the operations of multinational enterprises are in harmony with government policies, strengthen the basis of mutual confidence between enterprises and the societies in which they operate, help improve the foreign investment climate and enhance the contribution to sustainable development made by multinational enterprises. The guidelines provide voluntary principles and standards for responsible business conduct consistent with applicable laws.

## Appendix 1

Table outlining the main features of the Labour Law of the People's Republic of China<sup>4</sup>.

Employment Issues	Description
<b>Working Hours, Rest and Vacations</b>	<p><b>Article 36:</b> Labourers shall work for an average of no more than 8 hours a day and no more than 44 hours a week.</p> <p><b>Article 38:</b> Employers shall guarantee that staff and workers have at least one day off in week.</p> <p><b>Article 41:</b> Employers may extend working hours due to requirements of production or business after consultation with the trade union and labourers. The extended working time shall generally not exceed one hour each day; if such extension is called for due to special reasons, the extended hours shall not exceed three hours a day under the condition that the health of labourers is guaranteed. However, the total extension in a month shall not exceed thirty-six hours.</p> <p><b>Article 44:</b> Employers shall pay labourers remunerations higher than those for normal working hours under any of the following circumstances:</p> <ul style="list-style-type: none"> <li>– Pay no less than 150% of normal wages if the extension of working hours is arranged;</li> <li>– Pay no less than 200% of normal wages if the extended hours are arranged on days of rest and no deferred rest can be taken; and</li> <li>– Pay no less than 300% of normal wages if the extended hours are arranged on statutory holidays.</li> </ul> <p>The State shall practice a system of annual vacation with pay. Labourers who have kept working for one year and more shall be entitled to annual vacation with pay.</p>
<b>Wages</b>	<p><b>Article 48:</b> The State shall implement a system of guaranteed minimum wages. Specific standards on minimum wages shall be determined by the provincial governments, autonomous regions or municipalities directly under the Central Government and reported to the State Council for the record. Wages paid to labourers by the employer shall not be lower than the local standards on minimum wages.</p> <p><b>Article 51:</b> Employers shall pay wages according to law to labourers who observe statutory holidays, take leave during the periods of marriage or funeral, or participate in social activities in accordance with the law.</p>
<b>Occupational Health &amp; Safety</b>	<p><b>Article 52:</b> Employers must establish and perfect the system for occupational safety and health, strictly implement the rules and standards of the State on occupational safety and health, educate labourers on occupational safety and health, prevent accidents in the process of work, and reduce occupational hazards.</p> <p><b>Article 54:</b> Employers must provide labourers with occupational safety and health conditions conforming to the provisions of the State and necessary articles of labour protection, and providing regular health examination for labourers engaged in work with occupational hazards.</p> <p><b>Article 57:</b> Labourers that are to be engaged in specialised operations must receive specialised training and acquire qualifications for such special operations.</p>
<b>Special Protection for Female and Juvenile Workers</b>	<p><b>Article 58:</b> The State shall provide female workers and juvenile workers with special protection. “Juvenile workers” hereby refer to labourers at the age of 16 but not 18 yet.</p> <p><b>Article 62:</b> After childbirth, female workers shall be entitled to no less than ninety days of maternity leaves with pay</p> <p><b>Article 64:</b> No juvenile workers shall be arranged to engage in work down the pit of mines, work that is poisonous or harmful, work with Grade IV physical labour intensity as stipulated by the State, or other work that they should avoid.</p>

4. Information taken directly from [www.acftu.org.cn/labourlaw.htm](http://www.acftu.org.cn/labourlaw.htm), accessed March 2006. For the law in its entirety, please see the web site.

Employment Issues	Description
<b>Vocational Training</b>	<b>Article 66:</b> The State shall take various measures through various channels to expand vocational training undertakings so as to develop professional skills of labourers, improve their qualities, and raise their employment capability and work ability.
<b>Social Insurance and Welfare</b>	<p><b>Article 73:</b> Labourers shall, in accordance with the law, enjoy social insurance benefits under the following circumstances:</p> <ul style="list-style-type: none"> <li>– Retirement;</li> <li>– Illness or injury;</li> <li>– Disability caused by work-related injury or occupational disease;</li> <li>– Unemployment; and</li> <li>– Child-bearing.</li> </ul> <p>The survivors of the insured labourers shall be entitled to subsidies for survivors in accordance with the law. The conditions and standards for labourers to enjoy social insurance benefits shall be stipulated by laws, rules and regulations. The social insurance amount that labourers are entitled to, must be timely and paid in full.</p>
<b>Labour Disputes</b>	<b>Article 77:</b> Where a labour dispute between the employing unit and labourers takes place, the parties concerned may apply for mediation or arbitration or take legal proceedings according to law, or may seek for a settlement through consultation. The principle of mediation shall apply to the procedures of arbitration and lawsuit.
<b>Supervision and Inspection</b>	<b>Article 88:</b> Trade unions at various levels shall, in accordance with the law, safeguard the legitimate rights and interests of labourers, and supervise the implementation of laws, rules and regulations on labour by the employing units.
<b>Legal Responsibility</b>	<b>Article 89:</b> Where the rules and regulations on labour formulated by the employing unit run counter to the provisions of laws, rules and regulations, the labour administrative department shall give a warning to the unit, order it to make corrections; where any harms have been caused to labourers, the unit shall be liable for compensations.

There are also additional provisions covering specific situations, such as labour relations in Chinese-foreign joint ventures.

The law was implemented in 1995.

## Conclusion

Responsible management of a company's supply chain is a key area of interest for shareholders. Some companies have already implemented programmes to improve working conditions for contract manufacturers in their supply chain. Though these are steps in the right direction, the problem has by no means disappeared and much improvement is still needed. Companies must continue to work with suppliers, encourage change, monitor progress, train management and devise methods of improvement that respect different cultures.

Next quarter's SRI report will continue on the supply chain theme.

# SRI Activity

Please note that this activity log shows examples of SRI engagement over the quarter. It is not an exhaustive list of all engagement. A complete list of how Newton voted on securities during the period is available upon request

## Royal Dutch Shell

### **Subject: Ongoing tensions in Nigeria** **January 2006**

Following on from previous discussions with Royal Dutch Shell (RDS) relating to its operations in Nigeria, Newton contacted the company to gain a better understanding of the more recent upheavals in the region. In January, tension in Nigeria's Western Delta caused RDS to close and evacuate four of its flow stations. With elections scheduled in 2007, Newton expressed concern that a prolonged environment of high political tension could develop, potentially impacting operations of the company. RDS stated that it monitors the situation in the Western Delta on a day-to-day basis. The evacuation of the flow stations was in line with the company's safety procedures, where, in the event of danger, the first priority of the company is to protect its staff.

Previously, it has been the responsibility of the oil companies to provide security for assets. However, the State and Federal Governments are now taking on this responsibility, though they have, on occasion, sought logistical support from the oil operators. This is a positive development and shows increasing commitment from the government to tackle issues faced in Nigeria. The recent incidents are not impacting initiatives to encourage transparency of oil and gas revenues paid to and received by the government. RDS is helping to drive improvements in transparency by publicly disclosing information on oil revenues paid to the government. RDS remains committed to its operations in Nigeria.

## Novozymes

### **Subject: Company update** **January 2006**

Novozymes specialises in micro-organisms and enzymes, some of which are used in the production of bioethanol. With demand for bioethanol increasing, large-scale commercialisation of technology will be needed to convert biomass to ethanol. Novozymes announced, in early November, that it is launching three new enzymes, which make the production of ethanol from wheat, rye and barley up to 20% more efficient. Management of the company came into Newton to discuss, among other matters, the development of the bioethanol market. The company is seeing significant growth in demand for enzymes that are used in the ethanol conversion process. This is particularly felt in the United States and, increasingly, in China. Tax incentives in the US and in some parts of the EU are also supporting progress of the industry. Novozymes is strategically positioned to support and benefit from development of the bioethanol industry.

## Biofuels Corporation

### **Subject: Company update** **March 2006**

Biofuels Corporation is a UK listed company that is positioning itself to become a large-scale producer of biodiesel. Construction of the company's first biodiesel production plant was completed and put into operation in February this year. The company's management came into Newton to discuss developments of the global biodiesel market. A key concern from a socially responsible investment perspective is the sourcing of biofuel feedstocks. Amongst other matters, the meeting provided an opportunity to discuss the company's sourcing procedures. The company's biodiesel is produced in accordance with the biodiesel production standards EN590 and EN14214. The company uses a mix of feedstocks including rapeseed, soybean and palm oil for its biodiesel production. Rapeseed is sourced from the EU and UK, soybean from Latin America and palm oil from Malaysia and Indonesia. Currently, there are sustainability concerns surrounding the operations of Malaysian and Indonesian suppliers of palm oil. Biofuels Corporation's purchasing strategy is to source from established and highly reputable producers and traders. The company is a member of the Roundtable on Sustainable Palm Oil, which promotes the sustainable growth and use of palm oil. There are currently no sustainability guidelines for the palm oil industry. However, the company is involved in discussions to develop standards, accreditation and approval processes.

## Chemring

### **Subject: Disclosure of social, ethical and environmental considerations** **March 2006**

Newton contacted Chemring to discuss its reporting on social, ethical and environmental (SEE) considerations, which Newton felt was limited. The company stated it was planning to report on SEE considerations in line with the proposed guidelines for the Operating and Financial Review (OFR). However, with the abolition of the OFR at the end of last year, the company is reviewing its approach to SEE reporting. The 2005 accounts have just been published. Therefore, any reporting is not expected until the 2006 annual report and accounts are published. The company did state that SEE reporting is on its agenda for discussion at the next Board meeting. As an indication of what can be expected, the company has selected some relevant key performance indicators in alignment with the DEFRA voluntary environmental reporting guidelines. It plans to report on these in 2006. Newton outlined its approach to the monitoring and recording of disclosure levels on SEE matters and how this approach is translated into the exercise of voting rights on behalf of Newton's clients.

## MyTravel

### **Subject: Disclosure of social, ethical and environmental considerations**

#### **March 2006**

Newton contacted the company to discuss current reporting on SEE matters. The company stated it was aware that disclosure was not at best practice levels. The company has been looking at ways to improve this. However, final decisions on how to make progress in this area have not yet been made. Newton outlined its approach to the monitoring and recording of disclosure levels on SEE matters and how this approach is translated into the exercise of voting rights on behalf of Newton's clients. MyTravel said it would get back to Newton on this subject when more information was available. At the time of going to print, the company had yet to respond.

## BP

### **Subject: Company update**

#### **March 2006**

The company came into Newton to discuss the fundamentals of its business. In particular, Newton was interested in how the company is positioning itself in an environment of tightening oil supply. Discussions were also had in relation to the Prudhoe Bay oil spill, which occurred in early March. The cause of the spill was a small hole in an internal pipe in an in-field flow line. The pipeline is inspected frequently, which meant that only c.1,000 barrels of oil escaped. Due to the leak occurring in the winter season, temperatures were, on average, around -30 degrees centigrade. Therefore, the oil did not soak into the tundra. This meant that all the oil was recovered with minimal environmental damage. When asked what the company is doing to prevent such an incident recurring, the company stated that a full programme of inspection has been implemented across all wells in Alaska. New techniques to detect small holes are also being implemented.

## PetroChina

### **Subject: Company update**

#### **March 2006**

PetroChina is a Chinese oil and gas producing company. Its management came into Newton to discuss the recent strong results and plans for the future. PetroChina owns the chemical factory where an explosion, in November last year, caused a serious spill of benzene and nitrobenzene into the Songhua River in China. Newton took the opportunity to ask the management about plans to improve the company's health, safety and environmental (HS&E) record. The company stated that it places great emphasis on HS&E performance. Since the accident, the company has strengthened its internal HS&E systems by providing training for staff and further consolidating its emergency plans. The company is increasing investment in the management of HS&E procedures to ensure that all facilities have safety standards that satisfy government standards on pollution emissions. Final liabilities of the spill are still unknown as the Chinese government has yet to release its findings report. Therefore, there are still many unanswered questions surrounding this issue. Newton asked who is ultimately responsible for HS&E performance within PetroChina. The company explained it has a multi-tier approach with internal managers responsible for HS&E performance, while the company's Vice President is responsible for HS&E performance overall. Each business segment has a safety officer and all subsidiaries have safety measures which they must adhere to. A HS&E department oversees the implementation and functioning of all HS&E policies. Newton will continue to monitor the HS&E performance of the company as improvement in this area is needed.

## Attendance at corporate responsibility updates

### **Subject: Investor updates**

Over the quarter, Newton attended investor updates on corporate responsibility for Zurich Financial Services, Credit Suisse, UBS, Swiss Re, Roche, Ciba Specialty Chemical, Syngenta, and Ericsson.

# Company Meeting Log: Q1 2006

During the quarter, Newton analysts and fund managers had individual meetings with the management of 310 companies to initiate or maintain dialogue around financial performance and/or responsible investment matters. The insights gained through this engagement are used when making investment decisions. Meeting were held with the following companies:

Abbot	Davis Service Group	KPN	Samsung
ABN Amro	DBS	Krung Thai Bank	Samsung Electro-Mechanics
Acciona	DCA	KT & G	Samsung Electronics
Acorda Therapeutics	Dealogic	Liberty International	Samsung Fire & Marine
Actelion	Dechra Pharmaceuticals	Lite-On Technology	Schlumberger
Admiral	Deutsche Boerse	London Capital	Schneider Electric
Advan	Deutsche Wohnen	Lonza	Scott Wilson
Advanced Medical Solutions	Diageo	Lotte Shopping	Scottish Power
Agnico-Eagle Mines	Diagnosticos da America	Lucent	Sekisui Chemical
Air Liquide	DiC Entertainment	Media Acquisition	Serco
Alcatel	Digital Music	Macarthur Coal	Shin-Etsu Polymer
Alcon	Dignity	Macquarie Bank	Shiseido
Alfred McAlpine	DNO	Macquarie Korea Infrastructure Fund	SHL
Allco REIT	Dow Chemical	Mapletree Logistics	Siam Commercial
Alliance Unichem	Drax	March Networks	SK Corp
Alphameric	DSG International	Mears	SK Telecom
Altek	Dyno Nobel x 2	Medtronic	SkyePharma
Amdocs	EFG Eurobank	Melrose	Slough Estates
AMP	Electric Word	Minerva	Smartrac
Arthro Kinetics	Eli Lilly	Misawa Homes	Smith & Nephew
AstraZeneca	Enel	Misys	Smiths Group
AXA	ENI	Mitac International	Southern Energy
Axa Asia Pacific	Enterprise	Mitsubishi UFJ Financial	Speedel
BAE Systems	Enterprise Inns	Mizuno	ST Engineering
Baker Hughes	Esprit	Mobile Streams	St James's Place
Bank of Ayudhya	Excapsa Software	Morson International	St.Mary Land & Exploration
Bangkok Bank	Excel Coal x 2	MTN	Stada Arzneimittel
Banyan Tree	Exelon	Myogen	Stadium
Barclays	Falabella	MyTravel	Standard Chartered
BBA	Falconbridge	National Express	Stanley Works
Beazer Homes	Fidex	National Finance	Stolt Offshore x 2
Beckman Coulter	First Gen	National Semiconductor	Submarino
Benesse	FKI	Natura	Sybase
Bespak	Foxconn Technology	NCC	TAM
BHP Billiton	Fraport	NetServices	Technip
Biofuels Corporation	Geophysique	Newfield Exploration	Ted Baker
Block Shield	GKN	Nidec	Tektronix
Body Shop International	GlaxoSmithKline x 2	Nippon System Development	Telecom Egypt
Boots x 2	Golden Eagle	Nipson Digital Printing	Ternium
BP	Grainger Trust	Noble	Terumo
Bradford & Bingley	Greencore	Norsk Hydro	Tipp24
British American Tobacco	Grupo Modelo	Novo Nordisk	Tokai Carbon
Brixton	GUS	Novozymes	Tomkins
Bunzl	H.I.S	NS Solutions	Toshiba Plant Systems & Services
Cable & Wireless x 2	Hanson	OCBC Bank	Total
Cairn Energy	High Tech Computer x 2	Oilexco	Trinity Mirror
Cal Dive	Hitachi Chemical	Ovum	True Corp
Cambridge Silicon Radio	Hitachi Maxwell	Paladin Resources	Ubiquity Software
Capita	Homex	Pearson x 2	Ulster TV
Carclo	Honeywell	Pennon	Ultra Electronics
Carillion	HSBC	PetroChina	UMC Electronics
Carlsberg	Huneeed Technologies	Pfizer	Unilever
Carnival	Huntleigh Technology	POSCO	Unimicon Technology
CBD	Hyder Consulting	Praktiker	United Arrows
Cello	ICM Computer	Prelude Trust	UOB Kay Hian
CEMEX	IMI	Premier Farnell	Ushio
Central Pattana	Imperial Chemical Industries	Premier Foods	Veolia Environnement
Centrica	Incisive Media	Premier Research	Verbund
Centurion Energy	Infoma	Procter & Gamble	Vodafone
Chemring	Ingenious Media	Provident Financial	Vongroup
Cheung Kong Infrastructure	Inovio Biomedical	Prudential	Wal Mart de Mexico
China LotSynergy	Interserve	Psion	Weir Group
Cimarex Energy	Intertek	QinetiQ	Wellington Underwriting
Cisco	Intesa	Radstone	Wesfarmers
Clapham House	Investcom	Raffles Medical	Wilson Bowden
Clerkenwell Ventures	Irish Life & Permanent	Reckitt Benckiser	Wistron
Cobham	Isotron	Renishaw	Wolters Kluwer
Cohort	Investcom	Repsol	Wood Group
Colgate-Palmolive	Iwatani International	Reuters	Woodside Petroleum
Constellation Brands	JGC	Rexam	Woongjin Coway
Cooper Cos	John Laing	Ricardo	Wyeth
Covanta	Kalbe Farma	Rightmove	Xaar
CRC Solutions	Kangwon Land	Roc Oil	Zeon
CRH	Kasikornbank	Roche	Zurich Financial Services
Croda	Kingdom Hotel Investments	Rotork x 2	
Cyberlink	Kookmin Bank	Royal Dutch Shell	

In addition, the analysts and fund managers attended a large variety of external meetings arranged by the companies or by brokers and other research providers.

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