

# CSR Failures in Bangladeshi Apparel Industry: An Agency Theory Perspective

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**Abstract:** The apparel industry's complex global supply chain makes it difficult to monitor the upstream firms' Corporate Social Responsibility (CSR) practices. However, CSR failure in any stage of the supply chain also damages the downstream fashion brands' reputation and profitability. In recent years, customers' sensitivity towards environmental, social, and worker safety has strikingly increased, which holds fashion brands responsible for CSR failures, although they do not have complete control over overseas manufacturing firms. Several cases of apparel industry CSR failures in Bangladesh attracted global attention in the last decade. This study explores why CSR practices in the fashion industry's global supply chain are susceptible to implementation failures, particularly in the Bangladeshi apparel industry, and how they could be mitigated. Agency theory deals with the issues related to principal-agent conflicts arising from information asymmetry. So, agency theory helps understand the CSR implementation problem and possible solutions. The findings from the cases this study went through explain that CSR failures in the supply chain negatively affect the reputation of the fashion brands because consumers want to know more about the supply chain, where the products they are purchasing are coming from, who produces, and how; and they value the corporate social responsibly (CSR) practices in the manufacturing stage. Therefore, implementing a good and sustainable CSR policy is a major concern of retailers. Information asymmetry and goal conflicts among the contracting parties (Principal and agent) lead to adverse selection, moral hazard, and hold-up problems in maintaining a standard CSR practice. This study delves into these issues through the lens of agency theory and shows that agency theory instruments are suitable to explain the apparel industry's global supply chain relationships and compliance mechanisms and figure out the possible implications. Therefore, agency theory can help

mitigate the CSR failures of Bangladesh's Ready-Made Garments (RMG) industry.

**Keywords:** Agency Theory, Corporate Social Responsibility, Apparel Industry, Supply Chain Management, Ready-made Garments, Fashion Brands, Bangladesh, RMG sector, Rana Plaza, Tazreen Fashion

## 1. Introduction

Throughout the last few decades, The idea of corporate social responsibility (CSR) has received huge global attention [1,2]; the garment manufacturing industry is not an exception [3]. CSR is an ethical standard for businesses to be responsible and concerned for the welfare of society and the environment beyond legal responsibilities[4]. It has complex ramifications and varies from industry to industry. Ref. [5] developed five dimensions of CSR, such as social, environmental, stakeholder, economic, and voluntary, through a content analysis of different construction of CSR definitions. It can be categorized into two broad segments- human responsibility and environmental responsibility. Human responsibility includes the firm's responsibility toward its stakeholders associated with it, such as employees, customers, investors, suppliers, etc., so that all stakeholder's interests are protected. It focuses on discussing a conducive work environment, safety & security, workers' welfare & benefits, minimum wage to maintain a decent life, etc.

On the other hand, environmental responsibility includes environmental protection, waste management, etc. However, the concept of CSR

varies from context to context, industry to industry, and even with geographic location. Due to the nature of the apparel industry's global supply chains, standard CSR practices are complex in many ways. A supply chain is defined as a direct link between two or more upstream and downstream companies for the production flow [6]. Transparency in every stage of the supply chain is essential for good CSR practice [7]. The apparel industry's global supply chains of top fashion brands have some distinctive features that make it challenging for them to implement or at least monitor CSR practices in the upstream firms. Due to high labor costs and environmental protection laws in US and European countries, top EU and US fashion brands outsource their product from developing countries instead of manufacturing them in the US or Europe. Flight of manufacturing jobs travels from the west to developing countries [8]. The fashion industry's appetite for cheap products pushes developing countries into a high level of competition that leads to labor exploitation and environmental misery. This nature of distant production makes it challenging to ensure CSR (especially work environment and labor safety) by the downstream company (fashion brands); voluntary commitment is not always implemented. In addition, it is not legally mandated. That is why not every fashion brand is taking enough initiative to improve the Transparency of CSR compliance in their global supply chain and, in some cases, is unwilling to spend money and effort here.

However, clothing brands face internal and external pressure in realizing their responsibility of maintaining labor rights and the welfare of the environment and society. Internal pressure comes from their self-realization of responsibility towards society. Moreover, CSR has become a powerful tool for establishing brand reputation [9]. Studies showed that CSR positively affects a firm's market valuation [10]. Good CSR practice and supply chain management heighten customer satisfaction and loyalty and even help companies recover customers when service fails [11,12]. The external pressures come from the customer side. In recent years, the customers' sensitivity towards environmental, social, and worker safety issues has been augmented. Consumers want to know more about the supply chain, where the products they are purchasing are

coming from, who produces and how, and they value the company's CSR practice in the upstream supply chain<sup>[13,14]</sup>. Consumers' demand for transparency puts pressure on companies to disclose supply chain information. Consequently, retail fashion giants set up some codes of conduct to direct customers' concerns and prevent any harm to brand reputation<sup>[15]</sup> beyond their traditional order-winning criteria of lead time, capacity, price, quality, or other technical requirements.

Three cases of consumer reactions to CSR failure:

1. Clean Clothes Campaign<sup>1</sup>: It is a global network working to enhance the clothing industry working conditions and empower workers. It was founded in the Netherlands in 1989 and is now working in over 45 countries, collaborating with more than 200 organizations. It started working for garment workers' rights when the clothing industry started looking for cheaper production options and moving their production into developing countries. The campaign includes the issues such as providing workers a living wage and influencing consumers to boycott brands that do not follow a standard CSR.
2. Australian Fair Wear Campaign<sup>2</sup>: This campaign has been working to end the exploitation in the supply chain for home-based clothing workers in Australia since 1996. Fair Wear engages churches, community members, and NGOs to encourage fashion brands to ensure a transparent supply chain and improve the recognition of home-based workers<sup>[16]</sup>.
3. #PayUp movement<sup>3</sup>: Recently, during the COVID-19 pandemic, when many retailers were canceling their orders, leaving a situation of starvation for millions of garment workers, a nonprofit organization named Remake that works to change the

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<sup>1</sup> <https://cleanclothes.org/>

<sup>2</sup> <https://www.fairwear.org/>

<sup>3</sup> <https://payupfashion.com/>

fashion industry's harmful practices started a global #PayUp movement with the slogan "our clothes should not cost human lives." Organizers of the movement demand reforming seven labor rights goals: pay up, safe work environment, transparent supply chain, end starvation wages, pass a law against CSR violation, etc. This movement successfully unlocked \$15 billion of lost wages of poor workers during the COVID-19 pandemic<sup>4</sup>.

Workers are the most vulnerable and exploited stakeholders in the supply chain of the clothing industry. That is why CSR issues are getting more attention nowadays. CSR failure at any level of the supply chain affects the downstream firm's reputation and profitability negatively<sup>[17]</sup>. Since monitoring the upstream firm is expensive and there is asymmetric information among the supply chain partners, any severe hazardous event like the Tazreen fashion fire or Rana Plaza collapse that took thousands of workers' lives becomes an issue of public sentiment. Vertical integration of all the firms in the supply chain might be an efficient solution for a socially responsible CSR<sup>[18]</sup>, but not feasible in many cases. Some studies even suggest that CSR is not enough to address all the social responsibility in this era of critical supply chain systems; instead recommend a new approach to Supply Chain Responsibility (SCR)<sup>[19]</sup>. However, CSR in the clothing industry is becoming more structured day by day. It now focuses on protecting workers, the welfare of women workers, ethical remuneration and benefits, hazardous work environments, etc. The California Transparency in Supply Chains Act (CTSCA) 2010 requires annual disclosure of the firm's efforts in eliminating modern-day slavery and human trafficking from the supply chain<sup>[20]</sup>.

## 2. Background: The clothing industry in Bangladesh and CSR failures

The clothing industry (Ready-made Garments) has contributed significantly to the economic development of Bangladesh for the last three to four

decades. Being a labor-abundant country with seasonal unemployment<sup>[21,22]</sup>, it utilized surplus labor for this export-oriented labor-intensive industry and realized a huge success. Bangladesh's share of the world's ready-made garment export is about 6.4% which is second to China's share of 36%, and export earnings of Bangladesh are increasing every year. It creates a vast employment opportunity for low-skilled workers, particularly women. Over four million workers are employed in the apparel industry, with more than 60% women. It has a significant contribution to women's empowerment in terms of freedom of choice, participation in household decision-making, access to resources, and coping skill to shocks<sup>[23]</sup>. About 84% of the total export earnings of Bangladesh come from the RMG sectors. In 2019, the total value of export earnings was \$34.13 billion, which is about 12% of Bangladesh's Gross Domestic Product (GDP). RMG export earnings significantly contributed to GDP growth and employment in the last four decades, byproduct benefits of trade with developed countries<sup>[24]</sup>. 84% of the Bangladeshi apparel industry export destinations in the USA or the European Union. 95% of the export destinations are six developed countries, including Canada, Australia, Japan, and Turkey. The top US and European fashion brands which import from Bangladesh are H&M, Walmart, C&A, Zara, GAP, Target, TESCO, Carrefour, Levi's, JCPenny, etc. Bangladesh could attract top fashion brands because of their cheap labor, and negligence in maintaining a standard CSR practice. The minimum monthly wage for a worker was \$69<sup>5</sup> only till 2018 in Bangladesh, and it recently adjusted to \$96, which is the lowest monthly wage in the world<sup>6</sup>. Workers are being exploited in terms of low wages & benefits and forced to work in hazardous working conditions for long hours.

On November 24, 2012, 122 people died due to a fatal fire in a Bangladeshi garment factory named Tazreen Fashions, a supply chain for EU and US fashion brands. This incident attracted global

<sup>4</sup> <https://www.vogue.com/article/remake-payup-campaign-social-media-garment-workers-wages-gap>

<sup>5</sup> <https://thefinancialexpress.com.bd/views/rmg-sector-minimum-wage-conundrum-1532534075>

<sup>6</sup> <https://www.openaccessgovernment.org/bangladeshi-garment-workers/89939/>

attention to how hazardous Bangladeshi garment factories are for workers. The role of CSR and government came into discussion locally and globally on how factories can ensure a safe workstation for their employees<sup>[25]</sup>. The necessity of collaboration among all the stakeholders, such as the government, EU and US retailers, suppliers, labor unions, and NGOs, was discussed to create safe working conditions for workers. After a few months after the Tazreen fashion fire, on April 24, 2013, the world witnessed the deadliest garment-factory disaster in global history that killed 1138 workers and injured around 3000 more. The collapse of the eight-storied Rana Plaza building was caused because of the owner's negligence, the poorly built complex, ignoring safety measures, and overcrowded factories. It became the symbol of global inequality; how poor workers are dying to feed the giant companies' desire for cheap clothing.

After the Rana Plaza collapse, many criticisms came from global civil society, consumers, and NGOs. As a result, CSR policies drastically change to create the safest workstation for workers. On May 15, 2013, the five-year legally binding contract 'the Accord on Fire and Building Safety, was signed. It is a Global Framework Agreement among European fashion brands, retailers, and trade unions to create a safe workplace for Bangladeshi garment workers. The Alliance for Bangladesh Worker Safety was designed by the majority of the North American ready-made garment importer from Bangladesh. The Accord and Alliance have taken charge of testing the fire and electric safety, workplace practices, and other structural safety issues of the factory and training workers about their rights and safety policies. Many garment factories also took different self-initiative under CSR, prioritizing workers' safety<sup>[26]</sup>. Although the CSR issue receives lots of attention and is a growing practice in the apparel industry, there are still cases of CSR failure. It is reported that several fire incidents happened in different garment factories in recent years, too; workers' wages and benefits are still so poor. Ref.<sup>[27]</sup> explained that it is still at the very nascent stage in the apparel industries of Bangladesh, with no comprehensive regulations, poor & hazardous working condition, and poor wages & benefits. They recommend all the stakeholders act from their position, including US and EU buyers;

every stakeholder has some responsibility to establish a better working environment. Poor workers live a most vulnerable life and still dying to feed the world's desire for low-cost clothing.

Hundreds of literature tried to address the CSR policies in the apparel industry. Studies covered issues related to CSR like strengths, weaknesses, barriers, threats, possible areas of improvement of CSR, the necessity of coordination, and challenges of implementing CSR in a complex set of the global supply chain. Ref.<sup>[15]</sup> claims that although CSR successfully prevents child labor but very little success in labor rights. Ref.<sup>[28]</sup> analyzed how CSR policies in Bangladesh entered into a new paradigm after the tragic incident of Rana Plaza. They explained how policies designed generally for the US might also help explain regulations at the international level in the absence of a robust and central state and in the midst of powerful countervailing forces. Ref.<sup>[29]</sup> studied the factors that determine CSR disclosure in the Bangladeshi apparel industry. They found a positive relation between CSR disclosure and firm size but a negative relationship between family ownership. Another study shows that Bangladesh's clothing industry CSR practices are moderate for large suppliers, whereas it is not impressive in small & medium firms<sup>[30]</sup>. Ref.<sup>[26]</sup> studied how the standard practice of CSR in the RMG sector of Bangladesh would contribute to sustainable development by increasing the reputation of retailers and customers. Ref.<sup>[27]</sup> investigated the current CSR practices in the apparel industries of India, China, and Bangladesh. Based on their findings of poor working conditions and no comprehensive regulations, they emphasize collaboration among all the stakeholders to improve the current conditions.

Ref.<sup>[31]</sup> investigated how CSR is practiced in the apparel industry and the motivation behind CSR. This study argues that as a labor-intensive industry, the apparel sector has to care about the safety, security, and health of the workers in the company and their supply chains. It is also essential to handle waste efficiently to protect the environment. However, no studies analyzed the CSR failure issue from an agency theory perspective. This paper examines how the principal (the downstream fashion

brands) and agent (the downstream supply chain) interact in determining CSR and avoiding CSR failures. This study investigates the CSR failure in the global supply chain of the apparel industry through the lens of agency theory. It also evaluates how asymmetric information and opportunistic behavior may lead to CSR failure.

### 3. Application of Agency Theory

CSR failures in the apparel industry reveal that the principal-agent relationship may explain it since many characteristics of CSR failure are similar to the principal-agent perspective. Agency theory is an economic principle that deals with the relationship between the principal and agent, where the principal delegates work to an agent [32]. The conflicting interest between the principal and agent and information asymmetry creates the avenue of incomplete contracts because both parties want to maximize their self-interest [33]. Agency theory aims to solve disputes between parties by facilitating the most-efficient contract [34]. If a principal does not have enough information before finalizing the contract, this asymmetric information may lead to an adverse selection. Studies showed that spatial distance enhances the problem of asymmetric information [35,36]. Pre-contractual hold-up problems may arise if the principal has already invested in the relationship and depends on the agent fulfilling the contract but the agent shows opportunistic behavior [37]. The unobservability of an agent's performance may create hidden action and moral hazard problems [33]. The upstream manufacturing firm is the agent in the apparel industry supply chain, and the downstream fashion brands are the principal. CSR failures in this industry resemble the characteristics of principal-agent problems because of the presence of asymmetric information and conflicts of goals.

### 4. Contribution of Agency Theory

This section discusses how agency theory can be exploited to explain the interdependence among the different stakeholders of the fashion industry's global supply chain and the CSR failures in the Bangladeshi clothing industry. We analyze based on the principal's (the downstream retailer) perspective who

faces customers. Since it is difficult to observe the global supply chain comprehensively, there is a possibility that the agent-the upstream firm- may deviate from the contract of maintaining ethical standards in treating its workers and fulfilling CSR. Creating a good environment in the workstation, ensuring safety, and providing workers' rights come with a cost. So, agent firms may not fulfill the CSR conditions to supply low-cost clothes and earn a better profit margin.

On the other hand, goal conflicts exist among the supply chain members. For example, the principal wants to ensure safe working conditions for its supply chain workers due to internal and external demands, as we mentioned earlier, along with pressure for downward prices and lead time [38,39]. So, the agent (manufacturing firm) faces two apparently contradictory conditions: offering products at a competitive price & lead time and CSR compliance. Based on this, we analyze how to provide an efficient contract between the parties utilizing the theories of new institutional economics. We depict the relationship first and then discuss the principal-agent interactions with the help of agency theory.

The fashion industry supply chain is a multi-tier relationship, although it is not always the case. Western countries' fashion brands (the principal) are the downstream partner, and the upstream manufacturing Bangladeshi firms (the agent). There is another third-party supply chain stakeholder involved in many cases who liaison between the retailer and manufacturer firm- the sourcing agent. If active in the supply chain, this sourcing agent acts as an agent to the retailer and principal to the downstream manufacturing firms. In the last stage, manufacturing firms act as the principal, and the workers are the agents. So, in the apparel industry, sourcing agents and manufacturing firms play a dual role as agents in one case and as principals. Naturally, there exists a conflict of goals; every partner wants to maximize self-interest. However, for simplicity, we consider the sourcing agent and the manufacturer as the same entity- the manufacturer or agent. We are not discussing the agency problem of manufacturing firm owners and workers.

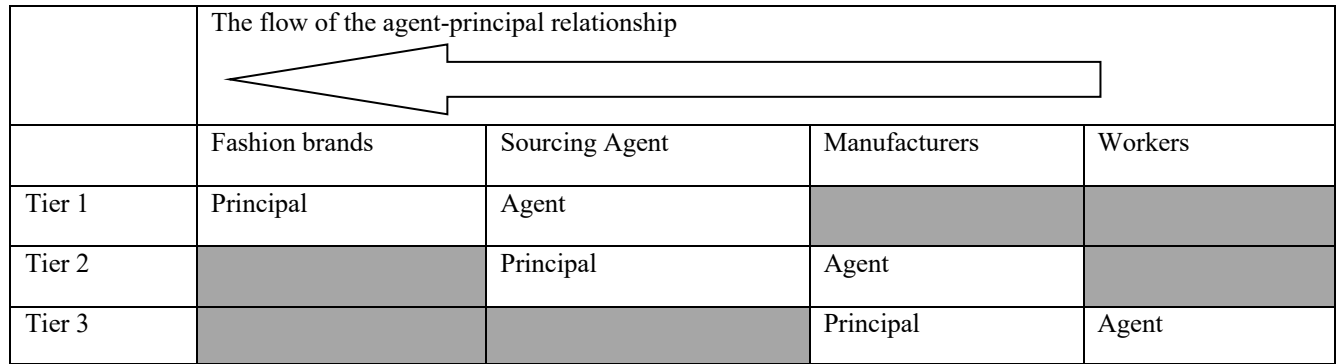


Figure 1: Principal-agent relationship in the supply chain of the apparel industry

In the pre-contractual period, it is difficult to assess the characteristics of a manufacturing firm where a fashion brand is ordering its products. The agent has hidden characteristics that are unknown to the principal. This asymmetric information creates a possibility of an adverse selection. Since CSR in the apparel industry is not legally binding, it depends on the manufacturing firm's sense of responsibility and commitment to society. It is difficult and expensive to judge a firm in the pre-contractual period. In the contractual period, the issue of hidden intention may lead to a hold-up problem if the principal invests heavily and the agent behaves opportunistically. Opportunistic behavior could be like placing pressure on the principal to overlook CSR mandates for the sake of both parties' benefits. Moreover, the principal cannot perfectly monitor what the agent is doing on the ground because of the spatial distance. A principal cannot directly monitor whether an agent is maintaining a good working environment for the workers, paying a standard wage, offering essential benefits, or not. Therefore, it creates an avenue for moral hazard.

## 5. Applying the Agency Theory Instruments

In the previous section, We discussed how agency theory could be utilized to understand the CSR failure in the global supply chain of the fashion industry. In this section, we will analyze how agency theory tools may help to avoid those failures. Although the supply chain contains more than one tier, we focus on the first tier as per the suggestion from the ref. [40].

### 5.1. Hidden Characteristics and Adverse Selection

Since there exists information asymmetry between the contracting parties (Principal and agent) before the deal, there is a possibility of adverse selection. Establishing trust among the parties is essential to avoid the adverse selection problem. This could be done through a mechanism that minimizes the information gap. Agency theory provides screening, signaling, and self-selection tools to overcome the adverse selection problem.

Screening is an effort by the principal to minimize the information gap about an agent's characteristics, for instance, observing through trial work of ref. [33]. In the apparel industry case, the principal may not be able to observe the agent directly due to a spatial distance. However, fashion brands can develop a Reputation Index for every upstream firm by utilizing the information about CSR compliance from previous contracts with other principals, existing CSR practices, certification from labor union and NGOs who works for the workers' rights, wages & benefits, ranking by the government and manufacturing firms' association, the ratio of workspace to the number of workers, other building and fire safety scale by the concerned authority, etc. A Higher Reputation index will indicate a reduction in the information gap between parties and a better work environment and workers' welfare. If fashion brands screen this way, agents will compete to improve their rank by complying with CSR terms. This process will help in searching for an agent. The reputation index should include negative points as a punishment for any violation of commitment regarding CSR. This fear of

losing reputation would work as a safeguard for fulfilling CSR commitments.

Signaling is another instrument to deal with adverse selection where the agent shows a signal to the principal about their capacity or qualification<sup>[33]</sup>. For example, CSR disclosure would be a good signal for manufacturing firms to convince the principal that they follow standard CSR guidelines. Weak firms that do not dare to disclose their current CSR practices. Another signal can be inviting the principal or local representatives to visit the manufacturing firm. However, signaling depends on the market situation too. As ref. [29] found that big firms are good at disclosing CSR while family-owned firms are not.

A self-selection is a tool where the principal creates a situation for the agent to choose whether they will go for a contract or not [33]. In this case, the burden of choosing a contract goes to the agent's shoulder. The principal can offer a performance-based contract, for instance, a high volume and long-term contract for a higher reputation index or good CSR practices, and vice versa. Incentives for maintaining workers' safety and severe punishment or sanction for commitment violation may help reveal true self-category.

### 5.2. *Hidden intentions and Hold-up Problems*

The hidden intention may create a hold-up problem which is very difficult to evaluate at the beginning of the contract. For example, it may arise if the principal invested a lot with a particular agent and the agent is showing opportunistic behavior, such as creating pressure on the principal to overlook CSR issues to get the product on time. To avoid hold-up problems, the principal needs to have explicit contracts about risk sharing, cost-sharing, price premiums, and guaranteed order continuity for CSR compliance.

### 5.3. *Hidden Action and Moral Hazard*

Since the principal cannot observe the agent's behavior with workers and the working conditions in the manufacturing firms, there is a possibility of moral hazard. Since maintaining a standard CSR practice is costly, they may deviate from their commitment at any point in time. Agency theory suggests behavior-based and outcome-based

contracts when there is a risk of hidden action. A behavior-based contract requires careful monitoring of actions which is very costly given the nature of the fashion industry's global supply chain and spatial distance. An agent would prefer a behavior-based contract if there is no outcome uncertainty and their additional services are rewarded.

Outcome-based contracts usually transfer the responsibility of the outcome to the agent<sup>[41]</sup>. It is designed based on the agent's effort. Here outcomes are work environment, safety measures, minimum wages, benefits for the workers, etc. An incentive for maintaining workplace safety and providing surviving wages to workers may work in this case. It could be done by paying a price premium for the firm that maintains a good practice. It may need further research, such as an experimental study, to explore whether customers are willing to pay a margin additional for the safety of the workers. Standard outcome and behavior measurement scales should also be developed to do this. These suggestions illustrate that outcome measuring scale and monitoring ability are the keys to applying outcome-based approaches<sup>[42]</sup>.

### 5.4. *New Institutional Approach: Integration*

Adverse selection and moral hazard come through a contract, which is central in agency theory. However, some options may reduce or eliminate the necessity of a formal agreement; integration is one of them. Manufacturing firms can be vertically integrated into the principal. It reduces the cost of trade and contracts and mitigates information asymmetry. However, although integration mitigates information asymmetry, it creates complexity for the principal. Sole responsibility is on the principal, which creates a huge risk. If any failure occurs, it will harm the reputation of the company. Even integrating more firms will make the situation more complex. Hence, the principal may fail to maintain CSR here.

## 6. Conclusion

Due to its complex global supply chain, monitoring CSR practices in the clothing industry is difficult and expensive for downstream fashion brands acting as principals. Retailers (principals) do not have full control over global suppliers. So, they rely on

manufacturers to implement the standard CSR practices (i.e., workers' safety, standard wage). In this study, we have analyzed cases illustrating that CSR failures negatively affect companies' reputation and revenue earnings because consumers are becoming concerned about CSR practices in the supply chain process. We have utilized instruments of agency theory to explore the reasons behind the CSR failures in the clothing industry. Agency theory proved suitable to explain the fashion industry's supply chain relationships and CSR failures. Agency theory can illustrate the complexity of the complex, multi-tier, global supply chain and help mitigate the information asymmetry problem between the contracting parties. The behavior-based contract could be a better option compared to outcome-based contracts for CSR implementation. It helps develop the mechanism to avoid CSR failures. We discussed when an institutional approach would work better. Strong and updated signaling tools might help to prevent the adverse selection of firms with bad CSR practices.

One major limitation of our article is that we do not have perfect knowledge of the clothing industry's complex global supply chain mechanism. Therefore, it demands further details to explore the information asymmetry and CSR implementation challenges in the apparel industry in a developing country like Bangladesh.

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