

GUIDE TO ETHICAL AND SOCIAL PROCUREMENT

Providing guidance on how to embed ethical considerations into procurement decisions for goods and services

Introduction

This guideline covers two sections:

1. *Section 1* covers the behavioural aspects of 'Ethical Procurement'
2. *Section 2* covers 'Social Procurement' directed towards the supply chain.

Section 1

What is Ethical Procurement?

Ethical procurement (often referred to as socially responsible procurement) refers, in this guide, to procurement processes which:

- Comply with relevant laws and organisational standards relating to ethical purchasing, probity, and employment conditions
- Respect fundamental international standards against criminal conduct (like bribery, corruption and fraud) and human rights abuse (like forced and child labour), and the need to respond to such matters where they are identified
- Result in progressive improvements in the lives of people who contribute to supply chains and are impacted by supply chain decisions.

What are Ethical Purchasing Principles?

The Ethical Purchasing Principles that will apply to this document are based on the Victorian Government Purchasing Board (VGPB) principles and government requirements that apply to public sector employees.

The Ethical Purchasing Principles include the following:

- **Openness and transparency** The process for awarding government contracts should be open, clear and defensible
- **Fairness** Businesses tendering for government contracts should be treated fairly
- **Simplicity** The implementation process should be as simple as possible to minimise tendering and contracting costs for businesses and government
- **Opportunity** The process should not discourage Small and Medium Enterprises (SMEs) and businesses in regional areas from tendering for government contracts
- **Rule of law** The basis of the Government's ethical employment standard is compliant with applicable industrial instruments and legislation
- **Current factual information** The assessment of whether a business satisfies the ethical employment standard should be based on the most up-to-date information available.

Applying Ethics within procurement

Ethics are moral principles or values that guide procurement officers in aspects of purchasing. Ethical behaviour encompasses the concepts of honesty, integrity, probity, diligence, fairness, trust and respect. Ethical behaviour includes avoiding conflicts of interest, and not making improper use of an individual's position.

The Public Sector Ethics Act 1994 and the *Public Administration Act 2004* establishes the following fundamental ethical obligations:

- Respect for the law and system of government
- Respect for persons
- Integrity
- Diligence
- Economy and efficiency.

The standards of conduct applicable to any employee are usually outlined in the organisation's Code of Conduct that sets out the standards of conduct consistent with its ethics obligations.

Ethical behaviour supports openness and accountability in procurement with the result that suppliers have confidence in participating in the Government marketplace. Ethical behaviour can reduce the cost of managing risks and has been developed to enhance trust in public administration.

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When procurement officers approach the market to buy goods or secure a service, they have a responsibility to obtain value for money. This must be achieved by acting in a non-discriminatory and ethical manner.

During procurement, probity is the evidence of ethical behaviour and is commonly associated with the practice of adopting and following well considered and sound procedures and is touched on towards the end of this document.

The organisation is usually concerned primarily with the behaviour of its officials when they are conducting procurement activities, and it highlights the ethical issues that they should be aware of in ensuring the proper conduct of procurement services and in achieving value for money during the process. For example:

- Reducing the risk of the organisation being exposed to legal and/or financial loss
- Providing potential contractors with confidence about fair treatment, with consequential improvements in competition and performance
- Guarding against collusion and fraud.

Building an Ethical Supply Chain

Sooner or later, every organisation is bound to find itself part of a supply chain that experiences a significant ethics or compliance violation.

Almost every organisation buys unfinished inputs provided by many other suppliers before refining them and sending them downstream toward their ultimate end-users. The ethics problem in the supply chain is that consumers often blame purchasers for ethical lapses that were actually committed further upstream by suppliers.

Most suppliers today do a good job of managing risk categories within their supply networks, however, some fall short when it comes to managing and mitigating integrity risk in their supply networks.

Considerations to mitigate these risks

In order to mitigate these risks, procurement officers should:

- Collect and maintain contact information for major suppliers and communicate with their suppliers on critical issues of ethics and compliance information to them on a regular basis
- Distribute the organisation's code of ethics and update suppliers
- Document suppliers receipt of requirements
- Hold a communication workshop with suppliers and advise on mission-critical topics relating to ethics and compliance.

If an ethics issue arises in your supply chain, at the very least your organisation will be able to credibly say that it has taken proactive steps to regulate and influence supplier conduct and behaviour.

Considerations when sourcing from another country

Where breaches of basic standards occur, such as those involving corruption, fraud, bribery and evidence of other social issues in the supply chains such as slavery and forced labour, a 'zero tolerance approach' should be adopted, with such breaches addressed immediately. This does not mean that a buyer 'cuts and runs' from a supply relationship, but that immediate action is taken to investigate the conduct and remediate it where possible. In relation to workers, the ethical objective is to achieve at least minimum working conditions as defined by the International Labour Organisation (ILO).

Good communication with suppliers is vital in making sure appropriate standards are set and upheld.

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Considerations leading to effective ethical procurement

The following external drivers influence an organisation's choice to purchase abroad, or from a particular supplier:

- **Economic** Exchange rates, profit margin, duties, tariffs, insurance, the employment market and availability of resources. Sustainable innovation can lead to the creation of new market space for products and services
- **Technological** The ability to communicate real-time information enables developing country suppliers to compete effectively
- **Legislation** Social, technical, environmental and economic/competition
- **Social** Social consciousness, e.g. avoidance of worker exploitation influences consumer behaviour and political activity. Increased worker satisfaction can improve productivity
- **Environmental** Use of energy, re-useable, non-toxic materials, reduction of waste and processes to improve profit margins, reduction of carbon in supply chains, etc.

Identifying and evaluating vulnerability and risk

An organisation needs to identify risks and vulnerabilities in its supply chain to be able to prioritise its actions to improve social and environmental impacts.

Identify vulnerabilities

In the initial stages of risk assessment, it is useful to look for 'known' supply chain vulnerabilities. These can be broken down on a geographical, sector, commodity, product or services basis. For example, there are known vulnerabilities to forced labour where migrant workers are used.

Assess risk against importance to the organisation

Initially assess purchases made against the following to establish which to prioritise:

- Level of spend versus level of business critical or operational risk (Kraljic matrix)
- Level of 'sustainability risk' or likelihood of non-compliance with the organisation's ethical or sustainability objectives
- Likelihood of non-compliance with international or national law, including vulnerability of supply chain to serious issues like fraud, bribery, corruption and forced labour.

Traditional Kraljic (spend versus operational risk) matrix assessments fail to highlight areas of ethical purchasing risk and may suggest inappropriate 'win/lose' procurement relationships. Some purchases made using this relationship style result in worker exploitation or harmful environmental impacts, particularly if sourcing from countries where the enforcement of laws is weak. Some of these purchases or categories when assessed on an 'ethical purchasing risk versus importance to organisation' matrix may fall into the high sustainability risk (see *Figure 1*).

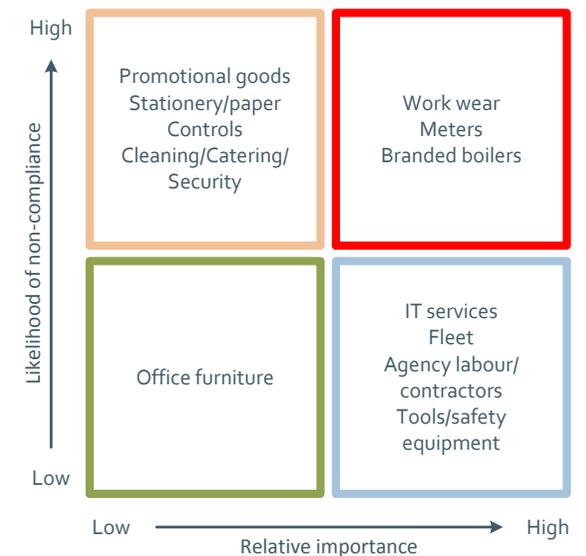


Figure 1. Ethical purchasing risk versus importance to organisation matrix

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Assess risk against scope for improvement

Buyers should look further into categories judged to have a high risk, to assess potential risk to be addressed proactively or for improvement to be made in conditions. There is frequently scope for improvement through better models, alternatives and innovation opportunities. On the other hand, the product or service may be inherently unsustainable or harmful.

Set targets for ethical procurement programme

Two types of targets are needed:

1. Operational targets may support an ethical procurement programme, e.g. policy development, implementation of business systems, training
2. Purchasing activity targets may focus on categories or the number of purchases/tenders achieving a particular level of social or environmental performance.

Practical considerations

- Are there any key contracts coming up for renewal?
- Are lower risk alternatives available?
- Do staff members have specific expertise or knowledge?
- Can external experts be engaged to assist in innovation and improvements?

Vulnerability analysis

At the end of this stage the procurement officer has identified the vulnerabilities in their supply chain to ethical and sustainability risk, relating to supplier or product risks, as well as found low risk or alternative sources/suppliers/products or where there is scope to improve, to avoid unacceptable risks.

Business to Business Ethics

This section provides guidelines for procurement officers in dealing with business ethical issues in the supply chain.

Procurement officers should be aware of the compliance criteria they must meet and what standards of ethical practice they need to satisfy in order to maintain the organisation's reputation.

The issues include the following categories.

Transparency, Confidentiality and Fairness

All suppliers should be treated fairly at all stages of the procurement process.

This means being open with all those involved, so that everyone, especially suppliers, understand the elements of the process, that is, the procedures,, timelines, expectations and requirements of the criteria for selection and contract obligations.

Supplier confidentiality should be safeguarded and unsuccessful suppliers should be debriefed with as much transparency about the procurement process as can be provided, for example, on the weaker aspects of the tender.

Use of Power

Procurement officers should discourage the arbitrary or unfair use of purchasing power or influence.

Power is a key element in supply relationships. Power is a key element in supply relationships. The exertion of undue influence or the abuses of power, as well as being unprofessional, may contravene relevant legislation and are unlikely to achieve long-term best value for money.

Ensure compliance with all applicable legislation, such as restraint of trade and anti-trust legislation, the *Competition Act 1998*, etc.

Corruption

Procurement officers must not tolerate corruption in any form.

Procurement officers aware of any corrupt activity have a duty to the profession and to their employing organisations to alert their senior management. Bribery is a criminal offence in most countries and the law is being strengthened to include offshore bribery.

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Declaring conflict of interest

All personal interests should be declared.

Procurement officers should encourage colleagues to declare any material personal interest that may affect, or be seen to affect, their impartiality or judgement in respect of their duties. Examples include owning a significant shareholding in a supplier organisation or close family members being employed by a key supplier.

Payments from Suppliers

Suppliers should not have to pay to be included on an approved or preferred supplier list.

Suppliers should be selected on the basis of meeting appropriate and fair criteria and should only be invited to contribute towards the cost of joint projects or initiatives where there are clear and tangible business benefits to the supplier.

Payment terms

Late payments undermine an organisation's credibility.

Procurement officers should ensure that their suppliers understand and agree to the organisation's payment terms. Procurement officers should try to ensure that valid invoices are paid in accordance with the agreed terms and colleagues should be prompted to ensure that payments be made promptly.

Supplier relationships and competition

Relationships with suppliers, regardless of duration, should be managed professionally.

Procurement officers should manage suppliers, and supply networks comprising multiple tiers of suppliers, in a professional manner. Both short and long term contracts have their place, but from time to time longer-term contracts especially should be subject to open and transparent competition. Where there is only one supplier capable of meeting requirements, established internal business controls should be respected in the quest for the best value for money solution.

This forms a key part of Government's position on Ethical Business Practices in procurement.

Since 1 January 2008, all staff across Victoria's public sector must consider human rights during their day-to-day work particularly in sourcing decisions.

Procurement officers should be mindful during the tender and contract process that suppliers are maintaining ethical employment standards. In particular, in purchases of goods and services from high-risk industries of textiles, clothing and footwear, cleaning and security services to ensure in particular that the following rights align with the Charter.

Social Responsibility

Some of the worker welfare issues which a socially responsible buying organisation should address when reviewing its supply chains include forced labour, freedom of association, health and safety, child labour, wages, working hours and discrimination.

Protection against forced labour

Suppliers should not use forced, bonded, child labour or non-voluntary prison labour in manufacturing of their goods or supply.

Employment relationship

Employees should have legal contracts.

Suppliers should establish recognised employment relationships with their employees that are in accordance with their national law and good practice.

Employees should be provided with an easy to read contract of employment, with particular clarity in relation to wages. In the event that employees are unable to read, the contract of employment should be read out and explained to them by a union representative or another appropriate third party.

Suppliers should not do anything to avoid providing employees with their legal or contractual rights.

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Freedom of association

Workers should have a right to collective bargaining.

Workers' rights may be compromised by constraints on unionisation. To guard against this, buyers should check that suppliers do not prevent or discourage employees from joining trade unions, nor discriminate against employees carrying out representative functions. Where the law restricts freedom of association and collective bargaining, suppliers should positively facilitate alternative means of representation.

Wages and working hours

Low wages raise ethical, economic and social problems in all countries. This is of particular concern in countries that produce low-value goods, where low rates of pay make these products competitive in the global market.

Governments are not always able to enforce the local minimum wage, and in some countries the minimum is not enough to support workers and their families. Some aid agencies recommend that workers should instead be paid a living wage.

Wages and benefits should at least meet industry benchmarks or national legal standards. As a minimum, the wages paid to suppliers' employees should meet their basic needs. Working hours should also comply with national laws or industry standards. Suppliers' employees should not be expected to work more than 48 hours per week on a regular basis and overtime should be voluntary and not be demanded on a regular basis.

Treatment of Employees

No harsh or inhumane treatment is allowed.

Under no circumstances should suppliers abuse or intimidate employees, in any fashion. Suppliers should have a grievance/appeal procedure that is clear and understandable and this should be given to the employee in writing. In the event that suppliers' employees are unable to read, the grievance/appeal procedure should be read out and explained to them by a union representative or another appropriate third party.

Law

Suppliers should always work within the laws of their own country

Discrimination

Suppliers should have a policy of equality for their employees involved in the manufacture of goods or services with no discrimination on the basis of race, caste, religion, nationality, age, gender, marital status, sexual orientation, disability, union membership or political affiliation or cultural differences.

Health and Safety

Working conditions should be safe and hygienic.

Occupational health and safety is covered in most countries by laws and regulations, which require employers to provide a safe working environment and employees to abide by safety procedures. However, in countries where the laws are not adequately enforced standards of health and safety are low in many factories and work sites.

Procurement officers should work with suppliers to introduce appropriate health and safety policies and procedures, which should be demonstrable in the workplace. Suppliers should assign responsibility for health and safety to a senior management representative.

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Probity as a means of managing procurement risks

Probity is the evidence of ethical behaviour in a particular process. The term probity means integrity, uprightness and honesty. Usually it means maintaining probity involves more than simply avoiding corrupt or dishonest conduct. It involves applying the organisation's values such as impartiality, accountability and transparency.

A procurement process that conforms to the expected standards of probity is one in which clear procedures that are consistent with Government policies and legislation are established, understood and followed from the outset. These procedures need to consider the legitimate interest of suppliers and ensure that all potential suppliers are treated fairly.

Further details are available in the *Guide to Ensuring Probity in Procurement Practice*.

Procurement officers should seek appropriate guidance, be open about concerns, and engage positively with suppliers and internal customers or peers, however difficult that may be. The resource implications of addressing these issues must be balanced against the potential risk to the reputation of the organisation and the organisation's requirement to comply with the ethical procurement rules.

Implementing ethical purchasing practices

Getting started

When first addressing ethical issues in the supply chain, it is important to devise a strategy to prioritise issues and put them in a manageable perspective, as follows:

- Review supply chains
- Identify problem areas
- Consult with others
- Construct policy
- Get senior management buy-in
- Conduct culture awareness training
- Establish a code of practice
- Other practical actions.

Review supply chains

Send questionnaires directly to suppliers asking for details of manufacturing units and subcontracts.

Build an accurate picture of your suppliers and their subcontractors.

Focus first upon your strategic suppliers, but remember it can sometimes be a non-strategic supplier that has the greatest potential to damage an organisation's reputation.

You may already be contacting your suppliers on health and safety environmental issues, so widening your enquiry to cover ethical issues may not in practice be as large as step as it first appears.

Identify problem areas

The next stage is to analyse the returns and identify potential problem supply routes, such as areas of risk associated with specific countries, human rights abuses or production processes. By identifying high-risk countries and commodities in your supply chains you can concentrate efforts in these areas. Focus first on suppliers in areas which are known to have a record of abuses and your major strategic suppliers. Individual risk assessments can be carried out on other suppliers by scrutinising responses to specific questions from the supplier review questionnaire.

Consult with others

It may be useful to consult others buying in the same area, with a view to pooling information. Consultation with local and international experts may also be helpful at this stage, as well as with other organisations to implement solutions.

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Construct policy

Once potential problems have been identified, you can then construct your ethical sourcing policy by identifying which issues your organisation can take responsibility for and which issues you want to prioritise.

Get senior management buy-in

As stated previously there is increasing pressure on businesses, to demonstrate good ethical business practice and many organisations are actively seeking to address these concerns.

If you have already drawn up a picture of your supply chains gathered from your supplier reviews as above, areas for concern can be highlighted to senior managers, together with recommendations for action.

Conduct culture awareness training

Everyone responsible for purchasing and supply management in an organisation should be aware of the organisation's policy on ethical purchasing and should be actively encouraged to support its principles. The same applies to suppliers.

All staff should be given training to make them aware of ethical issues and how the organisation plans to address them. Practical examples of the policy in action should be introduced into all internal (and external) training programmes as well as induction courses. Staff should be given a copy of the ethical code of practice and made aware of their responsibilities under the code.

Managers should sign-off on the code regularly and a review mechanism should be established. Ensure a suitably senior manager is appointed as the 'owner' of the code.

Having a code of ethics with an implementation programme is the minimum requirement for reputation management.

It is important also that suppliers and their staff are fully informed of the policy as it relates to them. Suppliers should distribute the code of practice to their staff, translated into the appropriate language. Procurement officers have a responsibility to determine acceptable behaviour between suppliers and colleagues, irrespective of their role or status in the organisation and to influence policy makers to define standards.

Suppliers often liaise directly with end users and other internal customers. The procurement officers should not necessarily discourage such liaison; indeed, maintaining product development awareness amongst users may well make it essential, but should develop organisation wide policies and educate colleagues about unacceptable or unethical relationships with suppliers.

Establish a code of practice

A well-developed code of practice will help organisations to be clear about their priorities and identifies those issues for which they are prepared to take responsibility. It also acts as a guide for procurement officers and other staff as well as suppliers.

Other practical actions

Encouraging suppliers to comply with an organisation's ethical policy can take place in parallel with the development of monitoring procedures, and may need to take place over a period of time, or be introduced in phases. As this may be a long process, it is important to keep focused on what you are trying to achieve.

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Section 2

What is Social Procurement?

Social procurement (also referred to as socially responsible procurement, social buying, or ethical purchasing) refers, in this guide, to procurements which:

- Result in progressive improvements in the lives of people who contribute to supply chains and are impacted by supply chain decisions
- A means to achieve organisational objectives towards delivering broader social benefits, through procurement of goods or outsourced services with superior social co-benefits.

What Principles apply?

Social procurement will incorporate Ethical Procurement Principles set out in the Ethical Purchasing Guide, and must still comply with all other Procurement Policies including that it demonstrates Value for Money.

The Ethical Purchasing Principles include the following:

- **Openness and transparency** The process for awarding contracts should be open, clear and defensible
- **Fairness** Businesses tendering for contracts should be treated fairly
- **Simplicity** The implementation process should be as simple as possible to minimise tendering and contracting costs for businesses and government
- **Opportunity** The process should not discourage SMEs and businesses in regional areas from tendering for contracts
- **Rule of law** The basis of the Government's ethical employment standard is compliance with applicable industrial instruments and legislation
- **Current factual information** The assessment of whether a business satisfies the ethical employment standard should be based on the most up-to-date information available.

Elements of Social Procurement

Potentially, analysis of the supplier market and health service requirements could reveal opportunities to procure specific social co-benefits as part of the objectives of a specific procurement.

Alternatively, a weighted evaluative preference could be assigned to social benefits, and tenderers invited to address related criteria within their tender responses for evaluation. This may result in awarding suppliers or purchasing goods that provide superior social co-benefits.

Table 1 (overleaf) outlines various ways in which social procurement can help public and private organisations achieve important social objectives.

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Social value objective	How these objectives can be achieved through social procurement
Employment and training	Building into the contract opportunities for employment for people who have been excluded from the workforce.
Social inclusion	Building into contracts consideration about how suppliers could respond to reducing social exclusion in place or amongst particular populations by addressing: <ul style="list-style-type: none"> • Poverty and low income • Lack of access to the job market • Limited social supports and networks • Lack of opportunities in local neighbourhoods • Exclusion from services.
Diversity and equality	Ensuring that 'minority' businesses have fair and equal access to purchasing and procurement opportunities e.g. indigenous businesses. Building a diverse supplier base that reflects the diversity of the community. Ensuring that small businesses and social benefit suppliers have fair and equal access to procurement opportunities.
Local suppliers	Wherever possible, be aware of opportunities to support participation from the local community and SMEs, while maintaining opportunities for global sourcing.
Social and service innovation	Procurement can support social innovation and market creation through consideration of how procurement can open new markets and suppliers have the opportunity to test and develop and scale innovations in a market environment.
Fair trade	Sourcing internationally-traded commodities from producers and manufacturers that adhere to fair trade practices can generate social benefits for disadvantaged communities, internationally, and can be seen as an ethical purchasing choice.

Table 1. Social procurement objectives

Implementing social procurement

Getting started

When first seeking to implement social procurement, it is important to devise a strategy to prioritise issues and put them in a manageable perspective, as follows:

- Review existing supplier market
- Identify opportunities
- Consult with others
- Get senior management buy-in
- Other practical actions.

Review existing supplier market

Build an accurate picture of existing suppliers and their subcontractors.

Focus first upon your strategic suppliers, but remember it can sometimes be a non-strategic supplier that has the greatest potential to incorporate social co-benefits through procurement.

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Identify opportunities

There may be existing knowledge of current or potential suppliers who provide strong social co-benefits.

Send questionnaires directly to suppliers asking for details of manufacturing units and subcontracts.

You may already be contacting your suppliers on health and safety or environmental issues, so widening your enquiry to cover ethical or social issues may not in practice be as large a step as it first appears.

Consult with others

It may be useful to consult others buying in the same area, with a view to pooling information. Consultation with local and international experts may also be helpful at this stage, as well as with other organisations to implement solutions.

Get senior management buy-in

As stated previously there is increasing pressure on businesses, to demonstrate good ethical business practice and many organisations are actively seeking to address these concerns.

If you have identified opportunities from your supplier reviews as above, these can be highlighted to senior managers, together with recommendations for action.

Other practical actions

Social procurement is not fundamentally different from any other procurement, only with an expanded scope of incorporating specific social benefits into either the objectives of the overall procurement project, or incorporating a meaningful evaluation of social co-benefits into the evaluation of tender offers.

If specific social procurement objectives (such as relating to employment and training) are desired, these need to be either set as mandatory requirements, or set as preferences against which responses can be systematically graded and weighted within the procurement decision-making process.

Mandatory requirements will restrict supply to those providers that can meet those minimum requirements, so it is important that all implications, including demonstrating that overall value for money for the purchasing organisation is achieved, are carefully assessed during the setting of the procurement strategy.

Refer to *Section 1* on Ethical Procurement for more details on procuring socially responsible goods and services.

More information

Related documents and templates are available on the HPV website.

For access contact the HPV Process Improvement team at processimprovement@hpv.org.au.