

# Social innovation at Franky and Ricky S.A.

## *Best practise report on social compliance: Peru*

By Yvette van Dok, Peter Bleeker, Advance Consulting

### 0. Introduction

This report is prepared by Yvette van Dok and Peter Bleeker of Advance Consulting, a Dutch based consultant that assists companies from the Netherlands and abroad to develop their international business, focussing mainly on initiatives in so-called "emerging economies". Advance Consulting supported the partners involved, Approvato Fashion, Franky and Ricky and Solidaridad in the elaboration of the project proposal, the implementation and evaluation of this project.

### 1. Profile of the company/factory

Name of the company	Franky & Ricky S.A., Arequipa, Peru
Since when is the company active?	Franky & Ricky was founded on June 1st, 1949 by Francisco Sahurie Giacaman., and later taken over by his two sons of whom Ricardo Sahurie still runs the factory.
How is it organised?	
Which processes are in house?	Knitting, dyeing, CMT
What is the annual turnover (also in Euro's)?	Approximately \$ 15 million (euro 10 million)
How many workers are employed?	916 workers
What products are made ?	T-shirt, polo's, sweatshirts
Who are the main clients?	Leading retail chains in North America and Europe
MADE-BY brand for which the company produces	M'Braze, since 2006

### 2. CSR context

Franky & Ricky S.A. from Arequipa, Peru, is a top quality garment manufacturer with export sales to leading retail chains in Europe and North America. A series of financial misfortunes brought the company in a vicious circle as it was no longer able to make investments to modernize its obsolete machinery, vital to keep up with international competition. As a result of consecutive years of operational losses, by the end of 2003 Franky & Ricky verged on the edge of bankruptcy, threatening more than 700 jobs.

In an ultimate bid to save the company, one of its principal clients, Approvato Fashion BV from the Netherlands, decided to make funds available for investment in new technology and other measures to turnaround Franky & Ricky's financial performance. The partnership, which furthermore included the Dutch NGO Solidaridad, successfully acquired 50% grant funding for its investment plan from PSOM, a Dutch government program that supports innovative projects in developing countries. Apart from technological innovation, the project included an important social component to improve the working conditions and participation of factory workers. Approximately € 1.5 million was spent on new machinery and equipment, computers and software, technical assistance and training, as well as certification of social accountability. The investments in F&R were made at a time when the company was in the worst financial position of its history. Unable to get any new bank financing, the company was rescued by providential grant funding from the Dutch government in combination with considerable co-financing from its Dutch business partners.

The analysis of the business outcomes in 2006 resulting from the investments shows that the results of Franky & Ricky have remarkably improved. Notwithstanding rising costs of production, the company

has return to profitability, as a result of spectacular production efficiency gains in combination with increased sales. The project secured employment of the workforce at Franky & Ricky, which expanded from 707 to 916 employees, and 189 new positions created with external contractors. The project introduced better working conditions and other social improvement that in 2006 earned the company the SA8000 certificate, as the first and so far only garment manufacturer in the Americas to be awarded this international recognition of corporate social responsibility. The SA8000 certificate will be more and more sought after by international clients whereas today only few textile factories in the world have this or any other recognized certification of social accountability. This provides Franky & Ricky with a unique selling point, in addition to the superior quality of its output. Moreover, the company is able to supply certified organic garments, for which world demand is picking up inexorably.

In September 2007, Franky & Ricky was officially released from the Chapter 11 status, making the company once again bankable for commercial financing of its further growth. The project provides a compelling example of how technological and social innovations go hand in hand when improving corporate performance.

### **3. Social compliance**

#### **3.1 Background and context**

The social compliance process at Franky & Ricky was part of a larger programme of technological and process innovation. After all, garment manufacturing is a labour intensive industry that cannot be successfully transformed without regard to the organization and personnel. During the years 2003-2006, several programs for social innovation were developed. One of the focus points in this was the certification for social accountability, SA8000.

In May 2006, as the first textile company in the Americas, F&R was awarded the SA8000 certificate. This international social accountability credential is based on international workplace standards in the ILO conventions and the UN's Universal Declaration of Human Rights and the Convention on Rights of the Child. It includes strict regulations on each of the following aspects:

- child labor
- forced labor
- health and safety
- freedom of association and right to collective bargaining
- discrimination
- discipline
- working hours
- compensation
- management systems.

SA8000 certification is complex in comparison to other certifications because it requires the involvement of all of the factory's employees. From director to machine operator, all staff members have to be informed of their labor rights, practice the safety rules and know to whom they can communicate any complaints.

The final SA8000 audit included 300 confidential interviews with employees at all levels to test their awareness of rights and knowledge of work safety procedures.

#### **3.2 Start of the process**

Before F&R started the process for SA8000 certification they had already gained experience in certification processes for BASQ and Organic Cotton. The company had also been developing their own social compliance system. Still, the preparation of the SA8000 audit required an enormous investment in time and effort of the staff members and workers of F&R. Based in the recommendations that were outcome of the pre-audit the main challenges for the certification were:

- to come up to the requirements for health and safety, which included the physical improvements on the workplace but also the organisation for risk management, assignment of staff members for health and safety and the training all personal.
- Training of all staff of the factory to make them aware of their social rights and conditions
- Communication systems and collective bargaining
- Payment system according to the local standards of living loan and the actualization of the internal working regulations
- Management information system, transparency in documentation of the processes
- Control of the providers

### 3.3 Implementation

The human resource department of F&R played a central role in the two years preparation for SA8000 certification which included the following actions:

- Training of all 910 employees of the company about the SA8000 norms, procedures and policies. A total of 1285 working days were spent on training and capacity building, imparted by F&R staff and external consultants, which illustrates the enormous investment in human capital.
- Structuring of communication and organization between employer and employees. The workers elected their own representative for this purpose while a transparent system was established with trusted workers' representatives to deal with cases of harassment and complaints.
- Organization and training of workers' brigades for First Aid, fire emergency and evacuation.
- A wide range of physical improvements to the security, safety, personal protection and ergonomic conditions in the factory such as fire extinguishers, a new electricity system, ventilators, anti-fatigue mats on the floors, sanitary facilities, drinking water filters, first aid kits, personal protection items, safety signs, and so on.
- The introduction of a system to administrate implementation of the SA8000 procedures. The quality control department manages a total of 263 documents that are part of the system to demonstrate SA8000 compliance.
- Training of suppliers. SA8000 requires that also F&R's suppliers, i.e. the 46 external confection workshops contracted operate according to the social accountability standards. F&R was given a time period of three years to make sure that these suppliers also become SA8000 certified.

Different local consultants in the area of health and safety, labor laws and social certification supported F&R in the process. Altogether, the necessary external consultancies, certification audits, training materials and hardware amounted to an investment of approximately \$100,000 as follows:

	EUR	USD
Pre-audit BVQI	4,793	5,950
Consultancies	10,918	13,239
Final Audit SGS consultants	14,147	20,825
Training materials	23,364	28,462
Hardware	26,257	32,286
<b>Total</b>	<b>79,479</b>	<b>100,762</b>

### 3.4 External workshops

External workshops provide F&R with extra capacity in confectioning, embroidery and printing, especially in peak periods. With the increase of F&R's production volume, the external workshops have become a permanent part of the regular production system. In 2003, F&R worked with 19 small confectioning workshops with approximately 360 employees. In 2006 their number had increased to 46 external workshops with a total of 549 employees who contributed 40% of all F&R's confectioning work. Their contribution is expected to exceed 50% in the near future.

The external workshops are a challenge for social innovation as they concern micro-enterprises that are spread out over the city of Arequipa. There are a number of deficiencies in the workshops such as

poor working conditions, high drop out rate of qualified workers, lack of quality control, long delivery time and low efficiency standards.

For the initial SA8000 certification, the requirement for F&R was to make sure that the workshops were informed about this process. At that moment, they did not have to come up to the SA8000 standards. However, a period of three years was given to F&R to make sure that 20 of their providers would also reflect the SA8000 standards. This implies that auditing the workshops forms part of the SA8000 audit F&R.

F&R has decided to strengthen the external workshops through an integrated program for SA8000, ISO9001, improved efficiency, quality control, administration and management. A special project (PSOM) has recently been launched in July 2008 and planned for a period of two years. The innovative concept is as follows:

- a number of new micro-enterprises form a consortium and bring their business physically together in one production location,
- several micro-enterprises link their machinery and workers to create one efficient production line,
- agreements between the micro-enterprises are made about the division of labor and income,
- F&R supports the infrastructure at the production site and provides a guaranteed workload, production materials, supervision, technical assistance, training, inspection and administrative management.

There are several advantages to this system; the combination of different machinery allows for more efficient production; the increased scale creates the opportunity for new investments in more specialized machinery, for example, in embroidery, button holes and button machines; the concentration of work gives better access to the support of F&R; and it finally generates a better income for the workers whose remuneration is based on the number of garments produced. For F&R it results in a better quality of work by the contractors, a flexible increase in production capacity, timely delivery and working procedures according to the standards of the company.

The SA8000 system for the workshops will become an integrated part of the system that is set-up by F&R. As such the workshops will be part of the internal control system of F&R and they will also be included in the bi-annual external SA8000 audits.

### 3.5 Workers perspective

The project has secured the financial situation of F&R and thus the employment of the entire workforce at F&R. F&R employees are for 75% women, mostly from the Arequipa area. The majority of the employees has been working for at least 10 years and more for the company. During the project period, the workforce was expanded by 209 employees. At the external workshops, 189 persons were newly employed. As a result 1067 jobs have been saved, whereas 398 new jobs were created in the project period.

Year	F&R	No. employees External workshops	Total
2003	707	360*	1067
2006	916	549	1465
<b>Increase</b>	<b>209</b>	<b>189</b>	<b>398</b>
Increase %	30%	53%	37%

\* estimate

With respect to wages and working hours: in general, people (in Lima) are paid the minimum wage for Peru, which is S/500 (US\$156). The 'living wage' established by the certifying body was difficult to calculate for Arequipa, because the conditions and living costs are very different from Lima. Therefore, the CB decided to follow the minimum wages.

Before the process started, F&R already paid according to the legal standards. There was no need to change this. A number of confection workers (in the lean manufacturing modules) receive a bonus for high efficiency<sup>1</sup>.

A health insurance premium is paid to every worker, in addition to the salary and together with the social package (extra months etc).

With respect to Freedom of Association: during the certification process there was no labour union. However, for the audit it was enough that the workers were familiar with the fact that they had to freedom to unionize and that procedures for collective bargaining were transparent. Discrimination has not been a big issue in the F&R factory.

Training, skill upgrading and personal development have been very important inputs to the development process. An intensive training program covering all aspects of the transformation process such as operation of the new machinery, social responsibility, lean manufacturing, confectioning and ERP was implemented.

As a result of the training and social innovation program, employees at F&R have developed, not only in their technical skills but also personally and in their position in the company. Workers have become coordinators of different brigades and staff members have increased their competencies and gained confidence in their role as leaders of the different projects.

This process is far from completed. As a follow-up to the project, a review of the organization at the level of management and support staff was required. This is presently addressed in an intensive process of team building and personal coaching, supported by external consultants. The health programme is a continuous point attention to improve the living conditions of the workers, make sure that good food is facilitated and that pregnancy controls and medical care can be offered internally.

The social innovation at F&R is an ongoing transformation process from a production-oriented organization to a thinking organization that the company is committed to become.

### **3.6 New export markets and clients**

The SA8000 certification has become an increasingly important element of F&R marketing. The certificate reassures clients that the products are manufactured to internationally accepted social standards, so they do not have to inspect the factory themselves.

F&R's clientele has increased from 24 clients in 2003 to 42 in 2007. Where previously the exports were mainly destined to Europe, today 50% of the sales are in the North American market. The company's exposure to market risks has thus been reduced<sup>2</sup>.

The project assisted F&R to initiate the production of fairtrade garments on the basis of certified organic yarn, originating from the organic cotton growers of Oro Blanco. In order to become a certified producer of organic textile, F&R entered the Global Organic Textile Standard (GOTS) in 2005.

Total production in 2006 equalled about 1.300.000 pieces. In 2007, total production volume was slightly higher. Over the two years (2006 and 2007) about 200.000 pieces of organic have been produced.

The extra price for organic items versus non organic items (price from factory) was:

- T-shirts: 0.45 \$ per piece organic extra
- Polo's: 1.25 \$ per piece organic extra

While the transformation to organic garment *production* in Peru was implemented without major obstacles, the *marketing* of organic cotton garments turned out to be quite a challenge. Existing

---

<sup>1</sup> The premium for overtime is not known to the author.

<sup>2</sup> Beyond the scope of the project, F&R obtained BASC (Business Alliance for Secure Commerce) certification in 2006 which is a requirement for trade with the USA.

clients were initially reluctant to shift their orders from conventional to organic cotton garments. The marginal price difference between conventional and organic clothing was perhaps a factor but the main concern of the clients how they would explain to their customers why they were selling 'fairtrade organic' garments, thereby implicitly disqualifying the conventionally produced garments in their collection.

Franky & Ricky has received support in the marketing of certified organic garments produced under fair-trade conditions from a new company called 'Fair & Co'. This company was created in 2006 as a joint venture between Approvato, Solidaridad and Triodos bank for the design and sales of sustainable fashion, produced from certified organic cotton under social responsible working conditions. Through this construction, Franky & Ricky has received several production orders for various labels.

Increasingly, the organic fair trade garments are gaining interest from existing clients, and discussion with new clients have led to new orders and good prospects for the future.

Up to 1 November 2007, F&R's sales volume of organic garments stood at 167,000 pieces. Whereas initial sales of organic garments have been slow, they are picking up rapidly with new orders in the pipeline as the market for certified organic fashion is in a lift, with more and more retail chains including sustainable fashion in their collection.

#### **4. Learnings and follow up**

The project is an example of how technological and social innovation go hand in hand when improving corporate performance in a sustainable way. One can not go without the other. This is only possible with a strong commitment of director and management.

Very important part of the success of the SA8000 certification is that all people in the organisation believe in what they are doing, in their product and in their team. It has greatly contributed to the pride and commitment of the employees for the company they work for.

Having acquired the SA8000 certificate, F&R now needs to make sure the certification is maintained. Therefore, SA8000 has become a structural part of the human resource program of the company and provides regular training refreshments and information updates to all employees. One staff member is now full time engaged as the health and safety officer of the company. The annual costs to maintain the certificate are \$47,000, which was only \$0.04 per garment in 2006 – a mere 0.33% of the export sales price.

F&R's SA8000 certification has resulted in publications in several local and international magazines and invitations to the director to be guest speaker at the international conference of SAI (Social Accountability International) in New York on 5 November 2007.

Once achieved the SA8000 certification, it provides the company with a unique selling point for new and existing clients.

The process never ends. It is a challenge to become SA8000 certified and another one to maintain the certification and extend it to the external workshops. Also here, a synergy between efficiency, sustainable economic development and technical and social innovation is needed and will be sought through an investment project that focuses specifically on the external workshops. This could form an inspiring example for the textile industry all over the world.

#### **Annexes**

- Tools used in social compliance trajectory
- Publications on social compliance of Franky&Ricky
- Interview+picture of a worker