

The Race to the Bottom

What is the "Race to the Bottom"?

I recently attended a meeting of The State and Local Government Anti-Sweatshop Consortium in Harrisburg, Pennsylvania where a distinguished professor from the University of California at Berkeley, Dara O'Rourke, gave a presentation on the root causes of sweatshops. He used the term the "race to the bottom". He was referring to the price pressures that companies feel from global competition. These pressures motivate them to find suppliers that will give them the lowest price, and fastest manufacturing cycle times; without regard to whether or not the factory is a sweatshop.

The term "race to the bottom" was first used by Supreme Court Justice Louis Brandeis back in the 1930s. This phrase describes how nations and states compete for business by dismantling protection and regulation that would otherwise protect the local population.

This, of course, describes what is happening today where countries like China have structured their society to become as they put it, "the world's factory". The result is a society that encourages the proliferation of factories with little regard to the health and safety of workers, or the impact on the local environment. Minimum wages are not living wages. And minimum wage laws are often ignored by local officials.

Another Side of the Race to the Bottom

There is a tremendous amount of consolidation in the sale of retail consumer electronics. Less than one hundred retailers control over 78% of the \$135 billion US consumer electronics retail sales. In fact, ten retailers (Best Buy, Wal-mart, Circuit City, Dell, Radio Shack, Target, CompUSA, Costco, Sears, and Sams Club) control over 58% of consumer electronics retail sales. This means that a few retailers can extend tremendous influence over brand manufacturers as the brands compete for their business.

A Real Life Example: Conversation with a CEO

Shenzhen China, over the border from Hong Kong, is what China calls its economic miracle. To me it is more like the wild west: skyscrapers and five star hotels contrasted by hustlers, prostitution, and poverty. I visited Shenzhen more times than I can count. On several occasions, I had the opportunity to meet and converse with CEOs who were doing business there. I remember one occasion in particular. Although this example is not from the electronics industry, it illustrates the consequences of the race to the bottom.

This particular gentleman was the CEO of an American company that made garden tools and kitchen knives. The company was quite successful and sold their products to major retail chains. We were traveling together on the airport shuttle from Shenzhen to Hong Kong, about a two hour ride. We

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For more information contact us: www.fairworkplace.org. or e-mail us: info@fairworkplace.org



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had time for quite a lengthy conversation. It turned out he had a deep sense of ethics. He was bothered by the fact that because of fierce price competition, he had to seek manufacturing in China, rather than his own factories in the US.

He seemed deeply bothered by something else. He tried to take comfort in the fact he would personally visit perspective factories and use only those that treated their workers well. However, he ran into several instances where this caused him problems with large retailers. One large retailer, who bought his garden tools, had their buyer make a routine visit to one of the factories he was using.

The buyer informed him that the factory the CEO was using was not giving them the lowest possible price. Because the factory he was using to produce his products was too clean and they treated their workers too well. Unfortunately, this thinking is not unusual and puts tremendous pressure on brand manufacturers.

Brands Pressure Factories

Here is some insight from my own experience as an executive in the electronics industry. I have personally attended meetings, many meetings, where I have witnessed first hand how brand manufacturers put pressure on factories. Here is typically how it goes down. The buyer from an American company, often an executive, will meet (in this case) a Taiwanese supplier. The buyer will look at the off the shelf product offering and inquire about customization. After they reach some tentative agreement, there is usually a discussion of price, minimum orders, and delivery time. At this point the buyer or executive asks "By the way, are you still making this in your Taiwan factory?" Of course he knows they still are. He then says, "Wouldn't it be cheaper to make it in your factory in China?". The executive from the factory protests. He knows too well the consequences on Taiwan's economy and people from the rush to China. He would like to keep as many products at "home" as possible.

Finally, the executive for the brand manufacturer gives the factory an ultimatum: I will only buy this product from you if you make it in your factory in China. Unfortunately, more often than not, the supplier will give in. Even though he knows that this behavior in the long run will have dire consequences for his local manufacturing plant.

Conclusion

I have tried to give you a taste of how company executives, foreign and domestic, are pressured by competition and retailers. In many instances this pressure is passed on to the factories. In order to help bring a stop to sweatshops in the electronics industry, we must attack some of the root causes and understand the thinking and actions that perpetuate these egregious practices.

