

## **Governance by Contract?**

# **The impact of the International Finance Corporation's Social Conditionality on Worker Organization and Social Dialogue**

### **Executive Summary**

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#### **Research plan**

The potential for transnational private or non-state regulation to have an impact on labour standards has been much canvassed in recent years. It has been argued that working conditions in developing economies can be improved by making supply contracts conditional on labour standards compliance or by offering access to premium price markets through product labels that certify the successful completion of a social auditing process. The apparently increasing reach and importance of this kind of market-driven approach to standards compliance has been cited as evidence of the emergence of a system of 'global labour governance' (Hassell, 2008; Meardi and Marginson, 2014) in which a multiplicity of public and private agencies monitor and enforce compliance with rules and standards derived from a basic normative consensus existing at the international level and centred on the International Labour Organization's 'core' conventions.

There is by now a fairly extensive research literature on private labour regulation. The emerging consensus is that while market incentives to improve wages and conditions of work have had a very modest positive effect on certain measurable welfare outcomes like hours of work and health and safety standards, there has been little discernible impact on the capacity of workers to pursue such improvements for themselves via collective action (AFL-CIO, 2013; Barrientos and Smith, 2007; Egels-Zandén and Merk, 2013; Lund-Thomsen and Lindgreen, 2014). This, despite the fact that reference to the ILO's conventions on freedom of association and collective bargaining rights is a ubiquitous feature of private labour standards.

It is tempting to conclude on this basis that the emerging system of global labour governance, has been captured by employers: in the absence of any change in power relations, improvements in pay and working conditions will always be limited by the financial interests of businesses. Nevertheless, the existing research suffers from two problems which may mean that this is too pessimistic a view. First, insufficient attention has been paid to the capacity of local actors to use private regulation proactively rather than waiting for some monitoring and enforcement process to take its course. Second, most of the evidence about the labour impacts of private regulation arises from small 'n' case studies limited to single firms or industrial sectors in particular locations. While larger scale studies do exist, we are not aware of any that permit comparisons between businesses that apply private regulation and those that do not. The aim of the 'Governance by Contract' project has been to take a step towards a more realistic global evaluation of the impact of private labour regulation by way of a study of the International Finance Corporation's (IFC) 'performance standards' system.

#### ***Objective of the study: the impact of firm-level labour standards conditionality in development finance***

The IFC is part of the World Bank Group and describes itself as 'the largest global development institution focused exclusively on the private sector in developing economies'. It invests directly in private sector businesses, most frequently in the form of loans or equity investments. Although as

part of the World Bank Group IFC is a public international organization, it competes for business with private sector lenders and operates on a fully commercial basis.

In the late 1990s and early 2000s, the IFC came under pressure from civil society actors, including international trade unions, who were concerned that it was taking too little account of the potentially negative impact of its investments on workers, the community and the environment. The IFC's response was to develop a comprehensive set of 'performance standards' covering everything from labour standards through pollution reduction and biodiversity conservation to the protection cultural heritage and the rights of indigenous peoples. Since 2006, loans and investments have been provided to client businesses on the express condition that those businesses either already comply with these standards or are willing to take steps to come into compliance. Compliance with the performance standards is written into finance contracts, giving the IFC the right to withhold funding or to withdraw from investment relationships entirely if it is not satisfied that the standards have been met.

In line with most other types of private regulation, the performance standards include two kinds of provisions on labour and working conditions. On the one hand there are 'outcome standards' that establish measurable conditions like the provision of a safe & healthy working environment or equality of treatment between men and women or migrant and non-migrant workers. On the other, there are 'process rights' that reflect the International Labour Organization's model of freedom of association, requiring client businesses to allow their employees complete liberty to form or join trade unions and to bargain collectively if they wish to do so. The potential for private regulation to have an impact on labour standards has been much discussed in recent years. The emerging consensus among researchers is that while market incentives have had a modest positive effect on outcome standards like hours of work, there has been little discernible impact on respect for the process rights that give workers the capacity to pursue such improvements for themselves via collective organization and action.

The overall aim of the research project was to assess whether the IFC standards system has managed to improve on this generally low standard of performance with respect to freedom of association and collective bargaining rights.

### *Hypotheses*

The very fact that the IFC feels that it is necessary to include protections for independent worker organization in its standards system means that it recognises a risk that its actual and potential client businesses may take illegitimate steps to deter unionization or to resist participation in collective bargaining, and that legal remedies for workers may be inaccessible or ineffective. If there is a risk of this kind, then there is a corresponding probability that an underlying workers' preference for collective industrial relations is not being satisfied in a certain proportion of cases.

If the PS2 provisions on workers' organizations are effective, we would expect to find that this probability is significantly reduced across the population of IFC client businesses and, as a consequence, that the incidence of collective industrial relations is higher on average in these businesses than in similar non-client businesses. This reasoning points to four hypotheses about the impact of transnational private regulation schemes on the enforcement of labour standards at the firm level. Two of these relate to the overall state of freedom of association and collective bargaining rights, and two relate to change in response to the performance standards.

### *External differentiation*

To probe the impact of the performance standards used by the IFC, it is critical to determine whether any observed difference in the incidence of collective industrial relations is due to IFC's selection criteria rather than any change in management attitude or practice arising subsequently to becoming an IFC client, including action taken in response to complaints from workers. Our first

proposition thus concerns whether IFC client businesses are in fact different from similar non-client businesses in terms of any relevant indicators relating to collective industrial relations. On the basis of the argument set out above we can propose the following hypothesis:

*H1 There is a significant difference between IFC client businesses and other firms in the same industrial sector and region with respect to one or more indicators of social dialogue.*

#### Conformity

The second issue is simply the conformity of IFC client businesses with the workers' organizations paragraphs in PS2. Our second hypothesis is as follows:

*H2 IFC client businesses are free of any significant violations either of the relevant national law or of the principle of freedom of association as set out in the workers' organizations paragraphs of PS2 and in the accompanying guidance notes.*

#### Internal change : direct effects

Our third area of interest is the effect of action taken in response to explicit IFC requirements.

*H3 In cases where mitigation measures concerning worker organizations or social dialogue are included in an action plan, or in cases where complaints have been made by workers' organizations, upheld by IFC and corrective measures specified, we would expect to find evidence of change coherent with these measures.*

#### Internal change : indirect effects

Our final area of interest is the indirect effect of businesses' adherence to the performance standards. The existence of the performance standards gives a certain legitimacy to workers' organizations and to processes of social dialogue. On the assumption that the content of the performance standards is widely known – an assumption that demands empirical confirmation – the performance standards system may in itself provide an impetus for industrial relations change by reducing the perceived risk of taking collective action.

*H4 Even in those client businesses where IFC has not asked for specific measures to be taken relating to freedom of association and collective bargaining rights, we would nevertheless expect to find evidence of change in one or more indicators of social dialogue.*

#### Research methods

With almost 2100 active and completed investment projects across the world that have been or are still subject to the requirements of the IFC performance standards, our first task was the identification of a sample of those projects. Having ruled out a stratified random sampling approach on the grounds that it led to a logistically unmanageable geographical spread of projects, we settled instead on a purposive sampling strategy. Our most basic research objectives were to ensure that we can draw some general conclusions on the basis of our specific findings, and that we have the capacity to make meaningful cross-national and cross-sectoral comparisons. The constraints were largely pragmatic: time and the requirement for travel. We therefore set about identifying geographic units based on the following criteria:

- the presence of a set of IFC client enterprises working in a reasonable range of different industrial sectors (excluding finance)
- the presence of sufficient regional concentration of client businesses to facilitate field researcher travel
- the inclusion of countries/regions with differing levels of economic development, as measured by GDP per capita

- the inclusion of countries/regions with differing traditions of trade unionism and workplace regulation, in particular common law as opposed to civil law regimes.

An analysis in these terms indicated four geographical units that fulfilled these criteria: Brazil, Turkey, the East African Community (Kenya, Burundi, Uganda, Rwanda and Tanzania) and the neighbouring states of Gujarat and Maharashtra in India. In our four regions we now had a list of 145 target enterprises. Researchers in each region were charged with gathering information on as many of these client businesses as possible. In the event it proved to be more difficult to get access to these businesses than we had anticipated. The businesses themselves were reluctant to talk to our researchers, still less to grant them unsupervised access to workers. The IFC declined to ask its clients directly to help us, although it did offer to write to client businesses vouching for the academic credentials of the project team. However, this offer was later rescinded without explanation. Nevertheless, our researchers were able to carry out in-person interviews with 297 workers from 53 different businesses, 34 union representatives from 30 businesses and 18 management representatives from 18 businesses. Altogether, information was gathered from 55 businesses. Our analysis, then, is based on the information made publicly available by IFC on the initial 145 businesses, plus survey data gathered in 55 of these. Our sample of 55 client businesses is clearly neither a random nor a representative sample but there is little reason to believe that it is systematically skewed in such a way as to affect our overall conclusions.

Our research strategy was to proceed via a ‘triangulation’ of opinions on the same subjects from different types of respondent: ordinary workers, union representatives and managers. To this end, the research team developed three separate but linked questionnaires. Certain questions were included in all questionnaires, with appropriate variations in phrasing, while others were specific to each type of respondent. The questionnaires were designed to permit the most realistic possible assessment of the reality of freedom of association within each enterprise and to allow us to relate that situation to action taken in response to IFC’s performance standards. About one third of the questions were written specifically with a view to understanding the effect of the application of the IFC performance standards framework. The rest were drawn from two established sources, the UK’s Workplace Employee Relations Survey and the joint IFC-ILO Better Work Programme’s ‘compliance assessment tool’.

In terms of data to serve as a baseline for estimating whether IFC client firms differed from non-client firms, the principal source of cross-nationally comparable firm-level data on businesses in developing economies is the World Bank Group, which has been conducting establishment surveys since the 1990s. The Bank’s Enterprise Surveys website now claims to provide data on 130,000 firms in 135 countries. Data is collected by private contractors in face-to-face structured interviews with business owners and senior managers for the main survey and up to 10 individual employees for the related employee survey (where this is included). Firms are selected according to a stratified sampling methodology (World Bank, 2009). The coverage of labour and employment issues in these surveys is limited, but up until around 2008-2009 they consistently included the simple question “What percentage of your workforce is currently unionized?”

## Results of the project

The study found that the **impact of the performance standards system on freedom of association and collective bargaining rights, and hence on union organization, has been marginal at best.**

### External differentiation

With regard to the evaluation of whether IFC client businesses are different from similar non-client businesses we were only able to consider union density as there is a lack of baseline firm level data on other factors. In considering the question of density, there are two things we need to bear in mind. The first is that union density scores are not normally distributed across firms and parametric

statistical tests are therefore inappropriate. The second factor is data quality. The World Bank firm-level data we have available about union density is for the most part based on employer estimates and takes the form of a single percentage figure with no information about the basis of calculation. We do not know, for example, whether part-time workers, workers on temporary contracts or agency workers are included. It would be impossible to use this kind of data as the basis for calculating robust cross-nationally comparable sectoral, regional or national average levels of union density.

Nevertheless, it would be unreasonable to assume that firm-level employer estimates of union membership tell us nothing at all. Where an employer reports 100% union membership this is almost guaranteed to be wrong, but it still says something important about relationships within the business work. The figure can be interpreted as an opinion about how important and present trade unions are in a firm that is closer to an ordinal than an interval measurement. From this perspective, a reported 100% union membership is higher than 50% membership, but the ‘highness’ is what counts rather than the 50 percentage point difference. Interpreting the management-reported density figures in this way implies the need to use a statistical analysis based on the rank ordering of data. Such nonparametric analyses do not take into account the size of the interval between each measurement, only their relation to each other. Conveniently, they do not require data to be normally distributed and are thus doubly appropriate (DeGroot and Schervish, 2012; Sprent and Smeeton, 2000).

The Wilcoxon Rank Sum test (also known as the Mann Whitney U test -- see Sprent and Smeeton, 2000, pp. 147–153), the nonparametric equivalent of a t-test for independent samples, is an appropriate means to determine whether there is any overall difference between the level of union density in each. It includes a means of compensating for unequal sample sizes. In our case the test showed a highly significant ( $p < 0.01$ ) difference between IFC and non-IFC client businesses, with the IFC businesses having higher union density. A simple inspection of table 1 below, however, shows that there are indeed some major differences between IFC client and non-client businesses. The table shows the percentage of IFC client and non-client businesses whose union density scores fall into each interval.

*Table 1: trade union density in IFC and non-IFC businesses*

Density	Not IFC client	IFC Client
0%	69.2%	50.7%
1%-33%	8.0%	19.2%
34%-66%	5.1%	17.8%
67%-100%	17.8%	12.3%
Total	100.0%	100.0%

These findings about union density need to be treated with care, however. As we will see below, there is little reason to believe that the higher overall level of union density in IFC clients is due to any effect of the application of the performance standards.

### Conformity

Our survey data provides prima facie evidence that despite the performance standards, violations of freedom of association and collective bargaining rights are far from unusual. Workers were asked about management attitudes to trade unions and whether they knew of any circumstances in which union membership or activity had been punished or non-membership rewarded.

- 73 workers employed in 25 different businesses reported that their employer was opposed to unionization. This represents 33.8% of responses other than ‘don’t know’. 51 workers responded that their employer was in favour of unionization and 93 that it was neutral on the issue.
- 42 workers employed in 17 different enterprises reported that they knew of cases in which employees had been punished or threatened for union membership or activities. This represents 22% of all workers responding either yes or no to this question rather than ‘don’t know’. When asked to specify what kind of reprisals workers had suffered, 24 respondents reported that they knew of cases of firing, 5 reported demotion, denial of promotion or obligatory transfer to an inferior post while 10 reported other types of harassment or intimidation.
- 20 workers employed in 9 different businesses reported that they knew of cases in which workers had been rewarded for not taking up union membership or not engaging in union activities. This represents 12.3% of all workers responding either yes or no to this question rather than ‘don’t know’. When asked to specify what kind of rewards workers had been given, 13 respondents reported that they knew of cases of promotion, 7 knew of wage increases and 2 of transfers to better positions.
- 50 workers employed in 13 different businesses reported that they knew of cases in which their employer had taken some kind of action to prevent workers from participating in strikes.
- Overall, 71 workers in 22 businesses reported one or more of the three types of violation. A violation was reported by an average of 55% of workers in each business where at least one worker reported a violation.

#### Internal change – direct effects

Unless the risk of non-conformity is thought to be negligible, IFC publishes an ‘environmental and social review summary’ (ESRS) for each client business which is a resumé of the results of the compliance review carried out either by IFC internal experts or consultants hired specifically for the task. The ESRS sets out the performance standards identified as applicable during the review together with the measures that the client has agreed will be taken to mitigate any problems with compliance. For each of the 135 enterprises in our sample for which an ESRS has been published, we coded the mitigation measures specified with respect to PS2 (excluding occupational health and safety measures) according to seven non-mutually-exclusive possible actions. Table 2 sets out these actions together with their incidence in each region.

*Table 2: PS2-related mitigation measures*

	Brazil	EAC	India	Turkey	Total
Total number of client businesses in each country	42	32	40	32	146
No ESRS (risk category C project)	6	1	2	1	10
Number of businesses in which <i>no</i> PS2-related mitigation measures are specified (excluding OHS)	20	21	18	13	72
Number of businesses in which PS2-related mitigation measures are specified (excluding OHS)	16	10	20	18	64
Percentage of businesses in each region in which PS2-related mitigation measures are specified	38.1%	31.3%	50%	56.3%	43.8%
<b>Incidence of mitigation measures</b>					
Formal written human resources policies/procedures/practices to be developed or reviewed and brought into line with PS2 where necessary	12	8	13	10	43
Freedom of association and collective bargaining rights to be incorporated into formal HR policy	4	0	1	5	10
Formal employee grievance redress procedure to be established or reviewed and brought into line with PS2 where necessary	9	2	8	4	23
Extension of normal HR practices to include contractor or temporary employees or correction of other differences of treatment between directly and indirectly employed workers	1	1	3	0	5

HR policies/procedures/practices to be communicated (or communicated more effectively) to employees	4	1	3	1	9
Information specifically about freedom of association and collective bargaining rights to be communicated (or communicated more effectively) to employees	2	0	0	1	3
Non-union elected employee representative structures to be established or reviewed and brought into line with PS2 where necessary	0	0	0	2	2
Average number of PS2 mitigation measures per business	2.00	1.40	1.40	1.28	1.48

As the table shows, by some way the most common mitigation measure is the development or updating of a formal human resource management policy, by which the IFC means a set of written procedures accessible to all employees that set out the principles of management the business will follow, the basic terms and conditions of employment and the practices and procedures that will be applied with respect to recruitment, maternity leave, training and so forth. The next most frequently mentioned measure is the establishment of a formal grievance redress procedure. Together, the formalization of HR policy and the establishment of grievance procedures make up 70% of the PS2-related mitigation measures we were able to identify (not including measures related to occupational health and safety).

There are only ten businesses (out of a total of 64 where any measures are specified) for which mitigation measures contain some explicit reference to freedom of association and collective bargaining rights. One of these businesses recognized a union and took part in collective bargaining, and another reported that there were union members present in its workforce but that it did not recognize any unions. The others were not unionized. For all ten businesses, the inclusion of freedom of association and collective bargaining rights in written, PS2-compliant HR policies is specified. In three cases, businesses also committed themselves to informing workers about these rights, for example via the provision of information in local languages.

In only two cases was any more specific action required. One (non-unionized) business committed itself to correcting an unspecified difference in treatment between white- and blue-collar staff with respect to freedom of association and collective bargaining rights. Another business reported that ‘historic anti-union activity’ had been alleged, but claimed that a third party audit had found ‘no evidence of suppression of freedom of association’.

#### Internal change – indirect effects

The data we have collected does not offer the possibility of considering the indirect effects hypothesis simply because it shows that the content of the performance standards system is *not* widely known. Just 18% of the workers interviewed were aware that the IFC had invested in their business and only 6% (18 workers out of 297) knew that the performance standards system exists and that it contains guarantees about freedom of association and collective bargaining. With such a small proportion of workers aware of the performance standards and their content, it would be wholly unrealistic to expect there to be any kind of effect on the perceived legitimacy of unionization and collective bargaining.

Union officers were rather more aware of the performance standards, with 10 out of 33 respondents (30%) reporting some knowledge the PS requirements. However only two of these officers dealt with workplaces that were not already unionised. Notably, none reported having been given information about the performance standards by the business itself.

It may be the case that management attitudes change independently of worker pressure in response to a declaration of adherence to the performance standards. If this is the case, workers may notice a change in attitude regardless of whether they are aware of the performance standards. The workers we surveyed were asked whether they thought the attitude of management in their workplace to trade unionism had changed over the last 3 to 5 years. 227 workers gave a response other than ‘Don’t know’. Of these, 28 reported that managers in their workplace had recently become more

favourable to trade unionism. However, 29 reported that managers had recently become less favourable.

### **Analysis of results**

At first glance, our findings suggest that the application of the performance standards has had a positive effect on union density, as IFC client businesses appear to have higher density scores than similar non-client businesses. However, our analysis of mitigation measures suggests that the likelihood of IFC requiring its clients to take any kind of action that will promote or encourage unionization is extremely small. Even in those cases where some kind of action was required it remained largely on the level of written policy or, in three cases, the provision of information. Beyond measures required by IFC, we found no evidence that employers spontaneously changed their practices in response to the performance standards. Freedom of association violations were reported by a significant minority of workers and only 6% of workers were aware that their employer had committed itself to respecting the performance standards on workers' organizations. In short, there is no good reason to believe that becoming an IFC client has any significant effect on unionization. As a result, the higher level of union membership among IFC clients than in similar non-client businesses must be due to the **IFC client selection process** rather than to any change in practice related to IFC supervision of performance standards compliance.

The performance standards' lack of impact on freedom of association and collective bargaining can be related to the **private contractual structure** of its compliance procedure. Although workers' rights are ostensibly protected by the performance standards, **workers are not parties to the private contract** that provides the legal means by which compliance is enforced. Rather, the parties are the IFC and the client business. The weakness of this 'governance by contract' lies in the fact that compliance enforcement depends on a third party's willingness to take action to enforce contractual conditions that affect relations between workers and employers. In the case of the performance standards system, the IFC's capacity to decide whether or not to enforce its contractual rights against its clients is almost unlimited, with no template for compliance and no independent process for the evaluation of claims of non-compliance. There is remarkably little scope for workers to take action *within* the regulatory structure.

This raises the question of power. From the workers' perspective, the enforcement of IFC labour standards is a question of political organization and action rather than of triggering a process of regulatory intervention. Whether or not the public normative commitment involved in agreeing to comply with the standards results in a change of management attitude or behaviour depends on the capacity of workers (a) to collect information about standards violations and to communicate this to the IFC; (b) to establish that what they interpret as standards violations are indeed violations; and, above all, (c) to create the kind of political and industrial pressure that would outweigh the IFC's commercial and reputational interest in *not* sanctioning its existing clients. However, in the particular case of freedom of association and collective bargaining, the **rights** supposedly guaranteed by the IFC labour standards are precisely those **that provide workers with the capacities that make political action possible**. The study showed that the **IFC takes few if any proactive steps to enforce these rights**. It also found no case in which the standards contributed to the organization of a previously unorganized workforce without the intervention of an existing union. When it comes to the enforcement of freedom of association rights, **workers who are not already well organized are caught in a 'catch 22'**: they need to *already* possess the collective capacity to take political action in order to enforce the rights that would give them that capacity.

### **Expected vs. actual results**

A premise of the 'Governance by Contract' project was that the existing research is arguably too pessimistic about the potential of private labour regulation to widen the scope for workers to take collective action. However, it seems that pessimism is in fact the appropriate attitude. Although at the outset we had no great expectations about the impact of the performance standards on labour

organization, we were surprised by quite how little change in business behaviour we observed. Although we are not in a position to say whether the level of violations of freedom of association rights reported by workers is higher or lower than average, it is striking that the reported **level of violations** should be so high in businesses **where managers have publicly committed themselves to avoiding anti-union behaviour**.

We also expected to find more evidence of trade union action in response to the performance standards. One obvious factor contributing to the paucity of such action – another surprising finding – is the **extremely low level of awareness of the performance standards among workers and trade union representatives**.

### Questions for further research

There are two findings of the project that point to a need for further research. The first is that the attitude of the standard-setter is a critical factor in determining how management practice changes in response to private labour regulation. We found that IFC's interpretation of what freedom of association and collective bargaining rights mean in practice diverges significantly from what has been established within the ILO's 'jurisprudential acquis' (Alston, 2004), the only existing interpretative reference point. Clearly, other standard-setters may take a different view. Second, the local context in which the standard is applied, particularly variations in the existing capacity of unions to organize collective action, is an important factor in determining the impact of private regulation. Taken together, these findings suggest that understanding the impact of private labour regulation demands that we look simultaneously at the policies of private regulators and the local context of application of private regulation.

### Policy recommendations

The policy recommendations that arise from the project are directed both at private regulators and those who may be in a position to lobby for changes in practice.

- Private regulators should adopt a pro-active approach to information collection, developing employer-independent transmission channels for information.
- Private regulators should ensure that workers are made aware of the standards their employers have agreed to respect.
- Private regulators should address much more clearly the issue of what respect for freedom of association and collective bargaining rights involves in practice, for example in terms of union access to workplaces.

### Publications and other activities

Participant observation at a meeting of construction trade union representatives in Ethiopia together with interviews with national and international union officers provided the empirical material for an initial paper in which we propose an analytic structure for evaluating the impact of transnational private regulation on the capacity of workers to take collective action. This paper has been published as a University of Lausanne working paper and will also be submitted to an appropriate journal. Two papers drawing on the qualitative material are under review with international journals. We are currently finalising a paper drawing on quantitative findings of our research. We also have two papers accepted at refereed international conferences plus two more proposals for which we are awaiting a response.

The principal researcher on the project was the co-convenor of a workshop on 'Decent work beyond the boundaries of the state' at the European Workshops in International Studies (EWIS) held in Turkey in May 2014. An edited volume based on the workshop and including a paper based with our findings has been accepted for publication by Routledge subject to minor amendments.

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