The business and its supply chain: a management alternative

Guide for the Responsible Management of the Supply Chain

Application of the 10 Principles of Global Compact in Business Administration

United Nations Global Compact Network Spain
“…Providers, suppliers, contractors, installers…”

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These “minimum principles” affecting the supply chain are collected in an appropriate manner in the 10 Principles of the United Nations Global Compact. But not only do the principles relating to Human Rights apply when we refer to suppliers from countries with weak political and legal institutions, but also the Principles relating to labour standards, environmental awareness and corruption must be taken into account.

The aim of this publication is to focus on the analysis of the supply chain to establish a risk rating that allows us to become aware of the problems, identify good practice and plan the development of company-supplier relationships which are mutually beneficial. Ultimately, helping companies manage their supply chain more responsibly in order to generate a sustainable profit in all business areas and activities.

This guide is aimed at companies and especially SMEs and focuses on the analysis of the supply chain to:
- Establish a risk classification
- Identify best practices
- Plan the development of the business-supply chain relations

Introduction

This document is the second published by the United Nations Global Compact Network Spain after the Implementation Guide of Principle 6 on non-discrimination in employment and occupation. Through these publications, the Global Compact Network Spain aims to facilitate the implementation of the Global Compact Principles in corporate governance and in particular in SMEs, as they have more difficulties in deep analysis and reflection about generally abstract topics, which do not have a readily measurable impact on their short-term results.

The choice of the “supply chain” as the interest group to analyze in this second guide is once more due to the particular usefulness that it has for SMEs, as it can be identified in the analysis by its dual condition: as a company that interacts with its suppliers and as a company which in turn is a provider for larger customers, who may be very sensitive to the issues of Corporate Social Responsibility and who therefore apply them in their supply chain.

The traditional separation of responsibilities of the law of mercantile contracts, which establishes a clear boundary between the internal behaviour of companies which have commercial relations, has been currently dimmed because society expects businesses to also be responsible for their suppliers, either by influencing them in order to respect certain minimum principles if they have the ability for it, or by avoiding being accomplices in an unbalanced situation, if they are unable to exert this influence due to their size.

Joaquín Garralda
Secretary
United Nations Global Compact Network Spain
What does this guide offer for the relations between business and supply chain?

“Qualitative and quantitative benefits”

For the customer business which focuses on the final quality of the product:

- Continuous improvement of production
- **Sustainable** and profitable production
- **Stable** relationship with suppliers
- Involvement in the production process, by suggesting changes or improvements that benefit the company and enable it to create **competitive advantages**
- Care of the image and reputation
- Decreasing the **risk** of malpractice complaints

For companies that make up the supply chain:

- Increase of **long-term contracts**
- Financial **stability** which allows accurate planning of the work strategy
- Increased **productivity**
- Assured **profitability** due to the existence of long-term contracts
- **Priority** of contracts against bids from other suppliers, if included in a program of continuous improvement promoted by the company
- Improved **motivation** of employees and their working conditions
- Access to **training** programs at reduced cost
- Reduction the cost of capital
- Incentives for **R&D&I**

**Common Benefits**

- Caring for the corporate image
- Reduction of costs
- Improvement of the internal management of the company
- Responding to the demands of society
The situation of the company

Globalization has given rise to large and complex organizations, and thus today it is difficult to ensure that a company has a 100% national nature. The majority have business partners, suppliers and customers abroad.

Reality

However, this feature is not perceived by the consumer who does not differentiate between the company and the links that make up its supply chain. Hence the consumers’ purchasing decisions are based on the general perception which they have of a particular brand.

Objective of a Company:

To improve competitiveness in the market

- Minimizing costs
- Identifying competitive advantages via R&D&I
- Controlling risks related to corporate reputation

The company that wants to control its risks related to corporate reputation and protect its value, begins by ensuring an adequate management of the supply chain.

It is essential to ensure that both parties share the same values, management standards and regulatory compliance, to ensure proper control of the risks in the supply chain.
### Work Methodology

#### 1. Evaluation of the risks in the supply chain

According to the particularities of each sector, company or working environment, the risks of the supply chain may be different. Hence, in order to diagnose risk it is necessary to answer the following questions:

<table>
<thead>
<tr>
<th>Risk of the supply chain</th>
<th>YES</th>
<th>NO</th>
</tr>
</thead>
<tbody>
<tr>
<td>Very High</td>
<td>YES</td>
<td>YES</td>
</tr>
<tr>
<td>High</td>
<td>YES</td>
<td>NO</td>
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<tr>
<td>Moderate</td>
<td>NO</td>
<td>YES</td>
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<tr>
<td>Low</td>
<td>NO</td>
<td>NO</td>
</tr>
<tr>
<td>Minimal</td>
<td>NO</td>
<td>YES</td>
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</tbody>
</table>

The brand, the product, the sector of the activity and the country of origin of the supplier influence its risk perception.

Map designed by the Global Compact Network Spain, in collaboration with Fundación Ecología y Desarrollo (Ecology and Development Foundation), EIRIS and FTSE4Good (p.31, Annex 2).

**High-risk sectors and products** (p.31, Annex 2).

(1) The World Bank considers high-income countries (high Income/other high Income) as safe countries. By default, low-income countries as well medium/low and medium/high, could be considered as risk countries (pp.32-33, Annex 2).

<table>
<thead>
<tr>
<th>Does the company have a <strong>brand known</strong> by the final consumer?</th>
<th>Do any of my providers supply me with <strong>high risk products</strong> or do they come from a <strong>high risk sector</strong>?</th>
<th>Do any of my direct suppliers work in a <strong>high risk country</strong>?</th>
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<tr>
<td>YES</td>
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</table>
Having defined the risk level of each provider, the client company will establish a personal working relationship with each of them.

The aim will be to promote responsible management of the supply chain, thus ensuring a stable and mutually beneficial relation for both parts.

The methodology of work to be developed will be determined by the greater or lesser risk of the supplier. Thus, for example, for a provider with a **risk** classified as “very high”, the customer company must cover the full four phases of the methodology. From there, suppliers which are considered as lower risk could be managed responsibly without having to develop all the phases of the methodology.

- Those providers with a lower risk only carry out the first phase
- Those providers with a high risk must develop the four phases

### Work Methodology

2. Stages in the management of the supply chain

<table>
<thead>
<tr>
<th>Risk of the Supply Chain</th>
<th>Phases in the management of the supply chain</th>
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<tbody>
<tr>
<td>Very High</td>
<td>01 Diagnosis</td>
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<td>1a Questionnaire</td>
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<td>1b External rating system</td>
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<td></td>
<td>1c Code of conduct</td>
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<td>High</td>
<td>02 Planning</td>
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<td></td>
<td>2a Fluid communication</td>
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<td></td>
<td>2b Financial support</td>
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<td></td>
<td>2c Training</td>
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<tr>
<td>Moderate</td>
<td>03 Supervision</td>
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<td></td>
<td>3a Visits to the plants</td>
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<td>3b External audits</td>
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<tr>
<td>Low</td>
<td>04 Decision Making</td>
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<td>4a Incentive</td>
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<td>4b Break of contract</td>
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<td>Minimal</td>
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This first phase is aimed towards improving the knowledge which the client company has of every member of its supply chain. For this it is advisable to define the minimum requirements on which the company needs to have information and then to verify their compliance. These requirements must be aligned with the corporate values of the company, so in the future it will be easier to ensure the alignment of the company with its supply chain.

There are different tools which can be of help in this task:
- 01a Questionnaire
- 01b Expert rating system
- 01c Code of conduct

This is a document in which the supplier must respond to a number of questions on various topics.

The questionnaire may be more or less comprehensive depending on the risk profile of the supplier.

Depending on the sector to which it belongs or the company that requests it, the document may contain a small number of questions or be more comprehensive.

In some cases, the company may require the supplier to certify its compliance with other current laws or certain rules in force, nationally or internationally.

The level of demand may also vary depending on whether a supplier is recurrent and significant or a one-off and with a low weight for the business (in terms of purchase volume, participation in the production process, etc.).

Listed below are the minimum data required from the provider in the questionnaires:
- Identification data of the company
- Contact person
- Company activity
- Products/services supplied
A description of some of the issues which are generally included in the questionnaires can be found in the following list:

- Possession of a quality certification, quality manual or Quality Department
- In the absence of a quality system, future plans for its implementation and implications thereof
- Internal Quality Control
- Knowledge and implementation of the 10 Principles of the Global Compact
- Environmental issues: certification, accreditation and implementation of an Environmental Management System (or provisions for its creation)

In addition to the previous list, on occasion additional information is requested on the following:

- Conduction of audits by the customer company or access to the results of a prior third-party audit
- Quality policy, management of employees, resources and regularity of internal and external controls
- Plans for training staff
- Analysis of potential environmental impacts prior to investment
- Existence of a Human Resources Department
- Working conditions of labour agreements
- Prevention of occupational risks
- Sustainability Report
- Adherence to CSR standards

The coexistence of international and domestic laws, due to the expansion of markets around the world, has raised in many cases a duality in the standards of multinational companies.

In those cases, when the client company operates in several countries or in sectors with certain characteristics, it may prove useful to employ external systems for the classification of suppliers.

**Working Case**

**Javierre, S.L.**, a SME in the construction sector, internally classifies all suppliers which, based on their nature and activity, could be a source of risk in breaches of environmental or social obligations and are also likely to affect the final result in relation to the quality of products and services. It maintains an internal register of approved suppliers with a preferential rating, providing an adjustment period to those which have aspects to improve and rejecting all those which do not conform to the specifications and policies of the company. This control and register are audited twice yearly by an independent consultant.

Systems managed by **Achilles South Europe, SL** are a tool which enables to manage and search for providers based on criteria established by the client company. These are useful systems for those sectors that are highly segmented, allowing all businesses in the sector to have access to the same information for the recruitment of their suppliers. These systems speed up the process in cases of direct recruitment of providers and especially in the management of subcontractors. Through a software application in which each supplier introduces its legal, commercial, quality, prevention of occupational hazards, environmental, and other data, the customer company can identify and select those suppliers which it wants to work with, following the selected criteria. At present, the system also incorporates data on the management of Corporate Social Responsibility on the part of the supplier. **AGBAR**, for example, uses this system to select a large part of their suppliers.
In order to set the **minimum requirements** to be met by each link in the supply chain, the customer can develop an internal Code of Conduct.

The certifications and standards listed in Annex 3 are those commonly used as a basis for the development of a Codes of Conduct and reflect the Universal Principles on Human Rights, Labour Standards and Environmental Management.

Today, companies suggest that, besides the knowledge and acceptance of Codes of Conduct, **measurable actions and results** are requested in order to monitor compliance.

**Working Case**

**MANGO MNG Holding S.L.** bases its Code of Conduct for manufacturers and workshops which produce garments and accessories on the guidelines and recommendations of the International Labour Organization and the United Nations. The Code of Conduct is mandatory for all suppliers wishing to work with the company. The Code prohibits child labour, forced labour, discrimination, the employment of disciplinary action against employees and also mentions, amongst other aspects, guarantees for freedom of association, the need for regulation of working hours and wages of workers. In addition, the company is in the final stages of creation of a working tool that will assign a factory number to each order which will enable tracking of each garment and monitoring of the origin of production at all times.
Following the results of the diagnosis phase, the client company must plan together with the provider a joint working strategy which they will develop. The objective of this phase will be to improve those aspects that have been rated as negative or inadequate at the stage of diagnosis and sketch a medium and long-term plan with the goal of aligning the actions and behaviour of the supplier with corporate values the client company.

In general, the planning phase is characterized by:

- **02a Fluid communication**
- **02b Financial support for the supplier**
- **02c Training on the part of the company**

**Fluid communication** with the supply chain enables, amongst other things, a more efficient administrative management and streamlines the tracking of orders and quality of the company-supplier relationship. To ensure this, there are simple tools, such as correspondence or the organization of regular meetings.

In the specific case of companies which have a large number of suppliers, the creation of a supplier portal that allows direct access to the supplier's most important information regarding their relationship with the client company (orders, invoices, codes of conduct, etc.) can serve as a simple and flexible tool of communication.

**Working Case**

Gas Natural SDG, S.A has more than 3,000 suppliers and this sometimes complicates their management greatly. Therefore, they are working on the implementation of a tool that will allow them to communicate with suppliers in a simpler form, through the Internet. This is the Supplier Portal, which will enable the handling of requests for offers, orders and invoices, providing seamless management of orders. Furthermore, in keeping with the provisions of Law 31/2007 of October 30, on recruitment procedures in the water, energy, transport and postal services (which repealed the law 48/1998 of December 30) from this portal it will also be possible to manage all the information related to labour aspects, certifications available, Social Security (TC1, TC2), contracts, etc. Furthermore, it is necessary that all this information is constantly updated in order to be allowed to keep working with the company.
In the case of companies whose production is dependent on suppliers who reside in developing countries, it is common to find examples where the company itself seeks a minimum salary level for employees in the supply chain to ensure a proper treatment of staff. In addition, sometimes the company funds the supplier to enable it to invest in producing quality raw materials. Other companies, for example, make machinery available to the supplier to promote speed, efficiency and quality. Others point their suppliers to continuous improvement programs which include financial assistance that enables them to plan their production in the long term by assuring a long-term contract.

When Starbucks Coffee decided to implement the responsible management of their supply chain, the first thing it did was focus on two aspects: quality and economic transparency. In relation to economic transparency, all suppliers who send samples of coffee to Starbucks Coffee, have to submit all the payments made throughout the supply chain and include all persons working in the manufacturing process of coffee. It is required that farmers receive at least the minimum wage stated by law of the country or, by category, the average salary of that post in the country. Economic transparency is applied to 98% of purchases. In addition, Starbucks Coffee has created the “Preferred Supplier” program which aims to encourage coffee producing suppliers to implement Corporate Social Responsibility practices. After the supplier has completed a questionnaire with questions relating to working hours, child labour, access to shelter, safety, environmental indicators, etc., a verifier is sent to give an assessment: 80% compliance – preferred supplier; 60% - preferential supplier; 50% - verified supplier. From there, the supplier has a year to improve its verification. What is obtained in return? Access to credits at low interest, preferential purchasing by Starbucks Coffee and Premium price for their coffee in the first year.

Grupo Ferrovial, S.A has more than 25,000 suppliers, although 3,000 of them represent 80% of the total revenue. All subcontractors are offered, on a regular basis, training courses in occupational hazard prevention and workshops on the use of certain types of machinery. They also have supplier/partner agreements to develop joint projects for new technologies. They are helped to develop new technical skills and, in general, investment in R&D&I is encouraged.
To ensure that the plans set out in the phase of joint planning and implementation are fulfilled, it is recommended that firms carry out a continuous and close monitoring of their supply chain. This can be done through visits to plants and audits, but the process in each case will depend on the risk of each provider.

It is recommended that contract with the suppliers includes which controls will be carried out to avoid potential misunderstandings between both parties. In this way, if it decided to terminate the contract by irregularities discovered after one of these controls, the contract will legally support the decision.

Those companies with limited resources to hire audits may include in their contracts a clause which mentions their right to access the results of external audits that are carried out by the supplier company or by a third party client.

The common elements to this phase are:

- **03a Visits to the plants**
- **03b External audits**

To monitor the suppliers which only operate in Spain, a visit to the premises of the supplier and the subsequent management of an evaluation report are usually sufficient to determine whether the firm is suitable to be worked with or not.

However, in companies with a more complex supply chain or which operate abroad, there is a danger that the visits are not sufficiently effective. In general, the visits are minimally scheduled, giving suppliers a lead time to prepare and be able to temporarily correct any failings in the eyes of its client.

**Working Case**

In developing countries, Gas Natural SDG, S.A visits its suppliers and sends auditors to verify whether the suppliers have the sufficient skill level to purchase material from them. International level companies certify, in situ, whether suppliers are complying with quality requirements and necessary technical specifications. Sometimes, Gas Natural contracts the services of an ocular inspector to check the management of the supply chain. In Spain, the listings of employees and documents relating to the payment of Social Security contributions are usually requested.
External audits

These audits are usually based on the need to find results backed by more standardized and concise information.

Given that there is widespread use of such control system, international audit firms have been established in the main countries of residence of suppliers, especially in Asia, hiring local staff with a thorough knowledge of the current legislation in the country and with the advantage of being able to visit the audited company at any time.

Working Case

In late 2006, Repsol YPF approved the new regulatory body, common to all Units of the company in all countries, which established the bases and minimal criteria to be respected in the process of Supplier Management. Repsol YPF supports and endorses the values of Integrity, Transparency, Accountability and Security set out in its Standard of Ethics and Conduct. The rating process is intended to assess whether a provider is capable of successfully delivering a product or service. Its criticality is established based on the good or service being supplied. In the case of critical goods and services, as well as gathering information, an audit is conducted on the provider’s own facilities. The outcome of the process determines the allocation of a rating (Qualified, Provisionally Qualified or Not Qualified) for the suppliers depending on whether or not they meet the requirements. Those companies which have supplied goods or services deemed as critical will receive an assessment, at least annually, of their performance. In the year 2008 a unified system for the management of suppliers, called SISPRO, has been developed.
After a period of collaboration (which typically revolves around the six months or a year), the company must conclude if its supply chain is sufficiently respectful of production requirements and criteria for quality management or not. Accordingly, the following steps to take would be:

04a Incentives for those suppliers which have fulfilled their compromises
04b Breaking of contracts with those suppliers who have not performed

In the event that the supplier delivers a quality product in compliance with the requirements of the contract, the company may want to encourage the result by implementing preferential measures such as long term financial support, long term contracts or accessibility to other customers.

- The financial support allows the supplier to purchase machinery and improve the salary of its employees. Both factors can have a positive impact on the quality of production.
- In addition, the long term contract gives the opportunity to schedule a working strategy, with the possibility of incurring in certain costs to achieve an improvement in the productive process of the supplier.
- Accessibility to other customers is an opportunity that comes with the improvement of reputation. If the supplier receives good reviews from the client company, other companies will be interested in working with it, which ultimately will mean access to new business opportunities.

Working Case

AGBAR encourages those suppliers which, in addition to complying with the terms established in the contract, innovate in products or transactions. Providers which have innovated in the service or the materials provided, have been rewarded with patents that revert positively on both the supplier and the company itself.
Failure to meet the criteria agreed in the contract may result in penalties or the termination of the contract. The company runs the risk of damaging its image unless it complies with the agreements.

The supplier is usually granted a grace period to improve and meet the requirements of the companies, but, generally, no more than the agreed period is granted and the contract is cancelled.

If the supplier is working in a developing country, it is likely that the deadline for compliance will be longer.

**Working Case**

Much of the business of AGBAR is characterized by being a regulated service that must comply with the provisions of the Administration in each case (especially in environmental issues). Hence, the limits to performance are clearly set both for the companies of the Group as for their suppliers. AGBAR counts with approval processes of vendors and products to meet those limits, and transfers the environmental requirements to the contracts it establishes with suppliers. Any possible breaches are a cause for termination of such contracts.
Appendix 1
Basic concepts and definitions

There are several terms used to refer to the company or person that supplies a product or service:

- **Provider or Supplier:** A person or company that provides or supplies everything needed for an end to large groups, associations, communities, etc. (Real Academia de la Lengua Española-RAE) (Royal Academy of Spanish Language)

- **Contractor:** Person who, by contract, executes a material work or is responsible for a service for the Government, for a corporation or for an individual (RAE)

- **Supply chain:** Network of facilities and means of distribution which has the goal of collecting materials, transforming these materials into intermediate products and finished products and distributing these finished products to consumers (Michael E. Porter, Harvard University)

This diversity of terms has been used throughout the workshop. In this guide, the term Supply Chain has been used in a general sense, always bearing in mind the diversity of concepts that exist depending on the product or service being provided.

- **EIRIS (p. 8):** Ethical Investment Research Service: Global provider of information which independently investigates the social, environmental and ethical aspects of businesses. EIRIS (located in the UK and the USA) collaborates with international research institutions and specializes in research on responsible investment. [www.eiris.org](http://www.eiris.org)

- **FTSE4Good (p. 8):** The work methodology has been established as described in the document “Supply Chain Labour Standards” of the FTSE4Good Index Series. FTSE4Good was created in 2001 in conjunction with the Ethical Investment Research Service (EIRIS) and the United Nations International Children’s Emergency Fund (UNICEF). It was designed to measure the behaviour of companies that meet recognized standards of CSR, thereby facilitating investment in them: [http://www.ftse.com/Indices/FTSE4Good_Index_Series/Downloads/FTSE4GoodJapanSupplyChainCriteriaEng.pdf](http://www.ftse.com/Indices/FTSE4Good_Index_Series/Downloads/FTSE4GoodJapanSupplyChainCriteriaEng.pdf)

- **High-risk products and sectors (p. 8):** In order to respond affirmatively or negatively to the questions, the Classification of high-risk Products and Sectors in Labour Rights in the Supply Chain proposed by EIRIS must be used, which is also used by FTSE in the development of its FTSE4Good index. At the moment there is no classification for areas of moderate risk, which means that in the future it may be that non designated sectors (low risk) are classified as a higher risk.

Classification of high-risk producers and sectors in Labour Law in the supply chain according to EIRIS and FTSE4Good: agricultural crops (sugarcane, coffee, tea, cocoa, tropical fruit, fresh vegetables, flowers), consumer products: clothing and footwear, toys, leisure, textiles and leather, food processing; supermarkets and department stores; small retailers of clothes, miscellaneous items, textile and drugstore.
## Economy Low income countries

<table>
<thead>
<tr>
<th>Argentina</th>
<th>Guinea-Bissau</th>
<th>Nigeria</th>
<th>Sierra Leone</th>
<th>Solomon Islands</th>
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## Economy Countries with medium/high income

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<td>Gabon</td>
<td>Zanzibar</td>
<td>Saint Lucia</td>
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<tr>
<td>Hungary</td>
<td>Montenegro</td>
<td>Saint Vincent and Grenadines</td>
<td></td>
</tr>
<tr>
<td>Island of Granada</td>
<td>Oman</td>
<td>Serbia</td>
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</tbody>
</table>

## Economy Countries with medium/low income

<table>
<thead>
<tr>
<th>Albania</th>
<th>Algeria</th>
<th>Angola</th>
<th>Armenia</th>
<th>Azerbaijan</th>
<th>Belarus</th>
<th>Bhutan</th>
<th>Bolivia</th>
<th>Bosnia and Herzegovina</th>
<th>Cameroon</th>
<th>Cape Verde</th>
<th>China</th>
<th>The West Bank and Gaza</th>
</tr>
</thead>
<tbody>
<tr>
<td>Afghanistan</td>
<td>Bangladesh</td>
<td>Benin</td>
<td>Burkina Faso</td>
<td>Burundi</td>
<td>Cambodia</td>
<td>Chad</td>
<td>Comoros</td>
<td>Ivory Coast</td>
<td>Eritrea</td>
<td>Ethiopia</td>
<td>Gambia</td>
<td>Ghana</td>
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</tbody>
</table>

For the elaboration of the Codes of Conduct of the supply chain, the companies have used the following Spanish and International Laws, regulations and certifications as a basis:

- **Spanish Legislation**
  - Law 31/1995 for Prevention of Labour Hazards
  - Law 2/1985 for Civilian Protection

- **Directives of the Spanish Association for Normalization and Certification (AENOR)**

- **European Union Directives**
  - EMAS (Eco-Management and Audit Scheme)

- **International Normalization Organization (ISO) Directives**
  - ISO 9004:2000 Directives for the improvement of performance in quality management systems
  - ISO 14000 Environmental Management Systems in production environments

- **Social Accountability International (SAI) Directives**
  - SA 8000 (Social Accountability)

- **United Nations Organization (UNO) Directives**
  - NUN Human Rights Regulations

- **Global Reporting Initiative (GRI) Directives**
  - GRI Indicators

- **International Labour Organization (ILO)**
  - ILO Regulations