ACT
Action Collaboration Transformation

ACT LABOUR COSTING PROTOCOLS

The ACT labour costing protocol provides guidance to brands for implementing the Purchasing Practices[1] commitment to cover wages and wage growth in brand purchasing prices as outlined in the ACT Memorandum of Understanding. The ACT labour costing protocol is based on three key pillars:

1. All ACT member brands agree to follow the **Labour Costing Principles**
2. The principles are operationalised through a variety of **labour costing methodologies**
3. ACT member brand labour costing is monitored through the **ACT accountability and monitoring framework** that includes internal assessments, anonymous feedback from suppliers and a complaints mechanism for suppliers and other stakeholders.

ACT LABOUR COSTING PRINCIPLE

1. The transformation of the global garment industry based on better wages requires **changes in the current business practices** and investment in sustainable business relationships based inter alia **on transparent and fact-based price calculations.** Brands recognise that a commitment to production countries and suppliers are a key enabler for paying living wages.
2. All garment and footwear volume sourced is based on the ACT labour costing protocol. Brands accept responsibility to ensure that labour cost have been calculated and to **verify that the price paid allows the payment of wages and all other labour costs**, although the detailed costing may be performed by the supplier.
3. The labour costing will allow for all direct and indirect labour costs to be isolated and **incorporated as a distinct costing block in price negotiations.**
4. Brands will conduct labour costings in line with predicted wage increases as soon as the information becomes available or, where exact data is not available, the best estimate of an expected wage increase, and to **incorporate this into purchasing prices.**
5. When other cost inputs (e.g. cost of fabric, energy costs, size of order) remain equal, **wage increases will be covered through higher purchasing prices.**
6. **Suppliers will not be expected to cover rising wage costs through unreasonable efficiency gains or reduced margins**. While brands and suppliers can work together to increases the efficiency[2] of any particular purchase order, brands will not impose unilateral expected efficiency improvements on the supplier. Indicative year on year average efficiency improvements can be agreed in a fair and reasonable manner with suppliers and are independent from negotiated or statutory wage increases.
7. **Brands will contribute to efficiency improvements** through better purchasing practices and training.
8. Brands will provide guidance to suppliers (manufacturers or intermediaries) on **labour costing.**
9. Brands will have an **internal monitoring mechanism** to track the application of ACT labour costing protocol including the reflection of higher wages and other labour costs in purchasing prices.

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1   Purchasing Practices Commitments: Brands commit that purchasing prices include wages as itemized cost'.
2   Buyer driven efficiency improvements include the size of order and the capacity utilisation driven by volatility in forecasting while supplier driven improvements investment in industrial upgrading through training and technology as well as improvements in process efficiency. There is obviously a limit to the expected efficiency improvements.

LABOUR COSTING MECHANISMS

The labour cost component of any given order can be determined through a cost-based calculation (CBC) model (e.g. open costing), through a labour share (LS) model or indeed through a combination of both. Most brands will likely use a combination of methodologies depending on the nature of the relationship to the supplier, whether the product was procured directly or through intermediaries etc. Developing multiple approaches will provide the flexibility to address adequately the sourcing and buying models different buyers apply.

The CBC requires a detailed level of open costing between buyers and suppliers to determine the price of an item. The LS model is designed to facilitate the ring-fencing of labour costs when negotiations rest on a FOB/CMT price and do not engage in detailed costing. The overall price of a product is in this case determined more on the basis of historic prices or benchmarking in the market.

CBS - COST BASED CALCULATION MODEL FOR RING FENCING LABOUR COSTS

The Cut-Make-Trim (CMT) price for any item is based on a number of cost items including labour cost component (LCC) – which is set by the labour minute value (LMV), the standard allowed minutes (SAM) and an efficiency factor – factory overheads, additional costs and factory mark-ups. The Free-on Board (FOB) price will also include material/ fabric and shipping. The illustration below uses the term of Cost of Making (CM) which is simply covering overheads and the labour cost component of the price. Depending on the specific buying model prices negotiations will include different aspects of the overall production process.

This costing-model for ring-fencing labour costs applies where suppliers and buyers negotiate prices on an open-costing basis. Transparency and detailed negotiations between buyers and suppliers allow a fact-based negotiation where wage costs can adequately be reflected as a costing block of the overall purchasing price. Other costing blocks must then of course also be identified as the illustration above already showed.

COSTING BLOCK	
Fabric costs	
Additional costs (trims/ zippers etc)	
Labour cost component (ILCC)	
Labour minute value	
SAM	
Effeciency Rate	
Total LCC	
Factory contributions (overheads and markups)	
Total	

The labour cost component (LCC) needs to be identified and ring-fenced in order for brands to facilitate the payment of the negotiated wage. The LCC is the direct and indirect labour cost required for producing any particular item. The LCC is calculated on the basis of a Labour Minute Value (LMV) and Standard Allowed Minutes (SAM) and an Efficiency factor specific to the production unit and type of order.

$$\text{Labour Minute Value} = \frac{(\text{Labour Minute Value} \times \text{Standard Allowed Minutes})}{(\text{Effeciency Factory})}$$

The Labour Minute Value (LMV) is the cost of labour of each production minute in a particular production unit. This means it is calculated on the basis of the cost of labour to the factory per real production minute. The production minutes of a factory will be the number of machine operators multiplied with the normal working time of the factory. The labour cost must include the cost of direct and indirect labour (including wages, mandatory allowances, social security contributions and maternity pay).

$$\text{Labour Cost Component} = \frac{(\text{Direct Labour Costs} + \text{Indirect Labour Costs})}{(\text{Total Production Minutes})}$$

The labour minute value needs to be based on the indirect and direct labour cost of all production workers and auxiliary workers but exclude factory management.

The Labour cost component furthermore depends on Standard Allowed Minutes (SAM) per garment and factory specific Efficiency. There are two main ways in which a SAM can be determined – by sampling an average time via in factory work study or by using a predetermined motion time system approach which uses synthetically generated standard minute values which become the target times subject to the reality of the factory environment.

Efficiency is the third dimension of assessing the labour costs. Efficiency has a major impact on the unit labour costs and also on the overhead cost per unit of output. There are different elements that impact on efficiency. Both buyers and suppliers have a role to play in improving efficiency. The efficiency factor is factory specific and will be included in the negotiations on orders as an input in the price.

Potential factors for buyer-driven efficiency improvements	Potential factors for supplier-driven efficiency improvements
Size of orders: In this case efficiency differences are directly linked to the order itself. Refitting of the line is more costly per unit for a small order and vice versa. The different costs are related to the individual contract.	Productivity, technology, infrastructure, vertical integration: These are elements of industrial upgrading that need to be part of the long-term sustainability of an industry.
Capacity utilisation: Under-utilisation (brand and supplier efficiency) of capacity caused by high volatility of orders, bad forecasting and planning etc. is increasing labour costs per unit. This is also be the case for over-utilisation (overtime).	Process efficiency: Process efficiency has an immediate and direct impact on costs. It reflects the actual number of workers required in a specific factory to provide a certain production capacity, the methods and layout used in the production process.

LABOUR SHARE COSTING MODEL FOR RING FENCING LABOUR COSTS

The LS model assumes that the negotiations will not enter the same level of detail as in the CBC model. Buyers and suppliers are not using an open costing method to determine the LMV of each production unit and hence negotiate in less detail on the different cost components of the price. The basis for negotiations is therefore either the FOB or CMT price, or potentially the Cost of Making (CM) price which means that factory mark-up, materials and shipping and other costs are separated. In this model ring-fencing the labour cost component also requires engagement with suppliers to determine a number of supplier and order specific factors, including the labour-share of a number of standard models, their indirect labour cost, the material used, as well as an efficiency factory for the order. Determining supplier specific costing blocks is also important in order to calculate any coast increase due to a national or sector wide wage increase.

If an agreement is reached over the percentage of overall costs which make up labour costs, then an increase in wage as a result of the CBA negotiations or minimum wage increases can be estimated through a percentage increase in the labour cost. The labour-share of a particular order however will also change as labour costs rise, complexity evolves of efficiency improves.

Therefore, the engagement with suppliers on their estimated labour-share for specific models, need to be repeated at regular intervals. This is especially important for new lines or orders where no comparable historical data exists. Although some standard models can be used to benchmark costs when ordering from existing suppliers, where brands enter a new business relationship these benchmarks will need to be developed.