

***FAIRPHONE***

# Paying Living Wage in the Electronics Supply Chain

Fairphone designs and produces smartphones with the goal of making improvements throughout the electronics supply chain. One of our key focus areas is improving working conditions, which includes providing decent work. Decent work is based on the idea that work is a source of personal dignity, and a person's ability to provide for their family is an important aspect in their life and role in society. According to the International Labour Organization (ILO)<sup>1</sup>, decent work involves:

- Opportunities for work that are productive and deliver a fair income.
- Security in the workplace and social protection for families.
- Better prospects for personal development and social integration.
- Freedom for people to express their concerns.
- Organize and participate in the decisions that affect their lives and equality of opportunity and treatment for all women and men.

This is at the core of Sustainable Development Goal 8: “Decent work and economic growth”. In all definitions of decent work, dignity, respect, safety and income are the key aspects.

As a whole, the electronics industry is known for unfavorable working conditions: the well-being of workers is not safeguarded, wages are low, and employees are not able to influence their work environment<sup>2</sup>.

Wages levels are a key concern for workers throughout the electronics supply chain. Low wages have a direct impact on workers themselves, as well as their family's well-being and quality of life. It can lead to people working long hours, and in more extreme cases, keep them locked-in the “poverty-trap” or encourage children to drop out of school and start working.

External stakeholders, such as consumers, public buyers (e.g., Electronics Watch), legislators, investors and banks (e.g., Platform Living Wage Financials), leading product or company certification standards such as Blue Angel, SA8000, Fairtrade and WFTO, as well as NGOs are paying more and more attention to living wages. Currently there are some examples of living wage programs in other industries, such as agriculture and textiles. However, there is a clear need for scalable living wage initiatives in the electronics industry.

This paper first covers the concept of living wages in general, and then looks specifically at how Fairphone is supporting one of their suppliers to enable them to pay living wages to their workers.

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<sup>1</sup> ILO <https://www.ilo.org/global/topics/decent-work/lang--en/index.htm>

<sup>2</sup> See for example the researches and articles by SOMO (<https://www.somo.nl/topic/electronics/>) and Good Electronics (<https://goodelectronics.org/>)

## What is a living income or wage?

The Global Living Wage Coalition (GLWC) is a collaboration of international organizations and social standards such as ISEAL, SAI, Fairtrade and Rainforest Alliance. The GLWC defines a living wage as:

“The remuneration received for a standard workweek by a worker in a particular place sufficient to afford a decent standard of living for the worker and her or his family. Elements of a decent standard of living include food, water, housing, education, health care, transportation, clothing, and other essential needs including provision for unexpected events.”<sup>3</sup>

For guidance on how to estimate living wages and effectively measure all the related elements, the GLWC employs the Anker Methodology. As a starting point, local and national living wage estimates may already be publicly available on the websites like the GLWC, Asia Floor Wage and the Wage Indicator Foundation. Because the cost of living in a big city may be different than the cost of living in the small village, local estimates can be especially useful. But if local figures are not available, national estimates can also serve as a useful point of reference.

## Low wages are a root cause of excessive overtime (and other issues)

In many countries where electronics production takes place, the legal minimum wage is not sufficient for workers to afford a decent standard of living for themselves and their families.

In other words, low incomes may mean that workers and their families lack or have limited access to food, education, health care, housing or other essential needs. In 2018, the Chinese NGO Worker Empowerment (WE) found that factory workers in Guangdong province who earn low wages cut their spending on food, housing, clothes and transport to substandard levels, in order to be able to pay for health care and to financially support to their family. As a result, the NGO concluded that they had a low quality of life<sup>4</sup>. To increase their income, workers may want to work extremely long hours or work multiple jobs. This shows how low wages can directly contribute to excessive working hours, a chronic issue in the electronics supply chains.

In addition, low wages can contribute to limiting children’s education opportunities, or in more extreme cases, encourage child labor. Children with limited access to education will likely perform low-skilled jobs for low wages when they become adults, continuing the cycle. Improved wages may be a crucial factor in breaking this cycle, reducing the need to work extremely long hours, improving their ability to afford essential needs such as housing, and therefore allowing them to achieve a better overall quality of life.

<sup>3</sup>GLWC <https://www.globallivingwage.org/about/what-is-a-living-wage/>

<sup>4</sup>Worker Empowerment (2018) “Workers’ wage and Living Expenses in Four Tier Cities in Guangdong Province” <http://www.workerempowerment.org/en/research-reports/260>

Low wages and excessive overtime are not just worker-related issues – they also directly impact employers. Excessive overtime can lead to lower efficiency, more mistakes and poor production quality. As a consequence, manufacturers face higher costs to cover rework, accidents and increased accident insurance. Situations like these also contribute to low satisfaction and depression among workers, which in turn leads to higher turnover, meaning loss of skilled workers and increased recruitment costs. Improved wages can have the opposite effect: a happy, stable and skilled workforce, as well as cost savings.

## Why should manufacturers invest in living wages at their own companies?

- **Being a responsible employer**

Ensuring that your staff can afford a decent standard of living is the right thing to do from both a moral and a legal standpoint.

- **Stable and skilled workforce**

Better wages contribute to higher worker satisfaction, higher retention rates of skilled workers, lower recruitment costs, better quality management and a safer workplace.

- **Managing excessive working hours**

Low wages are a key driver for excessive working hours. Improving wages enables companies to better control excessive overtime without negatively impacting workers' (financial) well-being and employee turnover.

- **Reputation, access to market and stakeholders**

Proactively build your reputation as a responsible employer, ensure access to (public) buyers with the highest procurement standards and meet the demands of other customers, investors and the community at large. Improved wages support the (economic) development of the community around the workplace as well.

## Why should an electronics brand or company support the payment of living wages in the supply chain?

- **Human rights**

Ensuring that people working throughout the supply chain can afford a decent standard of living is the right thing to do from both a moral and legal perspective

- **Managing excessive working hours**

Low wages are a key driver for workers wanting to work excessive working hours. Without addressing living wages, managing excessive overtime will remain an ongoing challenge.

- **Stable, quality supply**

A stable, skilled and happy workforce throughout the supply chain contributes to stable and high-quality supply, now and in the future.

- **Reputation, access to market and stakeholders**

Proactively build your reputation as a responsible company, ensure access to (public) buyers with the highest procurement standards and meet the demands of other customers, investors and the community at large. Improved wages further support the (economic) development of the community around the suppliers as well.

## Who pays for the living wages?

The electronics industry is highly competitive and is notable for having a large number of companies with negative earnings.<sup>5</sup> For example, in 2017, the semiconductor and other electronic components industry was ranked among the top 4 least profitable industries (out of thousands of industries) with an average profit margin of 0.3 percent.<sup>6</sup> The profit margins of Foxconn and other EMS factories (that design, manufacture and repair electronic devices) have dropped to 2-3 percent, and some are even generating no profits. While labor costs represent only 2 percent of the EMS product price, they represent upwards of 40 percent of the real EMS manufacturing cost.<sup>7</sup> According to ETUI “herein lies the main tension between the EMS provider and their workers, because mere fractions of a per cent in labor costs have a cumulative effect on millions of products and on margins”.<sup>8</sup>

Because legal minimum wages are far below the actual wages required for a decent standard of living, and because of tight competition between manufacturers and low profit margins, it is challenging for manufacturers to pay living wages solely based on their own initiative. Electronic brands can support their suppliers and provide the necessary incentive to take this step, by adopting a living wage strategy and financially contributing to living wage payments for their suppliers’ employees. Realistically, increased labor costs will either affect the margins of the companies further down the supply chain, or have to be passed on to the consumer. However, as our case study shows, the price increase for paying a living wage bonus to the workforce at our direct supplier is only 0.33 percent of the retail price. We feel that such a margin can be easily absorbed by the brand or its customers.

There are examples from outside of the electronics industry (agriculture and textiles) where brands provide financial support to supplier factories, mines and farms to realize living wages or incomes.<sup>9</sup> The case study below demonstrates how Fairphone is helping to introduce a living wage at one of our suppliers in the electronics industry.

Ideally, our goal is to move towards a 40-hour workweek for all of the employees with an income that is sufficient for covering the cost of living for the workers and their families. For the employees and their families, this will result in a higher quality of life, as well as an improved work-life balance.

Additionally, as mentioned previously, introducing a living wage also offers concrete benefits for the factory. Besides ensuring they align with local labor laws and international standards for working hours, it will also help them improve worker satisfaction. Higher satisfaction levels will in turn improve retention rates – helping the factory hold on to skilled workers and lowering recruitment costs. Finally, higher wages will reduce the need for excessive overtime and the accidents, quality issues, inefficiency and physical and mental strain that often accompany it.

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<sup>5</sup> <https://www.investopedia.com/ask/answers/051215/what-profit-margin-average-company-electronics-sector.asp>; <https://www.mckinsey.com/industries/consumer-packaged-goods/our-insights/consumer-electronics-gets-back-to-basics>

<sup>6</sup> <https://www.forbes.com/sites/sageworks/2017/09/24/these-industries-generate-the-lowest-profit-margins/#b34e1d5f49d2>

<sup>7</sup> European Trade Union Institute (ETUI) “Flexible workforces and low profit margins: electronics assembly between Europe and China European”. Page 166

<sup>8</sup> European Trade Union Institute (ETUI) “Flexible workforces and low profit margins: electronics assembly between Europe and China European”. Page 166

<sup>9</sup> For example, Fair Wear Foundation’s publication “Living Wages: an explorer’s notebook piloting living wages in garment factories” presents an overview of efforts of multiple companies addressing living wages at supplier factories. <https://www.fairwear.org/wp-content/uploads/2016/11/Explorers-Notebook-web.pdf> More examples from the agriculture sector can be found at websites of amongst others Global Living Wage Coalition (<https://www.globallivingwage.org>), ALIGN (<https://align-tool.com/>), Fairtrade.

## Case Study

### - How Fairphone is paying a living wage bonus at a first-tier supplier in China

The Fairphone 3 is produced at a manufacturing facility in Suzhou, China. Fairphone is working in close collaboration with the supplier to jointly improve worker satisfaction and working conditions. One of the central pillars of our approach is that it is worker driven: we actively seek input and participation of the workers themselves as part of the process of improving the working environment. From our interactions, it became clear that improving wages was a key priority for the factory's employees.

We therefore benchmarked the legal minimum wage versus publicly available living wage estimates and employee survey findings:

Legal minimum wage Suzhou for 40-hour work week (2019):	<b>2020 RMB (263 EUR)</b>
GLWC Living Wage estimate for Suzhou (2015):	<b>3534 RMB (460 EUR)</b>
Asia Floor Wage estimate for China (2017):	<b>4547 RMB (592 EUR)</b>
Survey: Workers' input on sufficient wage (Nov 2018):	<b>5000 RMB (651 EUR)</b>

As the table shows, the living wage estimates are more than double the legal minimum wage. This explains why workers want to work overtime – they simply want to increase their income so they can actually cover the cost of living.

To go into greater detail, Fairphone's Satisfaction Survey and dialogue session (conducted in November 2018) generated the following feedback from the supplier's employees:

- Wages and bonuses were rated as “the most urgent to improve”.
- Only 27% of workers found their income fair.
- 11% of all workers (with an average income of 3752 RMB) found it difficult to survive on their existing income. Of the workers who earn 3900 RMB or less, 77% found it insufficient or difficult to survive.

The lowest paid workers in the factory earn the legal minimum wage for a 40-hour workweek. As a result, the workers are keen to work overtime to increase their salary. But even with the extra income for overtime, the vast majority of the workers (>80 percent) still do not earn the 5000 RMB salary that workers feel is sufficient to cover the cost of living.

With these calculations in mind, it was clear we could not limit the working hours on our production line to 40 hours per week without hurting the financial well-being of the workers.

## Getting started

**To kick off our improvement plan, we first gathered available documentation on living wages in China and consulted:**

- The supplier’s management team
- The supplier’s workers
- Experts experienced in implementing living wages in the supply chain

**In defining our approach, the expert stakeholders recommended:**

- Gathering data and workers’ perspectives
- Defining the target wage, we’d like everyone to earn in the ideal scenario
- Defining the gap between the target wage and the current wages
- Defining who will receive the bonus
- Defining how workers will receive the bonus

## Defining the set-up

After reviewing the living wage estimates from the GLWC and Asia Floor Wage, and consulting workers through a survey and dialogue, we set the target wage at 5000 RMB before taxes (+/- 4500 RMB after taxes). In an ideal situation, this is the wage we would like everyone in the factory to earn.

Next, we calculated how much Fairphone would need to pay in order to achieve this wage on our production line. It is important to note that Fairphone is not the factory’s only customer. In fact, we likely account for less than 10% of the total production in the factory. To define how big the Fairphone’s share should be in bridging the gap to living wages for all factory workers, we looked at the how much labor time is spent per phone. This approach is fair in that the contribution per brand customer of the factory is proportional to their size of production.

Here is how we calculated the additional product price needed for living wages:

<b>Additional wage per hour needed for an average production line worker to reach the target wage</b>	<b>(monthly target wage 5000 RMB – average monthly wage of production line workers) / 173 hours</b>
x	
<b>Additional amount needed for all workers on Fairphone production line</b>	<b># of workers on production line</b>
/	
<b>Amount needed per phone</b>	<b># of phones produced per hour</b>
=	
	<b>1.50 EUR per phone</b>

So, by increasing the product price by 1.50 EUR, we can achieve a living wage for all workers on our production line. If all of the factory’s customers made the same calculation, all of the factory workers would get a full living wage.

We fixed the living wage bonus at 1.50 EUR per phone produced for one year and incorporated it into the product price. After one year, we will reevaluate the level of the bonus. For a product with a sales price of 450 EUR, the cost of paying a living wage accounts for 0.33% of the sales price.

The factory workers, as well as other stakeholders and experts, recommended to sharing the bonus with all workers in the factory, not just the workers on the Fairphone production line. We set the following guidelines for who receives the bonus:

- All workers earning less than the 5000 RMB target wage, regardless of their role
- Everyone who has worked at least 3 months at the factory (as incentive for retention)

Everyone who has worked at least 70% of the month (perceived as fairer than if everyone gets the same bonus regardless if you work one day or the full month)

Using this structure, we hope the bonus will go to those who need it most.

The bonus will be paid four times per year. It will be paid on top of the workers regular salary. In the first six months since the implementation, this resulted in workers receiving up to an additional 3000 RMB (or 422 Euro) per person. This is equivalent to 1.5 times the monthly legal minimum wage, so it is quite significant.

Because we share the bonus with all workers who earn less than 5000 RMB per month, the bonus per worker is lower than if we would only distribute it to those working on our production line. As a result, we can't yet limit working hours to 40 hours per week or we will hurt the financial well-being of the production line workers. In the long term, this is still the ambition. If more of the factory's customers start paying living wage bonuses, this can become a reality.

After 12 months, we will evaluate the implementation of the living wage bonus, the amount and its impact. As paying a living wage in the supply chain is still uncharted territory, we expect we will gain new insights and make some changes at that point in time.

### **Some of the impact indicators we will use in for the evaluation include:**

- Employee satisfaction
- Employee retention rates
- Number of workers who received a bonus
- Additional income received per worker per year
- Percent of workers are aware of the bonus
- Percent of workers feel it improves their income

## Start paying living wages in your supply chain!

Our attempts to increase wages and employee satisfaction are built on research, external consultation and employee input, but what we're doing is still in the very early stages. To improve initiatives like these, learn from each other and start making living wages the norm (and not the exception) in our industry, we'd like to call on all stakeholders to take the first steps towards helping workers in their supply chain achieve decent work and fair incomes. Here's how you can take the first step:

### **Start paying living wages in your supply chain, too.**

Just start. Don't get caught up on ideological details but start paying higher wages and learn along the way.

### **Address living wages as part of a wider program to improve working conditions.**

Don't solely focus on wage levels, but address wages holistically and ideally as part of a wider working conditions program.

### **Work together to drive change at the industry level.**

To effectively address wage levels in the supply chain, you need to address your own supply chains as well as industry as a whole. For example, the textile industry has ACT<sup>10</sup>, an inspirational collaboration of major fashion brands that lobbies for living wages and better collective bargaining in their supply chains. Let's work together on industry level.

### **Share lessons learned.**

Accelerate industry change by sharing what you have learned.

When it comes to living wages and incomes, the question for the future isn't whether we can afford to pay prices that support a living wage, but whether we can afford not to.<sup>11</sup>

<sup>10</sup> ACT <https://actonlivingwages.com/>

<sup>11</sup> Fairtrade (31 Jan 2020) A Business case for living incomes <https://www.fairtrade.net/news/a-business-case-for-living-incomes>

## Want to know more? Useful resources:

Ethical Trading Initiative's Base Code Guidance on living wages. [https://www.ethicaltrade.org/sites/default/files/shared\\_resources/eti\\_living\\_wage\\_guidance\\_2.pdf](https://www.ethicaltrade.org/sites/default/files/shared_resources/eti_living_wage_guidance_2.pdf)

Fair Wear's Guide book "Living Wages: an explorer's notebook piloting living wages in garment factories" presents an overview of efforts of multiple companies addressing living wages at supplier factories. <https://www.fairwear.org/wp-content/uploads/2016/11/Explorers-Notebook-web.pdf>

ASN Bank - Practical guidance document "Garment companies and living wage" [www.asnbank.nl > web > fileGarment companies and living wage - ASN Bank](http://www.asnbank.nl/web/fileGarment%20companies%20and%20living%20wage-ASN%20Bank)

Global Living Wage Coalition - Guidance resource on living wages and publishes living wage estimates <https://www.globallivingwage.org/>

ALIGN - Guidance tool for implementing living wages <https://align-tool.com>

Asia Floor Wage - Estimates of living wages in multiple Asian countries <https://asia.floorwage.org>

WageIndicator - wage information and labour laws available on 80 countries <http://www.wageindicator.org/main/Wageindicatorfoundation/wageindicatorcountries>

ACT - Collaboration of major fashion brands to lobby for living wages and better sectoral collective bargaining <https://actonlivingwages.com/>

ILO - "Purchasing practices and low wages in global supply chains: Empirical cases from the garment industry" [https://www.ilo.org/wcmsp5/groups/public/---ed\\_protect/---protrav/---travail/documents/publication/wcms\\_561141.pdf](https://www.ilo.org/wcmsp5/groups/public/---ed_protect/---protrav/---travail/documents/publication/wcms_561141.pdf)