Globalization has led many brand owners and retailers to expand their sourcing bases into emerging economies. Sourcing from emerging and developing economies may yield direct cost savings, but this practice often entails greater supplier responsibility risk (such as supplier noncompliance with environmental or labor standards). There exist a variety of different actions buyers can take to mitigate such risks, but the relative effectiveness of these actions is not clear. In this paper, we develop a supplier responsibility risk model in which some suppliers in emerging economies may be more prone than others to cut corners because of differences in suppliers' intrinsic ethical levels. Based on this model, we find that, when the stake of supplier responsibility problems is high, the buyer should offer the supplier price premiums, nonmonetary rewards, and long-term contracts. For the situation in which a supplier's intrinsic ethical level is unobservable to the buyer, we study a screening mechanism based on delayed payment terms. Surprisingly, we find that, when the stake of supplier responsibility problems is high, the optimal screening mechanism collapses to a random selection. We further discuss the implications of third-party certification programs and supplier development initiatives within our ethical sourcing framework.

Bio

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