

Code of conduct

for industrial subcontracting, supply and
partnership relations



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UNITED NATIONS INDUSTRIAL DEVELOPMENT ORGANIZATION

Industrial Subcontracting and Supply Chain Management
Industrial Promotion and Technology Branch

Vienna, 2006

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Justification

The growing use of industrial subcontracting has encouraged the development of a new concept of subcontracting relationships and demonstrated the importance as well as the necessity of transforming a relationship that started out as unbalanced and unequal into a relationship that is both more sustainable and more balanced between the various industrial partners.

Since 1985, UNIDO has endeavoured to defend and promote the concept of “industrial partnership”, which describes a modern form of industrial subcontracting, based on specialization and on up-to-date technological skills of subcontractors and suppliers, which leads to the development of fairer and more stable inter-company relationships.

“Industrial partnership” allows the main-contractors to concentrate on their core business and to adapt more easily to technical change while assuring adequate quality. It allows suppliers and subcontractors to concentrate on their field of specialization, improve their technology and access new markets or customers.

Moreover, in a modern industrial economy, subject to rapid change, the concept provides an essential element of flexibility, which is a key factor of competitiveness and progress, particularly necessary in the context of globalization.

Finally, this form of inter-company collaboration contributes to increasing trade between expanding regions and under-employed regions, and a better distribution of resources and tasks.

In legal terms, this modern concept of the subcontracting relationship helps to avoid disputes which are costly and damaging to the economic development of the companies concerned. In this sense, it is a degree of security and protection which is particularly important for long-term and international commitments. To ensure that all parties of a transaction are fully aware of their responsibilities, a professional code of ethics can play an important regulating and moderating role (while at the same time contributing to the economic development of the enterprises concerned), by recalling certain general principles of good business conduct inspired by some of the best practices observed by UNIDO in various countries.

Far from being forced on those involved, this code of conduct will, on the contrary, constitute voluntary guidelines which will stimulate constant improvement in industrial subcontracting and partnership relations suited to each company.

Some professional associations and industrial federations, together with certain internationally known companies will undertake to support the moral force of this code of conduct by sponsoring it, in order to encourage its observance by other companies.

Part I: Mutual obligations

In order to develop a relationship of true partnership between the main-contractor and the subcontractor, based on shared objectives and interests, in a framework of fairness, mutual trust and common benefit, recognizing and observing each other's rights and obligations, the parties shall endeavour to implement the following recommendations:

A. At the time of negotiation of the contract

1. *Definition of the general framework of the subcontracting relationship in clear and precise terms:*
 - 1.1 Identical understanding of the problems involved and a precise definition, for each subcontracted activity, of the rights and obligations of both parties;
 - 1.2 Preparation of a work plan (including a timetable) appropriate to the mutual collaboration;
 - 1.3 Preparation of (long-term) development plans which, as far as possible, set a schedule for regular and constant collaboration;
 - 1.4 Definition of all the elements and all the conditions for future orders: quantities to be supplied (max. and min.), time limits and periodicity; specifications, standards and qualities required; arrangements for inspection and reception; terms of payment and technical assistance requirements;
 - 1.5 Attachment to the contract of all the technical documents necessary for the proper performance of the work (drawings, technical nomenclatures, ...) if possible countersigned by both parties;
 - 1.6 Definition of the terms in the technical specification or terms of reference, so that they are as complete and precise as possible;
 - 1.7 Seeking a "fair price", i.e. remuneration which, for the best possible quality, taking into account the purpose of the product, offers the partners a fair deal in relation to their respective contributions.
2. *Definition of the important clauses of the contract:*
 - 2.1 Identification of the contract:
 - 2.1.1 Date of the contract (start and end of the contract);
 - 2.1.2 Duration of the contract:
 - (a) fixed term (unless one of the parties envisages an extension clause, the contract terminates on the expiry of the term agreed by the parties);
 - (b) indefinite term (each party may at any time terminate the contract unilaterally);
 - (c) A period of notice should be specified.
 - 2.1.3 Identity of the parties;
 - 2.1.4 Preamble: show clearly the title of the contract, the reasons for and the purpose of this subcontracting operation;

- 2.1.5 Definitions of the works, product and/or service (cf. Point 1 on the definition of the general framework of the subcontracting relationship);
- 2.1.6 Purpose of the contract: stipulate the transaction clearly.
- 2.2 Obligations of the main-contractor (or client).
- 2.3 Obligations of the subcontractor (or supplier).
- 2.4 Delivery terms.
- 2.5 Arrangements for delivery of the product:
 - 2.5.1. Determination of the frequency (even possibly “just in time”);
 - 2.5.2. Definition of the means of transport and type of packaging to be used;
 - 2.5.3. Determination of the terms of the transfer of ownership and of risks¹.
- 2.6 Acceptance of the work.
- 2.7 Penalties.
- 2.8 Price: calculation and adjustment of price (reference to a possible indexation clause).
- 2.9 Terms of payment:
 - 2.9.1 When is payment due?
 - 2.9.2 What instrument of payment will be used?
 - 2.9.3 Payment by instalments?
- 2.10 Payment guarantees (reservation of title clause; collaterals, ...);
- 2.11 Tax regime;
- 2.12 Export regime;
- 2.13 List of models and patterns, manufacturing moulds and jigs, and special tools;
 - 2.13.1 Definition of the destination of tools at the end of the contract (who owns it?);
 - 2.13.2 Definition of the destination of residual or waste materials and unused stock at the end of the contract.
- 2.14 Main-contractor’s trade marks/brands.
- 2.15 Subcontractor’s patents and know-how.
- 2.16 Confidentiality.
- 2.17 Acts of God and force majeure.
- 2.18 Contingencies clause.
- 2.19 Termination of the contract.
- 2.20 Assignment of the contract
- 2.21 Notification.
- 2.22 The applicable law.
- 2.23 Settlement of disputes (judicial; non-judicial).
- 2.24 Entry into force.
- 2.25 Contract documents.
- 2.26 Identity of the signatories to the contract and verification of powers.

N.B. For further legal information, the reader should refer to the “Practical Guide for Subcontracting Agreements”, prepared by UNIDO experts. The Guide also includes model contracts.

¹Reference, for example, to an INCOTERM clause which governs the obligation in respect of delivery and the point of transfer of risk.

B. During the performance of the contract

1. *Development of a relationship of trust between the partners based on:*
 - 1.1 *Mutual information*, firstly to improve the subcontracted products or services and secondly, to improve the value or the quality/price ratio. Within this framework of mutual information, the subcontractor suggests technical solutions most appropriate in his view and the main-contractor gives him credit for this research.
 - 1.2 Greater *cooperation*: collaboration with consultants, engineering and production control services.
 - 1.3 Better *communication or dialogue*:
 - 1.3.1 on the technical specifications (terms of reference);
 - 1.3.2 On all points that allow the subcontractor to define and focus his investment policy: initial investment; new investment; future investment; ...
2. *Development of secure and independent relationships:*

In this respect, subcontractors should ensure that they have a sufficiently diversified customer base (at least 3) and only assign a limited percentage of their production capacity to a single contractor. Likewise, main-contractors should seek to share their orders with at least 2 or 3 different subcontractors.

Part II: Obligations of the customer (main-contractor) towards the supplier (subcontractor)

1. *Obligation of careful selection*

To the extent that the subcontracting relationship creates a very close bond, and even interdependency, between the main-contractor and the subcontractor, the managers of the former must consider carefully before deciding on whether or not to subcontract: “to buy or to make” decision. This decision will be of crucial importance to the structure and operation of the two companies concerned. The decision will take account not only of economic factors (rational and objective data concerning the company and its environment) but also human factors.

In the same spirit, main-contractors should exercise particular vigilance and care in selecting subcontractors. Only subcontractors who can meet the main-contractor's requirements in terms of quantity and quality should be selected.

2. *Obligation to inform*

The obligation to inform will apply more particularly to the technical and financial aspects of the future order.

2.1 Technical aspects of the order:

2.1.1 Precise description, in writing, of the works or product (technical specifications, possible modifications).

2.1.2 Forecasting by the main-contractor, who should try to even out order quantities (to avoid piece-meal orders, which involved a risk of over- or under-utilization for the subcontractor).

2.1.3 Timely information to the subcontractor in the event of amendment to orders.

2.2 Financial aspect:

At the request of the subcontractor (who has concerns regarding the financial health of the main-contractor), the latter may provide him with documents confirming its sound financial health. In return, the subcontractor should undertake to respect the confidential nature of the information received in this manner.

In addition, the subcontractor may also try to obtain information from the industrial Subcontracting and Partnership Exchanges (SPX), which are subject to confidentiality in respect of third parties.

3. *Obligation of stability and security*

In order to encourage the eventual (medium or long-term) development of a real common industrial policy, the main-contractor will try to guarantee the subcontractor stability of orders.

Furthermore, the achievement of this objective can be reinforced in legal terms by the insertion of a *preference clause*. The purpose of this is to give priority to the subcontractor, where, for equal quality, his final offer is at the same price as the best price of the other companies consulted.

4. *Obligation of control*

The control relates to the quality of the product:

- Definition of the subcontractors production control criteria: joint definition of control criteria or involvement of third parties;
- Drawing up of “terms of reference” (an information file on the product, standards, specifications and other manufacturing details).

5. *Obligation of confidentiality* in relation to techniques (patents) and know-how used by the subcontractor.

Observance of this obligation will be ensured by a *mutual agreement of confidentiality*, either in the form of a separate agreement, or a special clause inserted in the main contract.

6. *Obligation to pay within a reasonable time*, to be determined in advance (reduction of payment terms).

7. *Participation of the main-contractor* in development and investment.

The main-contractor shall as far as possible endeavour to provide the subcontractor with technical support (by setting up a quality management system or providing him with the appropriate tools) and financial support (investment, credit guarantees, ...) while avoiding any interference.

Part III: Obligations of the supplier (subcontractor) towards the customer (main-contractor)

1. *Obligation to decide carefully*

Like the main-contractor, the subcontractor must exercise prudence and, in this respect, firstly consider his ability to respond to the offer (in relation, among others, to his financial capacity to cope with any economic risks, should they arise) and, secondly, weigh up the benefits and obligations that might result.

If appropriate, subcontractors should refuse orders for which they are ill-equipped technically, financially or in terms of the quantities or delivery terms requested.

2. *Proper performance of the contract:*

2.1 In terms of *quality*, which assumes:

2.1.1 A description of the work or product (reference to technical documents);

2.1.2 Reference to the standards to be met by the product;

2.1.3 Compliance with the terms of reference and technical specifications.

2.2 In terms of *delivery*:

2.2.1 Manufacturing deadlines;

2.2.2 Delivery deadlines.

3. *Obligation of confidentiality*

Observation of this obligation is all the more important where the main-contractor's instructions (drawings, tools, technical specifications, ...) are not protected by patent (protection of industrial property and processes used from competitors).

4. *Obligation to provide advice and technical assistance*

In so far as subcontractors have generally developed specific know-how, they will undertake to make this available to main-contractors, especially when they are responsible for the design of trials or for the development of prototypes, by drawing the main-contractor's attention to possible difficulties in implementing the project.

5. *Obligation to keep up to date with technical advances*

In order to produce a product of the highest possible quality, subcontractors must endeavour to take account of technical advances. In this way, products will benefit from progress achieved in their areas of specialization.

6. *Obligation to develop an independent company industrial strategy*

In order to avoid eventual technical dependency, which could lead to technological, then economic and financial dependency on the main-contractor (thus endangering the development of a long-lasting and structured subcontracting relationship), the subcontractor should seek to develop a specific and independent industrial and investment policy. He will thus develop certain activities and succeed in adapting progressively to more suitable techniques which can be replaced by new ones (alternative or innovative ones).

Part IV: Obligations of national administrations

1. To prepare and implement the regulations necessary for the development of subcontracting (for example, legislation to improve credit schemes and inter-company payment terms; customs legislation to encourage subcontracting operations and encourage access to suppliers, ...).
 - 1.1 To promote the potential for subcontracting in local companies: technical directories; specialist exhibitions; seminars; workshops; promotional films; ...
 - 1.2 To encourage public enterprises to subcontract part of their activities to small and medium-sized enterprises.
 - 1.3 To facilitate access to the subcontracting market and to tendering procedures for subcontractors' by adopting measures to increase transparency and to open public tenders to small and medium-sized enterprises or by offering them special facilities for the purpose.
 - 1.4 To adopt appropriate measures and programmes to increase the incorporation of products and/or services produced locally ("local content").
2. To provide technical assistance (through technical centres, quality control and standards offices) and financial support (through tax relieves, preferential customs duties and indirect taxes, subsidized export credits, credit and financing guarantees at preferential rates; legislation to avoid double taxation, ...) to local companies to allow them to become more competitive.

Part V: Obligations of industrial subcontracting and partnership exchanges (SPXs)*

In order to fulfil effectively the missions assigned to it, the SPX also relies on a code of conduct under which it must build a relationship of integrity and impartiality with its member or associated companies (treating all members equally) in a framework of confidentiality.

Apart from observing the ethical code of conduct, the SPX will also seek:

1. To promote, with the aid of UNIDO, the application of national codes of good conduct in subcontracting and partnership and guidelines on the legal aspects of contracts with subcontractors and suppliers.
2. To offer subcontractors and suppliers technical and legal advice, training, information, and, with respect to financing possibilities, financial incentives.
3. To introduce a non-judicial procedure for settlement of disputes, either by acting directly as mediator, or by entrusting the dispute to an arbitrator (chosen by mutual consent by the parties; expert to be appointed), or even a *national arbitration panel*.

*The reader may also refer to the "Guide for the creation of industrial subcontracting and partnership promotion centres (or exchanges)".

Printed in Austria
V.05-91325—January 2006—500



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