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# 04 Responsible supply chain

*Our supply chain provides the products, services, and raw materials for our tobacco, pharmaceutical, and beverage and processed food businesses. We have tens of thousands of suppliers around the world, many of which are small-scale farmers providing the raw materials we need for our products.*

*We expect all of our suppliers and business partners to uphold high standards of integrity. Our Responsible Procurement Policy, our Supplier Standards, and our Codes of Conduct detail our approach to selecting suppliers and establishing supplier standards.*

# Supplier standards and practices

With businesses in a wide range of sectors, our supply chain is large and complex. Wherever we operate, we expect our business partners to share our commitment to the highest standards of business integrity, legal compliance, and responsible business practice. At the Group level, our Responsible Procurement Policy sets this expectation. It clarifies that when selecting suppliers, we take account of candidates' compliance with relevant laws and regulations, and requires that we consider human rights, the environment, and other social responsibilities. Please visit [www.jt.com/csr/procurement/principle](http://www.jt.com/csr/procurement/principle) for more details on the policy.



In our tobacco business, we established the JT Group Principles in Leaf Tobacco Production in 2013. Under these principles, we work with contract tobacco growers to improve the quality of leaf tobacco, raise workplace standards, protect the environment, and work to eliminate child labor. Please visit [www.jt.com/csr/procurement/leaf\\_tobacco](http://www.jt.com/csr/procurement/leaf_tobacco) for more details on our tobacco production principles. More detail on our approach to sustainability in our tobacco supply chain is also provided on page 33.

In our pharmaceutical and beverage and processed food businesses, we select suppliers based on rigorous checks that prioritize quality and safety. Both sectors focus on the full chain of supply, an approach that is described as part of our product responsibility approach on pages 58–59.

## Know Your Supplier

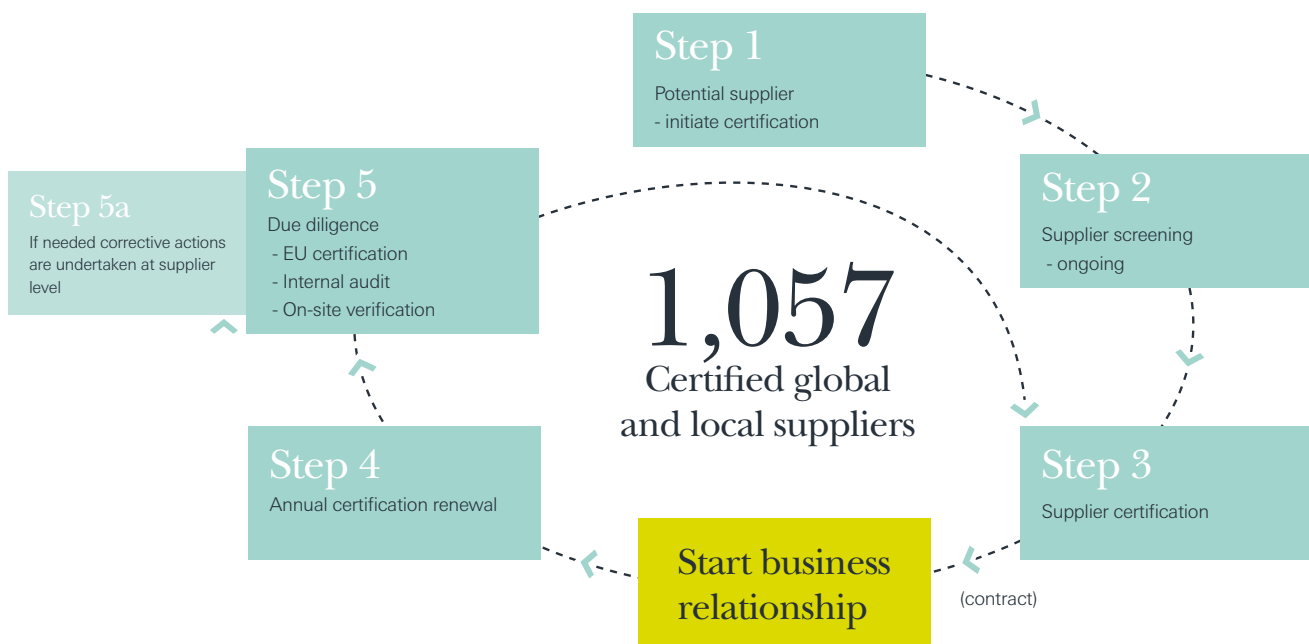
In JTI, our international tobacco business, we operate a formal supplier selection and review process, based on criteria such as assurance of supply; service delivery; quality of products and services; commercial flexibility; innovation; ethical business practices; and respect for environment, health, and safety regulations.

In line with the JTI Code of Conduct and recognized international standards, we also run a Know Your Supplier (KYS) program for key suppliers. KYS provides a framework for assuring that our suppliers respect business integrity, equal opportunities, fair employment, health and safety, and the environment. KYS also aims to help ensure that our supply chain is free from association with the illegal tobacco trade (see page 52).

Through KYS, a supplier completes an online questionnaire and provides supporting evidence to show that their business meets relevant technical and commercial standards and also complies with our KYS standards. Finally, once a supplier is contracted, they receive JTI's Supplier Standards, which set out a number of requirements that suppliers must meet.

In 2012, we introduced an additional step in the certification process, which involves a site visit to review compliance with our standards for specific categories of suppliers. In 2013, external auditors conducted 11 supplier site assessments, mainly in China. The suppliers involved have completed all corrective measures identified during these assessments.

## Certification process





### Supplier certification to KYS<sup>®E</sup> 2012 2013

Number of new certifications	203	446
Number of certifications renewed	386	611

## Monitoring compliance

Under KYS, in the event that shortfalls in standards are identified, a supplier is given the opportunity to implement corrective measures. We then follow up with the supplier to ensure these measures are effectively in place.

We take a zero tolerance approach to the illegal trade in tobacco products (see page 52). If we discover a supplier has knowingly engaged in illegal trade, or facilitated it, the supplier is blocked from doing business with us and their contract is terminated.



Agricultural Labor Practices training

## Know Your Grower

Our Agricultural Labor Practices (ALP) set the standards we expect of our contracted tobacco growers for safe and fair working conditions. Know Your Grower (KYG) is our program for monitoring and managing tobacco farmers' compliance with the ALP standards. An ongoing cycle of observation and continual improvement, KYG directly helps our contracted tobacco growers to meet their contractual obligations to the ALP standards (see page 35 for more details on ALP).

Within KYG, our farming experts observe labor practices during farm visits where they advise on the best growing methods to improve tobacco yield and quality. Farming experts record any misalignment with the ALP standards, along with other opportunities for improvement on contracted growers' farms, and provide advice on making improvements. Our farming experts play a central role in KYG, and their training not only includes the ALP but also provides the skills needed to support growers to bring about improvements.

With the observations and data collected through KYG, we aim to understand better those cases where growers do not meet the ALP. This allows programs to be developed to help them meet their commitments. This information will also provide the basis for tailor-made social investments in our farming communities.

Following successful pilots of KYG in Brazil and Serbia in 2013, and guided by the International Labour Organization (ILO) principles, we are accelerating implementation in these countries during 2014. We plan to implement KYG in the African countries where we buy tobacco leaf directly from contracted growers during the 2015–2016 crop seasons. As KYG coverage grows, we will train more farming experts to ensure thorough observation and the successful expansion of the program. In 2013, 1% of total growers were involved in KYG program preparation. It is planned to cover the whole directly contracted grower base by 2018.

	Target	2012	2013
Implement Know Your Grower incorporating ALP	Rollout in Serbia and Brazil during 2014 Rollout in U.S., Zambia, Malawi, and Tanzania by 2018	Preparation of pilot programs in Serbia and Brazil	Implementation of pilot programs in Serbia and Brazil

# Tobacco supply chain- *strategy*

Securing a long-term supply of quality tobacco leaf is the foundation of our tobacco supply chain strategy. It allows us to continue creating value for both the JT Group and the tobacco farming communities we work with. Our vision for international tobacco procurement (tobacco leaf procured internationally, i.e. outside Japan, is used by the whole Group) is to 'lead in sustainable leaf supply' and is underpinned by four key strategic goals:



## 1. Preservation of tobacco farming

Our first priority is to preserve tobacco farming and ensure the long-term viability of the farmers who supply us directly and indirectly. If farmers cannot make a profitable living from growing tobacco, then our business cannot succeed. Our farmer profits model is being tailored to different local circumstances and helps us to offer sustainable returns over the long term.

Profit comes from more than price alone. We work closely with farmers to ensure they have access to the right growing materials and use the best growing and curing methods to maximize the quality and yield of tobacco leaf per hectare. We also encourage crop rotation, which can provide alternative income, can improve food security, and promotes soil preservation. Research and innovation is crucial to understanding the best farming methods. Our Agronomy, Development, Extension, and Training (ADET) center in Brazil studies many aspects of tobacco farming, and works closely with farmers to implement the results on the ground.

## 2. Social and environmental leadership

By helping farmers to be profitable over the long term, we can make a positive contribution to social conditions in tobacco farming communities. We provide additional support by investing to improve quality of life and overall conditions in the rural communities where we operate. We do this by creating access to clean water, improving well-being, and advancing education through targeted social investments within our Grower Community Programs (see page 35).

We aim to reduce the environmental footprint of our tobacco supply chain, and our primary focus is on energy reduction and good forestry practices. The latter is of particular importance because we rely on wood as a vital fuel for flue-cured tobacco.

## 3. Operational excellence

It is vital that our operations are well equipped to support our supply chain. By allocating suitable resources to our operations, we ensure that the appropriate organization, capital infrastructure, systems, and processes are in place.

## 4. Access through partnership

We can only respond to the economic, social, and environmental factors that influence the long-term supply of tobacco leaf by working in partnership. We build direct relationships with farmers and, wherever possible, we aim to purchase tobacco directly from farmers rather than from auction floors. This helps to ensure that we secure access to tobacco leaf in a responsible manner. We also work in partnership with governments, NGOs, leaf tobacco dealers, and other stakeholders on issues in our tobacco supply chain.

The initiatives and data in the tobacco supply chain section of this report primarily relate to our directly contracted farmers outside Japan.

# Tobacco supply chain - *long-term farmer profits*

Long-term farmer profits are an essential part of our strategy to secure a lasting supply of high-quality tobacco leaf. Many factors affect the profitability of our farmers. Although some are outside our control, such as weather patterns and demographic change, we focus our attention on those that we can influence, including cost of production, yield, quality, and price. As a result, we have established four key pillars to improve farmer profits in our international procurement of tobacco:



## Managing direct relationships with farmers

Building and maintaining strong relationships with our farmers helps us to optimize the factors that improve their profitability. Our local farming experts work with our directly contracted farmers to help them improve tobacco production techniques. Across Zambia, Malawi, Serbia, U.S. and Brazil in 2013 we had 243 farming experts in place, up from 159 in 2012.



## Supporting production cost savings

Reducing the cost of tobacco growing, harvesting, and curing results in direct savings for farmers. We can reduce costs by helping farmers to be more efficient; for instance, fertilizer application in Brazil has been reduced by up to 15% since 2010, and by bringing down the cost of materials. We buy many input materials in bulk and pass savings on to our growers. By sourcing ourselves, we can also ensure quality and reliability.



## Modeling sustainable farmer returns

We have developed a unique farmer profits tool to support our goal of enabling farmers to earn sustainable profits over three to five years. Currently in place in Brazil, the tool takes into account the local conditions and other factors, including costs, risks, and alternative income sources, which inform the price that we negotiate with farmers each year. We also use the tool to check that the average price paid over multiple crop cycles delivers progress towards sustainable profit. We will roll out the tool across Malawi, Zambia, U.S., and Serbia in 2014.



## Innovation and better farming practices

Our ADET center in Brazil is dedicated to researching tobacco farming innovations that will improve quality and productivity. During 2013, there were 75 ongoing trials, including assessments on fertilizing and irrigation methods, curing efficiency, mechanization, and agroforestry and integrated pest management practices. The results of our research are passed on to farmers in numerous ways. In 2013, we trained 230 farmers at the ADET center, and our farming experts host field days on 'model farms', where a local farmer has been recognized for their expertise in applying our recommended agronomy practices.



## Half-a-hectare of tobacco in a box

The 'farm in a box', distributed by our international tobacco business, provides all a smallholder needs to start a 0.5 hectare plot of tobacco. Each pack contains selected seeds, crop protection materials, utensils, and safety equipment. An improved Grower Pack, now being distributed in Zambia, also contains a growing manual that provides farmers with guidance. If required, a farming expert can advise the grower, using the photographs or calendar in the manual. The pack also provides guidance on labor practices and safety procedures.

	<i>Target</i>	<i>2012</i>	<i>2013</i>
Good agricultural practices	100% of directly contracted farmers receive technical support	93%	95%
Farmer cost of production model	Farmer costs of production model implemented across all countries where we source tobacco directly from contracted farmers by 2013	100%	100%
Farmer profit modeling	Implement across all countries where we source tobacco directly from contracted farmers by the end of 2014	Pilot in Brazil	Review of pilot and model enhancement

# Tobacco supply chain - *Agricultural Labor Practices and child labor*

We source tobacco from several developing countries where communities are highly dependent on agriculture. Alongside improving growing standards, we work with our farmer communities to address a range of important issues. These include improving the rights and safety of tobacco workers through our Agricultural Labor Practices; improving living conditions and livelihoods through our Grower Community Programs (GCP); and eliminating child labor, for instance through education with our ARISE program (see page 8).

## *Agricultural Labor Practices*

Our Agricultural Labor Practices (ALP), launched in 2013, define the standards we expect of our contracted tobacco growers for safe working conditions, fair treatment, working hours, provision against forced labor, and freedom of association. They also describe our stance against child labor and measures to eliminate it. Growers' compliance with the ALP is monitored through our Know Your Grower (KYG) program, which is part of our wider Know Your Supplier approach. We will expect all contracted farmers to be compliant with the ALP once KYG program is fully implemented across our tobacco supply chain. For more detail on KYG and its rollout, please see page 32.

## *Grower Community Programs*

Our Grower Community Programs (GCP) deliver community projects based on an assessment of need. In 2013, we ran community programs in 82 communities: 11 in Brazil, 68 in Malawi, and 3 in Zambia. GCP priorities are school infrastructure, education, water, sanitation, and community well-being. In 2014, we plan to launch a scheme to sponsor teachers in order to build their skills and create conditions where both teachers and students can succeed.



### Grower Community Program: Zambia

In 2013, we drilled boreholes to provide access to water for an estimated 10,000 people in three Zambian tobacco communities. This reduces the time spent fetching water and improves access to clean running water. We have also funded a maternity ward in Zambia's Western Province, which provides access to safe pre- and post-natal care for approximately 140 women annually. In terms

of education, we are running adult literacy courses in the Chipata district, reaching around 300 people annually. We also built the Mwalauka village primary school, which provides education to around 500 children.

## Child labor

We take a strategic approach to eliminating child labor where we operate. At the core of our approach is an emphasis on improving the economics of farming. Encouraging more profitable farming practices, a guaranteed price for contracted farmers, and good agricultural standards will help prevent farmers from using child labor. Building on the economic approach, our social approach engages communities on the complex issues of child labor and establishes and trains community members on community child labor monitoring systems. This foundation underpins our key programs such as ARISE.

In 2012, in partnership with U.S.-based NGO Winrock International and the ILO, we launched a multi-year program to help prevent and eliminate child labor in our tobacco communities. The ARISE program works to tackle the social and economic factors that cause tobacco farmers to engage children in hazardous work.

ARISE aims to ensure that children are not part of the workforce by providing education and engaging with tobacco farming communities in various ways. This ranges from providing educational materials, after-school tutoring, and mentoring to vocational training for older children in farming schools. Through ARISE, we work with communities to improve their understanding of the long-term value of education, and the future prospects that it can bring. ARISE also works to replace lost income from child laborers through Family Support Scholarships, which can enable parents or guardians to send their children to school.

ARISE made good progress in 2013 with expansion in Malawi and Brazil, and the program has been implemented in Zambia. We aim to launch ARISE in Tanzania in the near future. See page 8 for more details on ARISE.

	Target	2012	2013
ARISE: our program to help prevent and eliminate child labor in tobacco growing communities	Expansion of the ARISE programs in Malawi and Brazil Implementation in Zambia in 2013, and Tanzania in 2015	Implementation in Malawi and Brazil	Program expanded in Malawi and Brazil and implemented in Zambia

## ARISE in 2013

	Brazil	Malawi	Totals
Children withdrawn or prevented from child labor	663	2,408	<b>3,071</b>
Children and youth enrolled in formal and informal education	573	2,408	<b>2,981</b>
Households with improved livelihoods	191	785	<b>976</b>
Children attending farm schools	90	500	<b>590</b>
Mothers attending agribusiness training	355	173	<b>528</b>
Community members educated in child labor elimination	930	1,162	<b>2,092</b>

### Freedom from child labor, training for a future

In the Ntcheu district, Malawi, the ARISE project has withdrawn 100 children and prevented 200 more from entering child labor. One of them, Doris, 16, could not go to school because she needed to earn money for her family's household. ARISE provided Doris with vocational training in carpentry skills in one of the program's Community Service Outlets. It has learning materials, well-maintained equipment, and provides training and start-up capital to establish a small enterprise. ARISE also provided similar support to one of Doris's relatives to make sure she and her siblings remain free of child labor.



### Topping up vocational schooling in Brazil

To reduce child labor, improve education, and retain young people in rural areas, we invest in vocational training schools for young people. In 2013, we renovated the rural vocational school in the Vale do Jaguari, which will serve the children of 230 of our contracted tobacco growers. Twenty students are enrolled so far and mostly learn horticulture skills in out-of-school lessons. The children can then return to the family farm to practice what they have learned, without interrupting their normal school hours. According to the President of the Vale do Jaguari Association representing these types of rural schools, "JTI is thinking about the future. The Company is helping to reduce the rural exodus by qualifying the youth in rural areas."

# Tobacco supply chain - *sustainable wood*

In many regions where we operate, wood is vital for effective tobacco curing, both as a fuel and for building curing barns. A sustainable supply of wood is therefore key to ensuring a long-term supply of leaf tobacco.

Deforestation has often been widespread due to pressure from agriculture and urbanization, weak regulation, and poor woodland management.

To tackle this situation, we work with tobacco growers to educate them on the environmental and economic value of wood. We help to replace the wood used for curing through tree planting initiatives and developing new barn construction techniques, supplemented by our reforestation program.

## Tree planting initiatives

Our agroforestry initiatives train and support farmers to plant and maintain enough trees to ensure they can meet the fuel and timber needs of today's tobacco growing communities, and those of future generations. In Brazil, agroforestry is well established and growers either plant trees for their own wood supply or purchase wood from local renewable sources.



A tree nursery at a local school in Zambia to teach the children about ecology, and provide seedlings to JTI contracted growers

### Agroforestry in Zambia

In Zambia, our agroforestry initiative offers a financial incentive to farmers for every tree seedling that survives each year. The year 2013 was an important one for the initiative, with four nurseries producing 457,200 seedlings and over 1,000 farmers attending our Agroforestry Roadshows. Three forestry experts and 41 farming experts continue to provide on-the-ground support to our tobacco growers, showing them the benefits of our Agroforestry Program.

### Reforestation

Supplementary to our agroforestry initiatives is our reforestation program. The program aims to regenerate previously deforested areas in locations where we have directly contracted farmers that depend on wood for fuel or timber. We also work on the efficiency of cooking stoves in local communities, which reduces fuel consumption.

During 2013, we exceeded our targets in Zambia's Eastern Province. We raised 3,595,281 seedlings and planted 3,304,679 trees against a target of three million, respectively. We also

improved kitchen stoves in 2,323 households. By 2014, we plan to have funded the planting of 24 million trees across Malawi, Zambia, and Tanzania.

## Barn construction techniques

Barns are used in both air-curing and flue-curing of tobacco. Wood-built barns are commonly used for air-curing, and wood is a common fuel source for flue-curing. To improve curing efficiency, we conduct trials to develop low-tech improvements in furnace and barn design adapted to the areas where we operate. We train farmers in new developments and provide direct support through our local farming experts. Recent innovations include our live barn initiative and new flue-curing technologies.

### Live barns

Live barns are changing the way that our farmers air-cure their tobacco in Malawi and Zambia. Instead of using vertical timbers, live barns are constructed by planting trees, which after three years grow to form the main structure of a curing barn. This avoids the need for maintenance and a continuous supply of wood for construction. During 2013, and as part of the pilot program, farmers in Malawi and Zambia collectively planted 314 live barns. By 2018, we plan to establish 18,000 live barns across Malawi and 4,700 across Zambia.

### New flue-curing barns

Flue-curing barns require a constant heat source for each week-long curing cycle. In Africa and Brazil, farmers mainly use wood, which in Africa is becoming scarce and expensive to source.

Added to this, inadequate curing infrastructure and access to building materials prevents farmers from realizing the full yield and quality potential of their crop, and hence affecting their profitability.

To tackle this, we have developed a new low-tech barn design for flue-curing. Farmers installing the new design features are anticipated to benefit from an increase in cured leaf of up to 15%, a higher-quality product, and reduced wood consumption of up to 65%.

		2012	2013
100% sustainable wood supply established in each country where we source tobacco directly from contracted farmers	Virginia, Flue-cured 100% by 2018	Brazil 90%	100%
		Zambia Implemented from 2013	2%
	Burley, Air-cured 100% by 2018	Malawi Implemented from 2013	33%
		Zambia Implemented from 2013	3%