From supply chains to value chains: A spotlight on CSR

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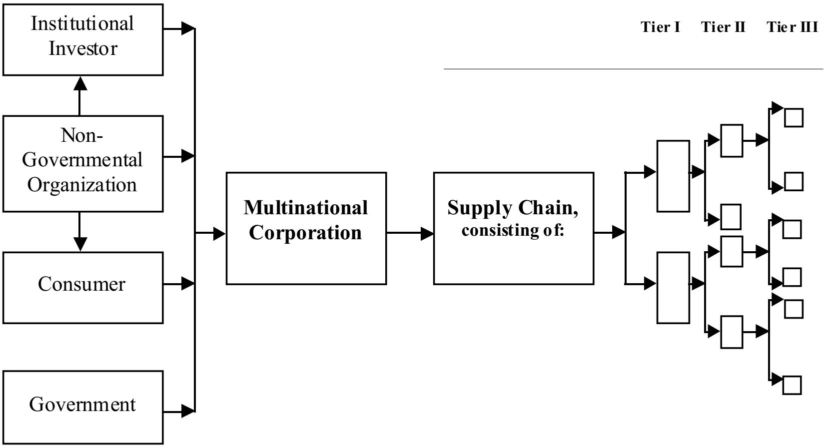
1. Introduction

Corporate social responsibility (CSR)[1] has become a hot topic in boardrooms across the world. Changes in corporate value systems are being driven by pressures from different actors, including governments, consumers, non-governmental organizations (NGOs) and institutional investors (diagram 1). Multinational corporations (MNCs) have operations spread across the globe, relying on both foreign affiliates and arm's-length suppliers arrayed along global supply chains, many of which encompass developing countries. What then does the growing CSR movement mean for developing country producers? The chapter addresses this question.

Diagram 1



CSR has relevance to many facets of a corporation's operations. Strong CSR policies can help to recruit the right people for the job, keep attrition rates low by promoting a "feel good" quotient, improve corporate image, prepare for future regulation, empower "soft" laws (Vogel, 2005, p.162), appease green customers, and convince institutional investors that the corporation is following sustainable practices that positively impact the bottom line.

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Managers are being asked to raise profits but in more socially and environmentally responsible ways. The bottom line continues to be the baseline for measuring corporate success. CSR activities must be seen as providing a measure of shareholder value (e.g., reputation, goodwill) which enhances a company's ability to produce income now and in the future. Multinational firms have created a new global economic space, sourcing products from far-flung global production networks and supply chains (Palmisano, 2006), and CSR advocates argue that MNCs ought therefore to be accountable not only to their shareholders but also to the communities that are affected by their decisions and transactions with suppliers wherever they may operate. Simultaneously, companies are finding business value in increasingly engaging in community programs across the world, as larger shares of their revenues and profits are earned from international operations.

2. CSR in international supply chains

With globalization of production networks, corporations have to extend the reach of their CSR policies not only to their overseas subsidiaries but also to suppliers over which they have varying degrees of operational control. The magnitude of the challenge involved in promoting CSR within MNCs and along their supply chains is illustrated by the fact that there are over 63,000 MNCs with over 800,000 subsidiaries multiplied by millions of suppliers and distributors (UNCTAD, 2001).

For developing country firms, the challenge is how to use CSR to competitive advantage, avoiding the risk that weak CSR practices exclude them from global supply chains. CSR is a considerable investment for small and medium-sized enterprises (SMEs) but at the same time the investment has the potential to contribute to long term competitiveness.[2]

2.1 Supply chains & SMEs in developing countries

Developing country firms can at times face contradictory pressures: on the one hand, buyers want to be able to certify that their suppliers comply with one or another CSR code of conduct; on the other, they require low prices and tight delivery schedules. While some suppliers in developing countries will be able to meet the challenge, others may face difficulty, none more so than SMEs. For, they are likely to have greater difficulty than large firms in bearing the fixed costs of CSR compliance.

Of the 2,909[3] business participants in developed and developing countries that have signed up with the UN Global Compact, slightly less than half are SMEs and more than a quarter are SMEs from developing countries.

2.2 The European experience of CSR & SMEs

One key difficulty in assessing the adoption of CSR by SMEs in supply chains is the dearth of available information on SMEs in developing countries. Insights gained from discussions and surveys of SMEs in developed countries provide a broad understanding of the issue and possible lessons for developing countries.

An October 2005 survey of more than 1,000 Danish SMEs revealed that ethical and moral considerations were the main reason for implementing CSR, although many SMEs are also motivated by aspects of the business case (improved company reputation, attracting and retaining employees, improving financial performance). Thirty six per cent of enterprises believe that CSR activities in general have a positive financial impact, while only 4 per cent are of the opinion that CSR activities in general have a negative financial impact. The relative importance of the impact on financial performance as a reason for engaging in CSR increased with the size of the company, which suggests that there may be important economies of scale in undertaking CSR investments (Kramer, Pfitzer and Lee, 2005).

3. The evolution of value systems

As illustrated in diagram 1, the business system is ruled by multiple relationships, some of which are explicitly contractual in nature, but most of which are not.

Sections 3.1 to 3.4 discuss the various relationships between the firm and those stakeholders which have a direct or indirect influence on the commercial success of the firm. An enabling environment for CSR is created if business is pushed to act by the presence of pressure actors like the government, institutional investors, NGOs and consumers. Depending on the nature and extent of those pressures, businesses will in turn demand compliance with more or less stringent CSR codes on the part of their suppliers, whether in developed or developing countries.

3.1 Pressure actor: Government as regulator & consumer

The government is the first non-business actor to pressure corporations to change behaviour. The pressures arise mostly from regulatory efforts that affect a business even before the first product is produced or sold. These efforts are considered to be the "least common denominator" for behavioural change and their effectiveness depends greatly on the ability of the government to ensure and enforce compliance. Governments typically exert pressure on business behaviour in areas related to employment conditions and pollution. In some cases these pressures evolve into investor and consumer protection programs.

Governments have a significant role to play in shaping the public policy environment in which businesses operate. Apart from playing the role of regulator, governments can actively engage in promoting CSR as consumers.

3.1.1 Government as regulator, facilitator & enabler

Compliance with an increasing number of CSR codes of conduct[4] can be technically difficult and expensive to achieve, in particular for SMEs in developing countries. While some CSR requirements mean complying with the law (e.g. international labour standards), others go beyond legal requirements. The local industry may find it impossible to cope in the short term, due to high costs, obsolete technology, lack of capacity and knowledge, and imperfect information. Governments in developing countries will need to work actively to enable companies to adapt to these requirements and avoid loss of export markets. Key reasons why governments should get involved in corporate social responsibility are discussed below.

- *Creating access to markets & international leverage*

  Trade and investment promotion is an important reason why governments should promote CSR. Domestic companies attempting to gain access to global supply chains and markets may need to present evidence of environmental and labour conditions that are consistent with international CSR codes of conduct. To maintain and build the export capacity of national industry, government needs to ensure that local companies have the ability, capacity and the support infrastructure to respond to these new market requirements.

- *Improving regulatory compliance & enforcement*

  Most CSR practices are in concert with international labour, humanitarian and environmental agreements and standards. In many developing countries, however, the ability of governments to effectively enforce the law is relatively weak. The adoption of CSR practices by large firms and their supply chains exerts an upward pull on the regulatory performance of suppliers in developing countries , which might contribute to promote legal compliance and reduce the cost of monitoring and enforcement for developing country governments.

- *Achieving social & environmental goals*

  Some CSR activities focus on the provision of welfare or environmental services that would in principle be provided by the government but are not because of budget or institutional limitations. These have included basic services such as access to electricity, clean water and sanitation, education and healthcare, as well as restoration of polluted sites and improved management of natural resources.

- *Establishing consistent best practices*

  CSR practices required by MNCs could be in conflict with national regulations and cultural or social practices in a given country. The government is in a position to ensure that CSR as practiced within its borders by MNCs does not run against regulatory mandates or conflict with accepted cultural norms.

3.1.2 Government as a consumer/buyer

Another clear area of influence for governments is through procurement processes. In most countries, government is the single largest individual consumer. If directed towards products manufactured with explicit concern for environmental and social aspects, this purchasing power can provide a critical mass for supplier companies to embrace CSR and can offer standards and information that support other consumers in implementing sustainable procurement practices. A recent study of European countries shows a sizable potential environmental benefit from “green purchases” of selected product groups. For example, if all public administrations in the European Union (EU) switched to green electricity, they would be able to reduce CO_2 emissions by 60 million tonnes, equivalent to 18 per cent of the EU’s obligation under the Kyoto Protocol (OECD, 2003).

A number of governments, including Canada, Switzerland, USA and the United Kingdom, have initiated “green” procurement programs, focusing on a variety of goods and services. Also, a number of governments have used public procurement to advance targeted social goals, such as decent employment, anti-discrimination, and human rights.

It is thus clear that governments have significant interest in supporting and monitoring CSR activities domestically, and can also be a driving force for change in global supply chains.

3.2 Pressure actor: Non-Governmental Organizations

The not-for-profit sector, excluding religious organizations, has become a US$1 trillion-plus industry (Salamon et al., 1999, p.8). More than 30,000 NGOs operate international programs, and roughly 1,000 have memberships drawn from three or more countries (Sikkink and Smith, 2002).

Getting some large corporations to change their policies is often easier than changing public policy (Vogel, 2005). NGOs have succeeded in installing elements of public accountability into the transnational activities of corporations where national or international regulatory pressures for accountability are weak or non-existent.

3.2.1 Knowledge navigators: NGOs vs. MNCs

To many in the NGO community, CSR is viewed as a means to ensure that the profit-driven behaviour of international companies is governed by consideration of broader impacts on society and environment (Ruggie, 2004). The ability of the NGO community to exert pressure on MNCs to change their behaviour depends crucially on the ability to move public opinion through the media. Thus, media and image management have become increasingly important.

NGOs have successfully utilized internet-enabled social networks, tapping into what Waterman (1998) terms “communication internationalism” for near instantaneous dissemination of information about corporate activities to global audiences (O'Sullivan, 2000).

A number of large corporations have responded to the adverse publicity propagated by NGOs by using the media to disseminate their own message. While NGOs use systems that require little or no investment and are decentralized, corporations have tended to rely on cash-intensive media strategies that flood the print media and TV air time with messages of their social and environmental responsibility. Nothing is to prevent them, however, from communicating through the same web-enabled social networks and they could be expected to do so in targeting certain audiences, especially youth.

3.2.2 Shifting gears: The changing NGO interface

Some of the larger NGOs have begun to cooperate with, rather than merely confront, the private for-profit sector, working as CSR advisors or partners to corporate actors.. One such example is that of the Environmental Defense Fund (EDF) and its cooperation with McDonalds. As Fred Krupp, the EDF President, recently explained, EDF's informal motto used to be to sue MNCs, whereas now the official tagline is, "Finding the ways that work." So after years of campaigns to pressure McDonalds into improving its operations, the EDF is not only working closely with the fast food giant to change its internal practices, but it has also enlisted McDonalds to pressure chicken suppliers to reduce antibiotic use. The EDF is also working closely with Federal Express in converting a part of the FEDEX truck fleet to hybrid vehicles.[5]

NGO-corporate relationships appear thus to evolve through three broad stages:

Stage 1: The NGO shame game

In this first stage, NGOs develop corporate "shame" lists. Companies engage in defensive public relations (PR) actions, which tend to go hand in hand with the adoption of superficial CSR practices.

With so many companies active in the CSR area and openly cooperating with NGOs, the activist community has now shifted criticism towards industry laggards. An example of this is the relationship between the Dogwood Alliance and Forest Ethics and some of the largest office supplies retailers. The two groups applauded Staples and Office Depot for their efforts to stop the sales of paper produced from endangered forests. It also staged, however, a series of demonstrations against OfficeMax and publicly denounced the company's lack of effort on the issue (Deutsch, 2006).

Because some NGO campaigns have led companies to sever ties with noncompliant suppliers, resulting in unintended negative consequences for workers and communities, the focus of such campaigns has tended to shift towards helping MNCs to support their suppliers in the implementation of CSR practices.

Stage 2: Partnering

In this stage, NGOs move away from applying pressure to companies responsible for social and environmental problems to identifying corporate partners to help solve problems. "Nonprofits often have a deeper understanding of the social problem, which enables them to help companies devise more comprehensive strategies and set more ambitious and attainable goals" (Kramer and Kania, 2006, p. 28). Company resources can be harnessed to complement NGO goals, but as NGOs fear tarnished reputations by aligning with MNCs, and MNCs fear public distrust, the partnership is a balancing act, which needs to come across as a credible and output-oriented process for it to be judged a success.

Case study #1: Greenpeace's inside-out approach[6]

> After the record-breaking heat waves in 2006, from Athens to Mumbai, the fall out from climate change has become an issue of great concern for governments and the public alike. To combat global warming and other environmental problems, Greenpeace's strategy is both to protest against environmental offenders and to help companies craft comprehensive and achievable CSR strategies. Using this inside-out approach, Greenpeace catapulted Greenfreeze, an obscure ozone- and climate-safe refrigerant, into widespread use (Hartman and Stafford, 2006).

Stage 3: MNCs as CSR thought leaders

In this stage, corporations are increasingly active in the field of CSR (e.g. Nike and Danisco) and no longer need to be prodded by NGOs to undertake such activities. Many have developed their own business cases for staying active in CSR and see it now as part and parcel of just being successful at business, with CSR activities being mostly driven by internal management systems.

3.3 Pressure actor: Consumers

In developing countries, MNCs interact with local consumers by engaging in CSR activities that enhance the standard of living in the community, through better access to education, healthcare, etc. These programs help MNCs to build a relationship with the consumer, bringing credibility to the product sold and building brand loyalty. Nevertheless, producing and selling what consumers want – including poor consumers – can be as important as engaging in broader community welfare activities.

Case study #2: Building a relationship with rural India

> Part of Unilever India's business model is a long-term commitment to contribute to economic development locally by serving the "bottom of the pyramid" consumer (those with income of less than US$2 a day). Its commercial success is highlighted by the extensive distribution network which reaches deep into the villages of India. Unilever India has helped its bottom line by tapping into the purchasing power of the once ignored rural consumer while at the same time helping to improve rural livelihoods. For example, acknowledging the water shortages that affected its rural consumers, Unilever introduced water-saving technology in its detergents, and bacteria-fighting soaps to reduce the incidence of diarrhoea fatalities due to poor hygiene (HLL, *www.hll.com*; Unilever, *www.unilever.com/ourvalues/environmentandsociety/default.asp*).

The needs and values of consumers have changed and will continue to change. A growing segment of consumers, particularly in developed countries, are wealthy enough to be concerned with more than basic product characteristics, i.e. with quality, timeliness and the environmental and social dimensions of production processes. In response to these changes, the business sector has been developing new non-functional features for brand differentiation such as environmental or social qualities of the manufacturing, transportation and marketing process.

3.3.1 Consumers' choice: Value over values

How far are consumers willing to pay for various environmental and social attributes of a product, extending to the way in which it was produced? Consumer surveys and other market research provide a complex picture of how far consumers' stated preferences translate into spending decisions.

Social and environmental certification systems provide opportunities for producers to gain market recognition for strong CSR performance. They also provide consumers with the ability to distinguish between products, based on the social and environmental qualities of the production process and impacts throughout the lifecycle of the product.

- *Boycotts vs. convenience*

Vogel (2005) notes that few consumers will change their purchasing habits in response to corporate practices that do not affect them directly. Consumers appear more willing to avoid a product produced in ways they regard as irresponsible, than to purchase a responsibly produced product. Yet "ethical boycotts" affect less than 2 per cent of market transactions and tend to be short-lived (Porter and Kramer, 2002, p. 67).

- *The gap between green consciousness & green consumerism*

There is evidence suggesting a major gap between what consumers say they would do and their actual behaviour (see for instance, Makower et al., 1991). In fact, this key insight has been a recurrent one in consumer polls and studies, which emphasize the primacy of a "value for money" calculation in consumers' purchasing decisions. A 2004 European Survey found that only 3 per cent of consumers actually modified their purchasing decisions because of social or environmental criteria, even though 75 per cent indicated that they would do so (Willard, 2002; Carrigan and Attalla, 2001; Boulstridge and Carrigan, 2000).

There is evidence, however, of growing consumer preference for certain classes of products thought to have health benefits in consumption – e.g., organic foods – also an increased willingness to base spending decisions on consideration of global environmental impacts (as for example with voluntary carbon offsets in travel and the purchase of hybrid or other less polluting motor vehicles).

3.4 Pressure actor: Institutional investors

A growing number of institutional investors are becoming increasingly sensitive to perceived corporate risk exposure related to CSR issues, including environmental management, child labour standards, women's employment criteria, corruption, etc. Companies have begun to recognize that there can be market rewards to "socially responsible" companies which manage to achieve or maintain robust bottom lines with sustainable practices. Some would argue that a strong CSR policy and practice reflects broader management strengths which can enhance corporate financial performance. Still, it remains unclear whether socially responsible investments can be expected consistently to outperform the market average.

3.4.1 Social investment: A growing trend

According to the Social Investment Forum (2005), by 2005 more than US$2.3 trillion or 9.4 per cent of all professionally managed assets in the US were managed with "social screens". During the period 1995-2005, professionally managed assets using one or more "social screens" grew by 258 per cent, approximately 10 percentage points above the total for all professionally managed assets.

More than half of institutional investors use two or more social screens. Tobacco, human rights, environment, equity in employment, community and labour relations are among the top 10 social screens used among institutional investors. Most of the growth in socially screened funds is accounted for by institutional investors such as government pension funds, unions and university endowments, which often have non-financial agendas.

3.4.2 Institutional investors: Taking charge

Institutional investors are more influential in the allocation of resources than individual shareholders. Many of these investors have begun to take a more aggressive position towards the activities of corporate management. The California Public Employees Retirement System (CalPERS), for instance, has since 1987 flagged relatively poor performers on corporate governance, termed “Focus Companies”. The companies are targeted by CalPERS activists in the form of partial take-overs to influence the board as a major shareholder or a significant threat of de-listing, in order to focus the management on change. This strategy, which has been called the “CalPERS effect”, while criticized by conventional fund holders as distracting the fund’s attention from returns, has proven to have positive financial results on the target companies and on CalPERs itself. A Wilshire Associates study of the “CalPERS Effect” examined the performance of 95 companies targeted by CalPERS between 1987 and 1999. The results indicate that the same stocks outperformed the Standard and Poor’s index by 14 per cent in the 5 years following CalPERS intervention, adding approximately US$150 million annually in additional returns to CalPERS (Nesbitt, 2001). In the UK, the Pensions Committee of the Environmental Agency of England and Wales (2004, p. 35-36) decided to become an active shareholder and compel managers to analyze environmental performance across the entire portfolio for fiduciary reasons.

If the number of funds requiring CSR related conditions continues to grow and gather significant market power, this segment of the financial market could eventually become the single most powerful relationship driving corporations towards increased CSR.

Evidence of this growth is found in platforms such as the UN Global Compact, which recently received commitments to its “Principles of Responsible Investment” from 50 institutional investors managing funds totalling over US$4 trillion.

4. Multinational corporations & their supply chains

Global supply chains encompass contractors and subcontractors in a multi-tier system of intermediaries. CSR compliance along supply chains is usually monitored up to first tier suppliers, but stakeholders are increasingly demanding assurances that CSR codes are being respected further down the supply chain. In its 2005 triennial International Survey of Corporate Responsibility Reporting in over 1600 companies across 16 countries, KPMG found that supplier issues are mentioned in 80 per cent of reports, although generally without specifics. Developing countries’ importance as suppliers in global supply chains has increased significantly, often making regulation and monitoring a challenge.

In what follows, we review different aspects of CSR adoption in global supply chains, including the rationale for MNCs and challenges to monitoring compliance, with a focus on implications for SMEs in developing countries.

4.1 Expanding market access

By engaging in community-support programs, MNCs are able to connect with their target consumer and establish relationships with key business partners in the local market. These CSR programs help guide business decision-making processes by acquainting companies with cultural norms in the host community and enabling better assessment of public expectations. The insight gained helps ensure that the company is recognized as a good corporate citizen within the community. Many companies also find that community involvement reduces local regulatory obstacles, provides access to the local political process, generates positive media coverage, and increases access to markets for their products and services.

Case Study #3: Bristol-Myers Squibb in Africa

> In June 2005, Bristol-Myers Squibb and Baylor College of Medicine announced the creation of a Pediatric AIDS Corps whose mission was to send 250 doctors to Africa to treat approximately 80,000 children over five years and to train local healthcare professionals. Additional children's clinical centres of excellence are to be built in Burkina Faso, in Uganda and in China, in a US$40 million program. This is in addition to the US$150 million "Secure the Future" program launched in 2000 as a partnership between the company and governments, physicians, and NGOs to help alleviate the HIV/AIDS crisis in this region (Bristol-Myers Squibb Foundation And Corporate Philanthropy,
> *www.bms.com/sr/philanthropy/data/globhiv.html;*
> *www.bms.com/sr/data/index.html*).

The benefit of CSR compliance is not straightforward, however. Body Shop is an exception in that it leverages compliance with strict CSR policies as part of its branding; but for most companies, compliance is an "invisible" attribute in the final product.

4.2 Relationship between intermediate producers & final product brands

Intermediate producers are becoming more sensitive to and aware of CSR. If they choose not to adopt and implement basic CSR policies, they may lose markets. By embracing CSR, on the other hand, supply chain contractors can differentiate themselves and possibly attract new clients.

Suppliers can reduce obsolete inventory, cut delivery time and streamline management systems, but adjusting supply chains to implement CSR policies is trickier. The concept of supply-chain innovation can be extended to include CSR. Supply chains are constantly being reviewed/updated to optimize costs and performance. Implementation of CSR policies should be given consideration at the stage of supply chain planning.

Most studies only address implementation of CSR practices at the level of first-tier suppliers in global supply chains (see, for instance, Jørgensen et al. 2003). The challenge is to enable more suppliers to implement CSR standards more easily and to monitor compliance beyond the first level of intermediaries. For example, Mattel Inc. has extended its audits of code compliance from plants where it controls 100 per cent of the output to second-tier plants where it buys between 40 per cent and 70 per cent of the output. Companies like IKEA conduct audits among second and third tier suppliers – e.g. in India and Pakistan, in order to address the use of child labour in the textile and carpet making industries (Andersen, 2005; The IKEA Group, 2005 and 2002).

4.3 MNCs driving change: If retailers pave the way…CSR is here to stay

What do Wal-Mart and Tesco have in common? Apart from being among the top 5 retailers worldwide[7], these expanding corporate mammoths have been on the cover of business magazines (Fortune and Newsweek International respectively) extolling their greening campaigns. While potentially very positive for the environment, social impacts may be less so. If Wal-Mart plans to focus on organic cotton and other organic fresh produce, the question is whether poor farmers are able to get the necessary certification, or whether a lucrative new market will be dominated by large farmers able to bear the certification costs.

In Zambia, a number of enterprises in the high value horticulture sector have established outgrowers schemes, some of which cover over 1,000 local smallholder farmers, where output is sold through the world's top companies such as Tesco, Wal-Mart, Sainsbury, and McCormick Spices. Such outgrower schemes have been effective in vertically integrating rural smallholder farmers into a global supply chain, while at the same time creating better access to markets, networks and new skills (World Bank, 2004a). Compliance of such small growers with corporate CSR codes may open up opportunities for NGOs to work with major corporate buyers to build capacities, especially among poor producers in the developing world.

Case Study #4: Kraft Foods Raises Consumer Awareness

In 2005, Kraft Foods bought 13 million pounds of Rainforest Alliance certified coffee beans grown by sustainable sources in coffee-growing communities around the world. Coffee from Rainforest Alliance Certified farms commands a higher price in the market which allows farmers a better standard of living. The move benefited more than 100,000 farmers, families and workers on 3,574 farms of all sizes in coffee-growing areas. It preserved more than 50,000 acres of forest in Central and South America and increased availability and awareness of certified sustainable coffees to mainstream consumers. In 2005 Kraft Foods began working with 1,000 cocoa suppliers in Ecuador as part of a pilot project to expand sustainable cocoa production (Kraft Foods, *www.kraft.com/responsibility/overview_building_trust.aspx*; Business in the Community, *www.bitc.org.uk/*).

If these giant retailers are serious about their new found "calling", then CSR will finally be given the boost it needs to become mainstream and be widely adopted. By making CSR products competitively priced and available at their local outlets, Wal-Mart and other large retailers are addressing some of the constraints that have made consumers reluctant to shift on a larger scale to "green" products, while at the same time capturing attention and consumer loyalty.

Case Study #5: Wal-Mart Tapping New Market Potential

Can Wal-Mart's green PR campaign lead a supply-chain revolution? Will Wal-Mart be able to set an example for companies that believe the environment and the economy are in conflict?

According to a Wal-Mart poll, 8 per cent of shoppers stopped visiting their outlets due to their stand on social issues (Mallaby, 2006). This may partially explain why the world's largest retailer has recently decided to launch a US$500 million environmental makeover with a number of clothing lines with environmental and social screens. The move not only aims to appease critics but is a new way to attract customers and build consumer loyalty. The interesting part of this move is the type of consumer that Wal-Mart serves. Wal-Mart apparently believes that the desire for more environmentally and socially sound products is not confined to the well-to-do shopper and that it can introduce successfully these lines to its core customer at Wal-Mart level prices.

This move holds immense promise for the development and strengthening of markets in socially and environmentally sound products given the company's huge purchasing power and its influence over the world's suppliers of consumer products. Should Wal-Mart's competitors follow suit, then consumer markets may change faster than predicted.

4.4 Are supply chains implementing comprehensive CSR policies?

Many suppliers operate on thin margins and short-term business horizons. Compounded by low barriers to entry in labour-intensive industries leading to overcapacity in the supply chain, and the high costs involved in adopting different codes of conduct for different clients, they are often wary of CSR. While some supply chain partners are beginning to appreciate the opportunities for greater market access provided by CSR, most are sellers of intermediate or generic final goods (where CSR compliance is not a visible attribute associated with their own brand) and hence are less likely to feel threatened by challenges to their reputation for non-compliance with codes (Vogel, 2005).

One way to address the potentially high costs to small producers of participation in CSR initiatives is for industry associations to assume some of those costs on behalf of their members. Progressive industry participants have an interest in such schemes to the extent that they can limit the risk of negative publicity spillovers from less responsible industry participants. The chocolate industry, for example, has developed an industry-wide program aimed to prevent child labour.

Case Study #6: Monitoring the supply chain

In 2000, Carrefour, the second largest retailer in the world worked with FIDH (Fédération Internationale des Droits de l'Homme), a group of 116 human rights organizations from around the world, to establish INFAS, a monitoring agency to help Carrefour establish a code of conduct for its suppliers. The purpose of the code was to commit the company's suppliers to recognize and respect international standards regarding working conditions set out in various ILO Conventions with regard to the abolition of child labour and forced labour, freedom of association and collective bargaining, non discrimination, etc. The basic goal was to contribute to the gradual and total elimination of child labour while respecting cultural diversity (Carrefour, *www.carrefour.com*; CSR Europe, *www.csreurope.org).*

Case Study #7: Cambodia in a post-quota regime

The US-Cambodia Bilateral Textile Agreement of 1999 offered Cambodia a quota in lucrative segments of the market based on adherence to core labour standards. The 2002 ILO synthesis report confirmed compliance with internationally recognized core labour standards and provided the US confidence that Cambodia was largely adhering to its international labour commitments. Even after the expiration of the aforementioned agreement, the Government of Cambodia hopes to maintain CSR as a source of competitive advantage. While some buyers will prefer Cambodia for this reason, this strategy would be more viable in combination with other efforts to raise skills to pursue higher value product niches.

Though Cambodia is trying to differentiate itself through CSR, domestic micro-enterprises and SMEs are only weakly linked as suppliers to large companies and MNCs. Thus, the ripple effect of CSR through the tiers of the supply chain, even for a country like Cambodia that is invested in the process, may be limited (International Labour Organization, 2002; and World Bank, 2004b).

4.6 Monitoring supply chain CSR

The outsourcing trend has stretched supply chains around the globe (Pande, Raman, and Srivatsan, 2006). The different players in the supply chain are at different tiers in the process, and each has different capabilities and incentives to implement a given MNC's CSR program, making management of the supply chain increasingly intricate. Management aside, the issue becomes complex due to the pressure from multiple stakeholders requiring the corporation to be more responsible through the lifecycle of the product. The pressure from some quarters is to ensure a sustainable product lifecycle, from environmental and social impacts arising from material extraction and manufacturing, to product use and disposal. This is a challenging task that requires additional company investment. Monitoring suppliers from around the world requires significant financial and human resources. Partly as a response to CSR pressures, but partly also for competitiveness reasons, the overall trend is to collapse the supply chain and develop longer-term relations with a smaller number of suppliers.

Large companies often prefer to rely on in-house programs to evaluate and strengthen CSR along supply chains. Hewlett-Packard (HP), for example, monitors its supply chain by using a self-assessment questionnaire. HP then works collaboratively with suppliers to achieve the required standard in areas identified as falling below requirements.

Where cost control of CSR initiatives is a priority, on-site monitoring by external independent monitoring firms can reduce costs by streamlining the travel and maintenance of large internal departments of company auditors. Industry initiatives – as illustrated by the following three examples – can help share costs and risks:

- ICT industry: the EICC[8] Implementation Group is made up of Cisco, Dell, IBM, Intel, HP, Microsoft, Sony and five contract manufacturers. The group coordinates with the supply-chain working group of the Global eSustainability Initiative (GeSI) to create common tools and applications for the ICT supply chain.
- Garment industry: Criticisms related to working conditions in the garment industry have prompted the formation of the Fair Labour Association (FLA), which represents a multi-stakholder coalition of companies, universities and NGOs. More than a dozen apparel industry leaders like Adidas-Salomon, Liz Claiborne, Nike, Patagonia, Reebok, Eddie Bauer, Phillips-Van Heusen, and Polo Ralph Lauren are members. The strong involvement of human rights and child advocacy NGOs gives consumers greater confidence about working conditions in the garment factories of suppliers to member companies.
- Consumer goods industry: the SA 8000 (Social Accountability 8000) program combines an “auditable” code of conduct that can be applied across consumer products industries with a system for its verification. This certification program for factories and workplaces includes signatory members like Avon, Dole Food, Eileen Fisher, Otto Versand and Toys "R" Us.

4.7 Ownership and incomplete implementation of CSR in supply chains

Implementation of good social and environmental practices will not survive in the long term if owners, managers, and supervisors along the supply chain are not convinced of the benefits of CSR.

Indeed, the lack of ownership among factory managers in the apparel industry has resulted in half-hearted implementation of externally imposed codes of conduct. Oxfam (2004) discovered that, while managers made sure of zero child and forced labour, they gave priority to fulfilling an order according to the requirements of time, cost and quality and had little patience for CSR policies regarding excessive working hours, forced overtime, and harassment of workers who attempt to form unions. The same is true of other industries where cost and time pressures are intense.

5. Barriers

In this section, we describe the different barriers affecting the adoption and dissemination of CSR practices from the point of view of the different stakeholders involved. We first outline the generic challenges to mainstreaming CSR as a tool for sustainable business practices.

First of all, CSR is very much a moving target. The scope and focus of CSR definitions is different among multilateral institutions, NGOs and the private sector. This makes it difficult to establish universal codes of conduct, resulting in mixed expectations of outcomes from the different stakeholders.

Furthermore, there is a lack of comprehensive global indices to measure environmental practices, labour conditions and other CSR practices within and between industries. Today, most companies measure progress in CSR by assessing progress towards meeting internal CSR targets year on year. These targets are unique to each company. The lack of coordination on code definition can result in excessive costs to all involved. To some extent this is being addressed through industry-wide initiatives or broader initiatives like the Global Compact. The more generic the CSR code, however, the less guidance it is likely to provide to a specific company's operations.

Operationalizing such codes remains a company-specific challenge. There seems to be much scope for improvement in this regard, as CSR policies often remain at the level of principle and are rarely contractually specified. For instance, a recent survey in Denmark has shown that the share of SMEs receiving buyer requirements that are contractual or subject to verification is a fraction of those receiving requirements in principle, and that the same discrepancy exists in the case of requirements applied by SMEs to their own suppliers (figure 2).

Efforts at greater standardization of CSR reporting have been gaining momentum. At least five European countries have already issued national guidelines for quality assurance of Sustainability or CSR reports and the accountancy profession has endorsed the need for an international standard. Greater rigor and consistency in CSR reports would allow the financial markets and other stakeholders to rely more meaningfully on the information provided by companies in these reports.

More specifically, key challenges for MNCs and their suppliers include:

- *Lack of compliance due to insufficient understanding of business benefits*

Many suppliers remain sceptical about the tangible benefits of CSR to their bottom line. A number of suppliers do not fully accept code compliance as part of the contractual agreement and see it more as an encroachment of a Western value system. Staff too, need to be convinced of the necessity of codes of conduct and are unlikely to take compliance seriously unless they face the consequences of non-compliance. A number of companies now publish information about the number of investigations and disciplinary events.

- *Second-hand corporate commitments*

Some companies look at CSR more as a fashionable trend rather than a "coherent practical program," resulting in low commitment and investment in code compliance. The adoption of environmental and social requirements by SMEs in the supply chain depends on their perception of buyer requirements, as very few of them are contractual and subject to verification. Most CSR initiatives are understaffed – i.e. CSR is usually a line or a project added to a job profile of existing employees. Some companies do appoint staff to monitor CSR progress, but most are not empowered or assigned adequate resources.

- *Inefficiencies & confusion due to conflicting buyer requirements*

It is estimated that 1,000 buyer codes existed as of 2003 (Jørgensen et al., 2003). The overlapping codes, generate inefficiencies and confusion as suppliers becomes preoccupied with meeting the different requirements (codes of conduct) of each of their buyers and get caught in "compliance limbo," unable to offer time and resources to address real implementation.

- *Free-riders & first mover disadvantage*

Firms that are serious about CSR invest in setting up an enabling infrastructure, bridge gaps in compliance and commit both financial and human resources into realizing social goals. Because a large number of firms have not as yet embraced CSR, this sends mixed signals to suppliers and undermines the efforts of CSR-progressive buyers. Free-riders compound the problem and act as a disincentive for further investment by buyers. An interesting example highlighted in the IFC paper on "Establishing CSR Drivers in Agribusiness" (Tallontire and Greenhalgh, 2005) is that of brand name firms producing chocolate. The suppliers of these firms are widely dispersed smallholder producers, making it practically impossible to trace a batch of cocoa beans to a particular grower. The business case for a single firm to take responsibility for social conditions along the supply chain is not strong, as other firms are also likely to benefit from such action as free riders. One lesson is that traceability and strong market linkages are important if single firms are to be motivated by a business case to take responsibility for social issues along the supply chain.

- *Mixed messages to suppliers*

Suppliers often find it difficult to determine a firm's true priorities. Firms demand adherence to CSR policies, but at the same time demand delivery on lower prices and shorter lead times. While subscribing to both is possible, suppliers are willing to take up the challenge only if the firm's commitment is concrete and relayed through clear signals and incentives.

Challenges for institutional investors are twofold:

- *Weak evidence of CSR's impact on consumer behaviour*

It is difficult to forecast the impact of CSR on the bottom line because of the lack of relevant market information. Consumer polls show major gaps between what consumers say they would do and their actual behaviour. A 2004 European Survey, for instance, found that while 75 per cent of consumers indicated that they are ready to modify their purchasing decisions because of social or environmental criteria, only 3 per cent actually did so (Capron and Quairel-Lanoizelee, 2004, p.57).

- *Inadequate CSR reporting*

Although more and more companies are producing separate reports on corporate responsibility and achievement of social and environmental goals, most of the information being provided is not specific enough to be of value to financial analysts and institutional investors, thus limiting its usefulness to those with the most power to influence corporate behaviour.

Finally, key challenges to governments include the following:

- *Tension between developing & developed country perspectives of CSR*

While most developing-country governments and suppliers believe that national laws and regulations take precedence in guiding corporate behaviour, the concept of CSR often implicitly takes a developed-country perspective on complex societal and cultural issues.

- *Government capacity building*

CSR initiatives in developing countries range from regulating code compliance through a supply chain to building schools and making healthcare service available to communities, a function traditionally performed by governments. Such services are often provided in a public-private partnership with governments and this is generally to be preferred to simply replacing government, since corporate presence in the community may be time-bound and the services must not be. Thus, it is important that such partnership involve strengthening of government capacities to sustain such programs over the long run.

6. Conclusions

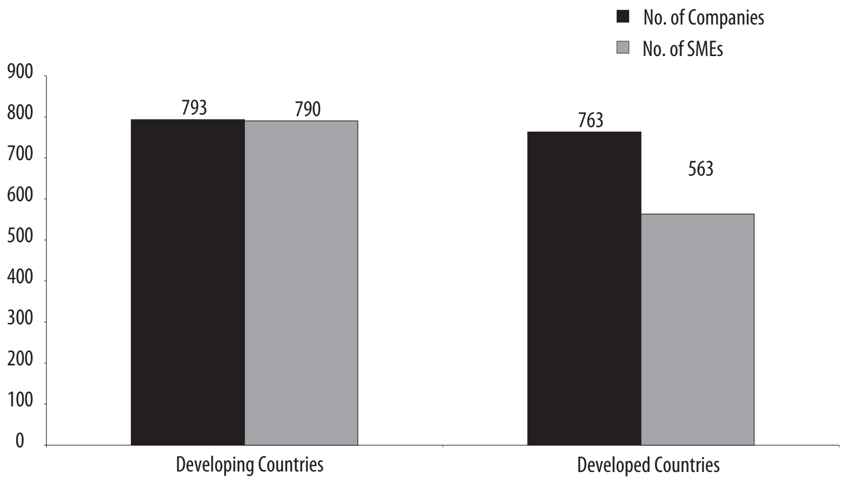
CSR could be seen as a model of extended corporate governance whereby those who run a company (managers, directors, entrepreneurs) have responsibilities that range from fulfilment of fiduciary duties towards owners to fulfilment of broader environmental and social objectives as responsible corporate citizens.

CSR issues are likely to become more important as companies in developing countries expand abroad. Identifying the barriers to CSR is half the battle. By engaging in dialogue, suppliers, buyers, NGOs and government can aim to define the scope of CSR, align financial incentives with CSR goals and create a critical mass of CSR-committed enterprises that permits the realization of scale economies, e.g., in compliance monitoring.

Large multinational buyers have an important role to play in helping their smaller suppliers address resource constraints through capacity-building initiatives. The capacity-building process involves a needs assessment of each supplier, training and workshop activities. By improving the social and environmental situation of suppliers, large buyer firms expect a return on their investment in the form of long term relationships, quality improvements (Observatoire sur le Responsabilité Sociétale des Entreprises, 2003) and fewer risks of supplier failure, while benefits for suppliers include development of business through social and environmental improvements, access to specialist advice from MNC professionals and stronger ties with multinational buyers.

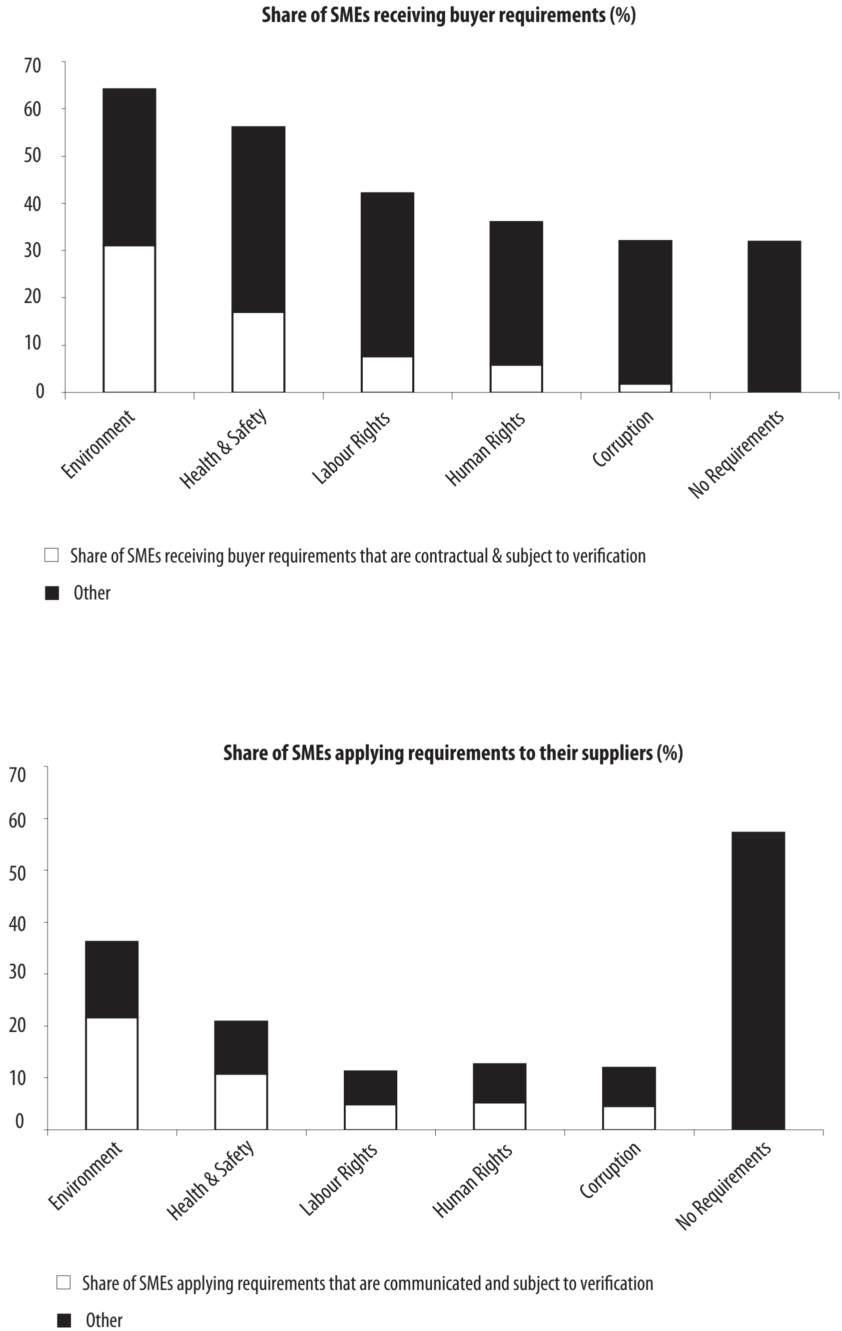
Finally, adoption of CSR by supply chain firms in developing countries can result in positive spillovers and redefine industry standards. By linking to communities of CSR practice, developing country firms may be able to compensate for weak enabling environments – e.g., absence of the rule of law and weak local standards of corporate governance.

Figure 1. Number of global compact companies and SMEs in developed and developing countries



Source: The authors based on UN Global Compact's participation database (as of November 8, 2006).
Obs.: The country groupings follow the WDI definitions, where all low-income, low-middle income and upper middle income economies are considered developing countries and all high-income economies are considered developed countries. SMEs are defined by the UN Global Compact as 'business participants with less than 250 and more than 10 full-time employees.'

Figure 2. CSR requirements and SMEs in global supply chains



Source: Jorgensen and Knudsen (2006).

Notes

1 The Johannesburg Plan of Implementation that emerged from the World Summit on Sustainable Development in 2002 refers to 'corporate social and environmental responsibility and accountability'. CSR, the more familiar term, is defined by the World Business Council for Sustainable Development as "the continuing commitment by business to behave ethically and contribute to economic development while improving the quality of life of the workforce and their families as well as of the local community and society at large" (WBCSD, Corporate Social Responsibility: Meeting Changing Expectations, 1999).

2 Expert Group Resources on CSR, SMEs and Regional Competitiveness (January 2006), Enterprise and Industry, European Commission http://ec.europa.eu/enterprise/csr/ms_sme_topic1.htm.

3 As per figures of the UN Global Compact's participation database (www.unglobalcompact.org), November 8, 2006.

4 Codes of Conduct are defined as the mechanism by which MNCs establish social and environmental guidelines for their suppliers.

5 Environmental Defense Fund WorldWide (www.environmentaldefense.org).

6 Case studies in the text are "leadership" practices in CSR. They have been chosen as illustrative examples to represent innovation, higher than average commitment, or a comprehensive approach to the issue.

7 Wal-Mart, Carrefour, Home Depot, Metro and Tesco are the top 5 retailers worldwide – according to the Deloitte 2006 Global Retailing Powers study.

8 EICC is the Electronic Industry Code of Conduct.

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