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Corporate Social Responsibility (CSR) and the Development Agenda:

Should SMEs Care?

by

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EXECUTIVE SUMMARY

In recent years, increasing attention has been given to the concept of corporate social responsibility (CSR) as a postulate for ethical behaviour of business and as a basis for good corporate citizenship. Amidst shocking evidence of large-scale corporate irresponsibility and fraud on both sides of the Atlantic, there is insistence that business can and should act in a manner that respects the legitimate goals and demands of all stakeholders.

In economic and industrial development, a critically important role is played by micro, small and medium enterprises. While being important at all levels of development, empirical studies have clearly shown that at the lower income levels typical for developing countries, the prevalence of SMEs is particularly pronounced.

The present paper reviews recent trends in CSR theory and practice and, in doing so, places special emphasis on their relevance for small and medium enterprises (SMEs) and on the context of economic development in developing countries. It is argued that at the end of the day, CSR will only prevail and remain an important force if SMEs can be effectively engaged and if CSR can be shown to impact on the development agenda, i.e. first and foremost on enhancing productivity as a long-term determinant of economic growth.

CHAPTER I:

Context

A. The rise of CSR: short-term episode or long-term trend?

In recent years, increasing attention has been given to the concept of corporate social responsibility (CSR) as a postulate for ethical behaviour of business and as a basis for good corporate citizenship. Amidst shocking evidence of large-scale corporate irresponsibility and fraud on both sides of the Atlantic (see the topical cases of e.g. Enron and Parmalat), there is insistence that business can and should act in a manner that respects the legitimate goals and demands of all stakeholders. A wide array of initiatives abound in terms of public-private partnerships, both at the country level and within the UN system[1]; cross-border corporate coalitions such as the World Business Council for Sustainable Development (WBCSD) or the International Business Leaders Forum (IBLF); global conferences, studies and workshops; social standards, labels and related monitoring mechanisms; fair trade groups; and socially responsible investment funds.

The ruling economic paradigm has it that markets - whether global or national – are about efficiency in resource allocation, about competition as a source of economic dynamism, about productivity gains that translate into lower costs and/or higher quality. Companies, through seeking to maximize their profits, ensure that economies grow, consumer demand is met and economic development processes are set in motion. Where, however, does this leave issues related to corporate responsibility? Is the business of business to generate profits no matter under what conditions, or does the business agenda encompass human, environmental and social dimensions? And if so, are these dimensions tantamount to additional costs, or can they be a source of competitiveness and thus market access?

In a significant political move, the European Commission has designated 2005 as the year of corporate social responsibility in European Union countries. Likewise, individual EU member states have taken important steps, such as the UK appointing a Minister for CSR within the Department for Trade and Industry, France legally requiring companies to include social and environmental impact in their annual reports, the Netherlands linking financial support schemes for large companies to compliance with the OECD

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[1] J.Nelson: Building Partnerhips. Cooperation between the United Nations System and the Private Sector, New York, 2002.

Guidelines for Multinational Enterprises or the Danish Government establishing the Copenhagen Centre (a CSR focused research institution).

What is this emphasis on CSR all about? Are we looking at just the flavour of the month? At the latest hype or fad of a development community increasingly disillusioned with the performance and capacities of the public sector? Or do we see the seeds of a genuinely new role model for business and corporate behaviour? Are businesses, in particular transnational corporations (TNCs), really looking beyond the short-term dictates of the market and moving from shareholder value to shared values?

It has been observed that the globalization process has gradually disconnected fast-moving international networks of production and finance from a lagging system of global policies and institutions. A disequilibrium is thus created between the economic domain proper and the broader framework of shared values.[2] In a closely connected development, as pointed out by Harvard economist Dani Rodrik, "international economic integration is taking place against the background of receding governments and diminished social obligations".[3] Does this imply that we are witnessing the emergence of increasingly hybrid governance structures in which social needs are no longer the exclusive realm of the state? While the social dimension has been an inherent feature in the European brand of post-war market economies ('social market economy' in Germany; 'planification' in France), we can now witness attempts to anchor responsible business practices in the corporate world itself, within a context of voluntary action.

The present paper reviews recent trends in CSR theory and practice and, in doing so, places special emphasis on their relevance for small and medium enterprises (SMEs) and on the context of economic development in developing countries. It is argued that at the end of the day, CSR will only prevail and remain an important force if SMEs can be effectively engaged and if CSR can be shown to impact on the development agenda, i.e. first and foremost on enhancing productivity as a long-term determinant of economic growth.[4]

B. CSR definition and relevance to SMEs

CSR has been defined in many different ways. At bottom, it refers to companies integrating "social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis (…) not only fulfilling legal expectations, but also going beyond compliance."[5] Importantly, the above EU definition links CSR practice intrinsically to business operations thus excluding corporate philanthropy and connecting CSR with the core of a company's operations. This

[2] G.Kell, J.G.Ruggie: Global Markets and Social Legitimacy: The Case of the 'Global Compact', Transnational Corporations, Vol.8, No.3, December 1999, pp.101-120.
[3] D.Rodrik: Survey on Globalization: Is Government Disappearing?, The Economist, 29 September 2001, p.16.
[4] UNIDO: Developing Industry: Productivity Enhancement for Social Advance, Vienna, August 2003, p.41.
[5] European Commission: Promoting a European Framework for Corporate Social Responsibility. Green Paper, July 2001, p.8.

emphasis on economic benefits derived from environmental and social considerations, is generally referred to as the 'CSR business case'.

This 'business case' for CSR can be traced to a number of different motives and mechanisms. These range from defensive attempts at avoiding financial losses and protecting image and reputation, to a pro-active cost-benefit-calculus that factors in financial gains from productivity improvements (e.g. resulting from enlightened human resource management or from higher energy or material efficiency) and ultimately, CSR as the core of a company's corporate strategy where CSR itself becomes the basis for brand equity and the driver of organizational learning, innovation and technology management.[6]

However, as stated in the EU Green Paper, CSR practice has so far primarily been the domain of large TNCs whereas "its wider application in SMEs including micro-businesses is of central importance, given that they are the greatest contributors to the economy and employment."[7]

Indeed, in economic and industrial development, a critically important role is played by micro, small and medium enterprises which, on average, make up over 90% of enterprises and account for 50-60% of employment – in particular in the developing world. While being important at all levels of development, empirical studies have clearly shown that at the lower income levels typical for developing countries, the prevalence of SMEs is particularly pronounced. Also, as average income increases, the size distribution of firms typically moves upwards, with the share of micro-enterprises going down and that of more sophisticated medium enterprises rising.[8] There is a rich body of research on the development contribution of SMEs. While not entirely without some controversial areas, there would appear to be widespread consensus on the following points:

- SMEs (partly because of the industrial sub-sectors and product groups covered by them) tend to employ more labour-intensive production processes than large enterprises. Accordingly, they contribute significantly to the provision of productive employment opportunities, the generation of income and ultimately, the reduction of poverty. It is essentially through the promotion of SMEs that individual countries and the international community at large can make progress towards reaching the Millennium Development Goal of halving poverty levels by the year 2015.

- There is ample empirical evidence that countries with a high share of small industrial enterprises have succeeded in making the income distribution (both regionally and functionally) more equitable. This in turn is a key contribution to ensuring long-term social stability by alleviating ex-post redistributional pressure and by reducing economic disparities between urban and rural areas.

- SMEs are key to the transition from agriculture-led to industrial economies as

[6] UNIDO: Corporate Social Responsibility. Implications for Small and Medium Enterprises in Developing Countries, Vienna, October 2002, p.7.
[7] Ibid, p.8.
[8] D.R.Snodgrass, T.Biggs: Industrialization and the Small Firm. Patterns and Policies, International Centre for Economic Growth and Harvard Institute for International Development, 1996.

they provide simple opportunities for value-adding processing activities which can generate sustainable livelihoods. In this context, the predominant role of women is of particular importance.

- SMEs are a seedbed for entrepreneurship development, innovation and risk-taking behaviour and provide the foundation for long-term growth dynamics and the transition towards larger enterprises.

- SMEs support the building up of systemic productive capacities. They help to absorb productive resources at all levels of the economy and contribute to the creation of resilient economic systems in which small and large firms are interlinked.

- Such linkages are of increasing importance also for the attraction of foreign investment. Investing TNCs seek reliable domestic suppliers for their supply chains. There is thus a premium on the existence of domestic supporting industries in the competition for foreign investors.

- SMEs, as amply demonstrated in information and communication technologies, are a significant source of innovation, often producing goods in niche markets in a highly flexible and customized manner.

As the above non-exhaustive list demonstrates, the development contributions of SMEs are varied and can be found at the intersection of economic and social dimensions: SMEs foster economic cohesion by linking up with, and supporting larger enterprises, by serving niche markets and in general by contributing to the build-up of systemic productive capacities. At the same time, SMEs foster social cohesion by reducing development gaps and disparities, thus spreading the gains of economic growth to broader population segments and backward regions.

When viewing the operating landscape of SMEs in developing countries, there are at least three types of business environments in which they operate:

- Enterprises that act as subcontractors in international value chains, usually as suppliers to TNCs. This category of enterprise is increasingly under customer pressure to conform to minimum standards for employee remuneration, work conditions, and environmental performance. This pressure reflects the degree to which their client TNCs adopt CSR as operating policy, and the degree to which those clients pass CSR requirements along their value chains.

- Enterprises that independently service international markets. Such enterprises would adopt CSR measures to the extent required by domestic or international regulation, or the extent to which consumer pressure exerts an influence, or the extent to which enlightened entrepreneurship is exercised by management to make CSR a voluntary tenet of company policy.

- Enterprises that service domestic markets or national value chains. Such enterprises adopt CSR to the extent that domestic regulation, customer pressure or community concerns force the course of action. Domestically oriented enterprises are the most preponderant among SMEs in developing countries. It may be fair to assume that in developing countries, due to weak regulatory capacities and nascent consumer and community organization, external pressures to adopt CSR would be relatively weak, leaving the motivation to voluntary initiative as a result of enlightened entrepreneurship exercised by owners or managers of the enterprise.

In particular the first group listed above refers to the general significance of business linkages between TNCs and SMEs and the role of global value chains in providing access to export markets for SMEs. Specifically with regard to CSR practices, such business linkages assume great importance in terms of TNCs sourcing parts, components and services from SME suppliers thus enhancing the local content of production within global value chains. It is this group of export-oriented, globally linked SMEs in developing countries that are the focus of this paper. In view of their high significance for CSR practices, the role and forms of business linkages within global value chains are elaborated in greater detail below.

CHAPTER II:

CSR and Business Linkages

A. TNCs, SMEs and the significance of business linkages

Global value chains[9] governed by TNCs account for a significant part of world production (currently estimated at more than 25%), and being unable to participate in these chains can effectively exclude SMEs in developing countries from a large share of economic opportunities. Conversely, integration in value chains represents one of the most effective ways of promoting the upgrading of developing country SMEs since such integration can provide them access to markets, upgraded technology, improved management practices, and other benefits.[10] In a somewhat stylised perspective, value chains can be of two types, buyer-driven and producer-driven. The type of value chain affects the economic benefits that the SMEs, and the countries in which they operate, may obtain. It also affects the importance and forms of CSR strategies.

In (mostly trade-based) *buyer-driven chains,* larger firms – often a large retailer – tend to work with decentralized networks of SMEs as independent suppliers, mostly providing them with tight product specifications. This type of chain is often found in labour-intensive non-durable consumer goods industries such as garments, leather and toys. Entry barriers (in terms of technologies, capabilities and skills required) are relatively low, furnishing many opportunities for developing country SMEs capable of meeting the buyers' requirements. However, the benefits for SMEs in terms of technological learning from engaging in these chains tend to be quite limited. The main short-term development effect of participating in these chains is likely to be an increase in employment, though the lead firm can also help to tackle issues such as child labour and environmental pollution, and participation may offer SMEs a way to step-by-step upgrading of their capabilities.

[9] Value chains are defined as the full range of activities that are required to bring a product or service from conception through the different stages of design, production and delivery to final consumers and disposal after use. Depending on the features of the products and of its consumers, value chains can be confined to a single nation, or can span a region or different regions.
[10] UNIDO: Integrating SMEs in Global Value Chains. Towards Partnership for Development, Vienna, August 2001; and for a broader perspective UNIDO: Industrial Development Report 2002/2003. Competing through Innovation and Learning, Vienna 2002.

In (mostly investment-based) *producer-driven chains* the lead firm, typically a large firm in a technology-intensive industry, exercises much closer control over its suppliers. When these are not wholly owned, joint ventures are a common form of cooperation and even where no equity ties exist at all, joint value chain management systems are often introduced. Only the more advanced transition economies and developing countries are likely to have the human and technological capacities needed by the lead firm. The role of independent local producers tends to be more limited although the know-how transfer effects can be important. The automotive and electronics industries are typical examples with sectors characterized by such value chains.

Clearly, integration of SMEs in global value chains generates both opportunities and risks. On the positive side, technology may be upgraded, technical and management skills enhanced and market access strengthened. The extent to which such benefits are disseminated to society at large can vary considerably. This depends on spillover effects, which are likely to be particularly strong when the SMEs participating in value chains, are themselves linked in networks with other firms and institutions or, better still, form part of a local cluster of firms.[11]

At the same time, there is a danger that SMEs may be relegated to the role of mere suppliers of parts and components thus possibly stifling their own innovation dynamics and exposing them to a high degree of dependency on the prime manufacturers to whom they supply. A careful assessment is therefore required to ensure that value chain integration does not run counter to SME development strategies focussing on the promotion of direct exporting capabilities. Both approaches have their merits and need to be reconciled by the prevailing national industrial development strategy.

B. Business linkages: a public good?

Although the potential benefits to SMEs and to local economic development are significant, and though large corporations recognize the value of having high quality suppliers from within developing host countries, business linkages are often quite difficult to establish. Many large corporations do operate limited vendor development programmes for their first-tier suppliers out of their own commercial interest of developing a stable supply base. While compulsory domestic content regulations are gradually being removed in line with WTO provisions, TNCs active in developing countries continue to have a commercial interest in local sourcing on a voluntary basis. Incentives are manifold: from ensuring a continued ‘licence to operate’, to reducing transport costs and optimising just-in-time delivery. However, large corporations usually cannot justify bearing alone the expense of upgrading entire local productive systems, which however is often required to reduce capability gaps. Also, the benefits of such efforts cannot be completely appropriated at the firm level, thus assuming significant elements of a public goods character.

[11] For a general introduction into the concept of SME clusters, see UNIDO: Development of Clusters and Networks of SMEs, Vienna 2001.

In reality, therefore, the development of business linkages between TNCs and SMEs "is impeded by market failures in the supply of information, skills and infrastructure."[12] This is largely due to the fact that quite abruptly, producers in developing countries are faced with quality, productivity and CSR requirements that do not yet apply to their domestic markets.[13] Specifically,

- TNCs may have insufficient information about the existence and capabilities of potential business partners.
- The second tier and third tier small suppliers do not receive sufficient technical support thus negatively affecting the performance of the entire supply chain.
- Awareness of technical, quality and CSR-related standards may be lacking and/or the technical infrastructure for compliance (e.g. testing laboratories) may be lacking.
- And, in a broader perspective, incentives may be biased against SMEs and their access to capital may be restrained.

Hence, there is a case for an intermediary to intervene and complement market mechanisms in creating sustainable business linkages. Any such linkage support programme initiated by an impartial broker will need to adopt a sector-wide approach, strengthen existing service institutions, work with local partners and arrange for world-class expertise to be delivered to SME suppliers.[14]

C. CSR-oriented business linkage and partnership programmes

With the above rationale in mind, many governments, SME support institutions and also some TNCs themselves have initiated programmes that are aimed at enhancing the capabilities and performance of SMEs as partners for local sourcing. This paper does not intend to provide a full account of such programmes. Notable examples include Singapore's Local Industry Upgrading Programme, the Source Wales programme, Ireland's National Linkage Programme as well as the company programmes of Unilever in Viet Nam, Toyota in Thailand, Intel in Malaysia or Motorola in China.[15]

[12] D.Stanton, T.Polatajko: Business Linkages: Their Value and Donor Approaches Towards Them, UK Department for International Development, London 2001 (mimeo), p.3.
[13] D.Keesing, S.Lall: Marketing Manufactured Exports from Developing Countries: Learning Sequences and Public Support, in: G.Helleiner (ed.): Trade Policy, Industrialization and Development, Oxford 1992.
[14] For a detailed assessment of an innovative business linkage programme in the automotive industry, see R.Samii, L.N.van Wassenhove, S.Bhattacharya: An Innovative Public-Private Parnership: New Approach to Development, World Development. Vol.30, No.6, 2002, pp.991-1008.
[15] For an excellent overview see UNCTAD: World Investment Report 2001. Promoting Linkages, New York and Geneva 2001, pp.127-192 and T.Altenburg: Linkages and Spillovers between Transnational Corporations and Small and Medium-Sized Enterprises in Developing Countries – Opportunities and Policies, in: UNCTAD: TNC-SME Linkages for Development. Issues –Experiences- Best Practices, New York and Geneva 2000, pp.3-61.

While the above programmes tend to focus on company-level measures of quality upgrading and productivity enhancement, there are further initiatives that adopt a broader developmental perspective and explicitly take on board principles of CSR. Three examples are presented below.

(1) Within the framework of initiatives launched by bilateral development agencies, the *German Public-Private Partnership* (PPP) *Programme* is of particular significance, both in terms of the scope and the volume of its activities. The PPP facility was launched in 1999 by the Ministry for Economic Cooperation and Development (BMZ) and is being implemented by various organizations, including the German Society for Technical Cooperation (GTZ). For its first three years of operation, this new facility was provided with funding of Euro 56 million. The programme is primarily aimed at SMEs that are active in developing countries and willing to engage in PPP projects that are rooted in, yet go beyond a company's core business, and make a tangible contribution to development policy objectives. The company is generally expected to bear at least 50 % of project costs.

The PPP Programme has been evaluated in 2002 and found to provide an innovative instrument and new impetus for involving private business in the development agenda and fostering economically and socially responsible activities. However, the evaluation also establishes that the vast number of relatively small projects tends to lack coherence and macro-level impact, and has frequently led to an ex-post integration into already existing development cooperation strategies. Furthermore, it is recommended to give preference to projects involving partnerships not with just one company but with several actors, including civil society organizations.[16]

(2) The formation of such multi-sector partnerships is the characteristic feature of the *UNIDO Business Partnership Programme.*[17] This programme works with TNCs as well as business representative organizations, research institutions and NGOs and is explicitly aimed at helping SMEs in developing countries to meet the rising demands of quality, productivity and social responsibility. While only a limited number of projects have so far been implemented (with a focus on the automotive component industry in India and South Africa), tangible results have been achieved in terms of SME performance improvements and improved business linkages. The rationale of this programme has been to move beyond the limited support that individual TNCs may provide to their preferred suppliers, and initiate an upgrading process at the level of industrial sub-sectors – leading to better quality, higher productivity, environmentally sound production and improved working conditions. Key lessons learnt include:

- The pooling and integration of different types of expertise (local and international; operational and analytical; economic, social and environmental) ensures a holistic perspective on development and constitutes an important asset of a multi-sector partnership approach.

[16] T.Altenburg, T.Chahoud: Public-private Partnerships. Assessment of the First Years, Development and Cooperation, Vol.30. No.4, April 2003, pp.144-147.
[17] UNIDO: Business Partnerships for Industrial Development, Vienna, February 2002.

- TNCs, beyond the narrow confines of their own supply chain, often have a shared interest in upgrading the capabilities and improving the tiering structure of an entire industrial sector so as to improve their local sourcing potentials. This can lead to significant cost savings (compared to either importing or in-house production of components) and, through providing local employment and technology upgrading, can provide a welcome recognition as a good corporate citizen.

- SMEs can be motivated to participate in partnership programmes provided the incentives in terms of expected benefits are strong enough. This makes it essential to kick-start partnership programmes with support services, which generate quick, tangible and measurable impact in terms of productivity and quality gains, leading to increased sales and market shares.

- The demonstration of business benefits from a partnership approach, widens the horizon of SME managers and makes them responsive to a broader CSR agenda: a commitment to applying environmentally friendly processes, a commitment to waste minimization, a commitment to reducing work-related accidents, a commitment to enlightened human resource management, e.g. through more emphasis on training – in essence a commitment to improving the impact of business on workers and the environment is a result of instilling a longer-term perspective and of developing a clear CSR business case. Thus, while a CSR agenda was clearly not the initial trigger of SME participation in a partnership project, many SMEs now see clear merits in positioning themselves as responsible companies and some SMEs have even decided to join the UN Global Compact.

(3) The *UN Global Compact* constitutes the highest profile initiative seeking an alliance and alignment between corporate strategies on the one hand and broader development objectives on the other hand. On the occasion of the Davos World Economic Forum in January 1999, the Global Compact was proposed to the business community by UN Secretary-General Kofi Annan. With the aim of making globalization more stable, more sustainable and more inclusive, globally operating businesses were called upon to enhance their commitment to the public interest and subscribe to internationally agreed values and principles. In essence, therefore, the Global Compact is an initiative to safeguard sustainable growth within the context of globalization by promoting a core set of universal values, which are fundamental to meeting the socio-economic needs of the world's people. More specifically, nine principles in the spheres of human rights, labour and environment are to be respected by any member of the Global Compact.[18]

Today, the Global Compact encompasses more than 1,000 companies (including many of the largest TNCs but also about 25% SME membership with 42% of these SMEs coming from developing countries), labour groups, academic institutions and civil

[18] These are: protection of internationally proclaimed human rights; no involvement in human rights abuses; freedom of association and right to collective bargaining; Elimination of forced and compulsory labour; abolition of child labour; elimination of discrimination; precautionary approach to environmental challenges; initiatives to promote environmental responsibility; and development and diffusion of environmentally friendly technologies.

society organizations. The core UN agencies of the UN Global Compact are: ILO (labour), UNEP (environment), UNHCHR (human rights), UNIDO (SMEs) and UNDP (country-level promotion). In 2002, the Secretary-General established an Advisory Council on the Global Compact, composed of senior business representatives, international labour leaders, public policy experts and heads of international CSOs. In January 2002, the UN General Assembly passed a resolution (GA/56/76) endorsing the continued engagement of the UN system with the private sector, including through the Global Compact initiative.

The main activity areas of the Global Compact include: Policy Dialogues (action-oriented dialogues between UN organizations, business and CSOs), Annual International Learning Fora, Outreach Initiatives (taking the Global Compact to the country-level, through organizing awareness and advocacy events) as well as Partnership Projects. While the Global Compact does not directly facilitate or manage partnership projects, it does focus on their encouragement and communication. The partnership projects themselves are implemented by the relevant specialized UN agencies.

At bottom, the Global Compact is a value-based network seeking to mobilize the power of convictions, transparency and dialogue to foster the adoption and dissemination of good practices of corporate citizenship. As such, it is "nothing more than a moral compass"[19] and has attracted support and membership not only from business leaders but also from leading globally operating civil society organizations, such as Amnesty International, World Wide Fund for Nature and Human Rights Watch. It goes without saying that likewise, the Global Compact has also been subject to various types of criticism, primarily related to the voluntary character of the initiative and the alleged softness of compliance monitoring.

[19] G.Kell: The Global Compact. Origins, Operations, Progress, Challenges, The Journal of Corporate Citizenship, Issue 11, Autumn 2003, p.47.

CHAPTER III:

Does CSR Pay?

A. The CSR business case: micro-level evidence

All of the above would appear to demonstrate that the ongoing discourse on CSR has been very much a Northern agenda, a debate driven by OECD-based transnational corporations on the one hand and by bilateral and multilateral development agencies on the other. However, if referring to the advantages offered by globalization is to be more than a mere lip service, then the debate and practice of CSR needs to be taken to the South, arguments need to be openly exchanged, and concrete benefits need to be demonstrated. Otherwise, the CSR drive will be easily stigmatized as an unholy alliance of big business interests and donor-led do-gooders campaigns.

In this context, it is critically important to prove the business case of CSR. Compelling evidence needs to be delivered that being socially responsible also impacts on the bottom line. This is essential for the big corporate players; it is certainly imperative for those smaller companies in the developing world that are part of global value chains and engage in export-oriented activities.

Fortunately, empirical evidence supporting the business case is growing. The long-run benefits for companies adopting CSR strategies can indeed be significant and involve the following key dimensions[20]:

- *Cost savings*: here the emphasis is on operational savings (less waste, less energy and material inputs, higher efficiency in resource use) resulting from environmental process improvements within an eco-efficiency perspective.

- *Enhanced staff loyalty*: companies with advanced human resource development programmes (e.g. high investment in training, family-friendly policies, incentives and reward schemes) enjoy higher levels of loyalty and lower levels of absenteeism, and will also find it easier to recruit, develop and retain staff

[20] C.O.Holliday, Jr., S.Schmidheiny, P.Watts: Walking the Talk. The Business Case for Sustainable Development, San Francisco 2002; UNIDO: Corporate Social Responsibility. Implications for Small and Medium Enterprises in Developing Countries, Vienna, July 2002, pp.7-9.

- *Improved government relations*: The 'license to operate' is key for companies seeking to continue or even expand their business operations, in particular in challenging political environments. This license is more easily obtained when demonstrating social and environmental responsibility. Also, more cooperative government responses and reduced bureaucratic hurdles may result.

- *Innovation and learning*: Engaging in stakeholder dialogues makes companies more sensitive to their operating environment and often results in enhanced capacities for risk management, anticipation of challenges and ultimately, introducing viable process and product improvements. "It is very likely that companies that have invested in partnerships with NGOs, trade unions and public bodies (…) will be more competent in identifying and building profitable business partnerships."[21]

- *Enhanced reputation*: In particular for companies with a high-value retail brand, the positive image effects of CSR can be a decisive actor for future market development.

- *Consumer response*: While responsible consumer behaviour is still somewhat confined to niche markets, it appears to be growing rapidly. In European countries (one of the most significant export markets for developing country producers), around 25 % of all consumers respond to a company's social image when deciding to purchase a product or service. At the same time, two thirds of Europeans see involvement in social issues as a growing responsibility for private business.[22] A key question of course is whether or not such attitudes translate into brand loyalty and a willingness to pay a premium for 'responsible' products. This appears to be an under-researched area and evidence from various fair trade organizations is inconclusive.

The recent growth (albeit from a low basis) in *socially responsible investment (SRI) funds* can be regarded as a further reflection of the CSR business case. SRI funds seek to attract capital on the assumption that it pays to be an ethical company, i.e. that CSR strategies translate into higher competitiveness and profitability. While the overall evidence is still scanty, there are growing signs of such a positive relationship. Research undertaken by the UK Institute of Business Ethics indicates that companies with established ethics codes outperform those without such codes in terms of economic value added and market value added as well as in the stability of their price/earnings ratios thus resulting in higher *long-term* shareholder value.[23] It is further noteworthy that, since its launch in 1999, the Dow Jones Sustainability Index (DJSI) has consistently outperformed the Dow Jones Global Index (DJGI) World.

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[21] The Copenhagen Centre and AccountAbility: Corporate Responsibility and the Competitive Advantage of Nations, Copenhagen, July 2002, p.21.
[22] CSR Europe: European Survey of Consumers' Attitudes towards Corporate Social Responsibility, Survey 2000.
[23] A.Maitland: Profits from the Righteous Path, in: Financial Times, 3 April 2003, p.9.

There can be no doubt that proving the business case of CSR is most important for SMEs. Large corporations will give relatively higher weight to reputation and image benefits through positioning themselves as good corporate citizens. However, for SMEs, the bottom line of short-term economic survival is more pressing. They tend to be more vulnerable to economic losses and will thus be more dependent on direct economic benefits of CSR-oriented strategies. There are several factors that could influence the adoption of CSR in day-to-day business operations of SMEs:

- In economically difficult times, SMEs are forced to prioritize short-term survival over investment of time or money into longer-term strategic measures.

- In addition to the difficulties posed by the economic conjuncture, smaller enterprises tend to have meagre managerial and financial resources to undertake activities beyond the immediate concerns of business survival and profitability.

- SMEs tend to have little autonomy of action in their relationships with regulatory authorities, customers and other stakeholders, hence their capacity for CSR initiatives would be considerably more constrained than would be the case for larger corporations.

- Given different social and cultural conditions, there may be very different perceptions of what does and what does not constitute CSR in different national situations. Also there may be existing business practices of firms in developing countries that could reflect concern for socially and environmentally responsible business practice - the so-called "silent CSR".

In this context, the results of a survey of CSR activities carried out amongst more than 7,500 European SMEs can shed some light on the profile and key features of those companies:[24]

- For 28 % of surveyed SMEs, CSR activities (both regular and occasional) are part and parcel of their business strategy.

- From a geographical perspective, there is a clear North-South divide with Northern country SMEs exhibiting the highest incidence of CSR activities.

- Likewise, a strong correlation between CSR activities and company size can be observed: 48 % of micro enterprises, 65 % of small enterprises and 70 % of medium enterprises report external social activities.

- Most importantly, the survey establishes a significant role of the enterprise strategy pursued: the highest percentages of planned CSR activities are found amongst SMEs with a distinct orientation towards growth, higher quality and innovation. This would appear to confirm that CSR engagement can be a positive

[24] European Commission: European SMEs and Social and Environmental Responsibility, Observatory of European SMEs, No.4, 2002.

factor in overall strategies that rely on the 'high road' towards competitiveness.

B. Responsible competitiveness: macro-level evidence

The above considerations bring us closer to the question whether - on top of casuistic micro-evidence at the firm level – there is a 'macro-case' in favour of socially responsible development strategies. In other words: assuming that a critical mass of companies act in a socially and environmentally responsible manner and that economic governance structures and incentives are designed to encourage such a strategy, would this result in enhanced overall competitiveness? This is the question addressed in innovative recent research undertaken by Simon Zadek and his team on behalf of the Copenhagen Centre and AccountAbility.[25] Starting from a productivity-based notion of economic competitiveness, they construct a country-level Corporate Responsibility Index, which is composed of indicators grouped in seven components, as summarized in the table below.

Table: Variables and Indicators of the National Corporate Responsibility Index

Component	Data
1. Corporate Governance	o Transparency and disclosure rating o Strength of auditing and accounting standards o Degree of independence of boards
2. Ethical business practices	o Bribe Payers' Index o Anti-dumping measures against country o Business costs of corruption o Strength of corporate ethics
3. Progressive policy formulation	o Nature of environmental gains o Strength of regulatory standards o Ratification of Kyoto Protocol o Sign up to UN Global Compact
4. Building human capital	o Fatal accidents/100,000 workers o Extent of staff training o Employee protection legislation o Employment Laws Index
5. Engagement with civil society	o Degree of civic freedom o Consumer groups per 10m people o Public trust in business o Sophistication of consumers o Customer orientation of companies
6. Contributions to public finance	o Corporate tax levels o Prevalence of irregular payments in tax collection o Share of public spending on education
7. Environmental management	o Compliance with env. regulations o Prevalence of env. management systems o Emissions of carbon dioxide per unit of GDP o Share of companies rated in DJSI

Subsequently, the above Index is plotted against various measures of competitiveness, such as the Growth Competitiveness Index (GCI) of the Word Economic Forum (WEF), with the result of a fairly strong positive correlation. While admitting the generally tenuous relationship between correlation and causality, the authors claim that several of the seven components listed in the above Table have stronger explanatory power than e.g. gross national income, in explaining competitiveness. Finally, by combining the National

[25] The following section summarizes key points emerging from this research. See AccountAbility and The Copenhagen Centre: Responsible Competitiveness Index 2003. Aligning corporate responsibility and the Competitiveness of Nations, December 2003.

Corporate Responsibility Index with the technology sub-index, public institutions sub-index and macro-economic sub-index of the GCI, an overall Responsible Competitiveness Index is formed and comparisons are drawn.

It is far too early to arrive at clear-cut conclusions as to the degree to which responsibility deficits may actually detract from growth and competitiveness potentials at the national level. However, this new line of research for the first time, asks challenging questions that should be further pursued. It complements firm-level evidence with macro data and pushes the CSR agenda to a new level of aggregation.

CHAPTER IV:

Conclusions and Outlook

Not without a certain dose of irony, it can be claimed that within the 'triple bottom line' (economic, environmental and social) of corporate performance, it is the economic dimension of CSR, which has been least explored and that the way in which large TNCs interact with their SME suppliers is, in and by itself, a key dimension of CSR strategies. The build-up of stable, long-term and trust-based relationships contributes to nurturing local entrepreneurship and employment and can be among the most powerful social contributions large enterprises can make. Conversely, 'hit and run' strategies of footloose investment responding to short-term wage differentials are intrinsically irresponsible: they tend to bring investment in good times and leave immediately when challenges arise. Therefore, enlightened strategies of supply chain management are part and parcel of the CSR agenda. In this context, the results of a recent World Bank survey among more than 200 supply chain specialists are rather discouraging.[26] It shows that present practice may not be sustainable as they often rely on a top-down approach with high quality demands on suppliers yet little support in meeting those demands. However, technical and management support should be seen as a necessary complement to standards and codes; responsible corporations are those moving from a mere compliance mode to an engagement mode, from harm minimization to value creation.

SMEs, in particular those in developing countries and those active in manufacturing for export markets, need to be provided with the tools to monitor, and report on, their own CSR performance and to continuously improve that performance. This calls for the identification of synergies between social and environmental improvements on the one hand, and productivity gains, technology upgrading, innovation and market access on the other. It also calls for mentoring and support from both large corporations and development agencies. Only if a critical mass of SMEs buys into the CSR concept, and if they can reap economic benefits from CSR practice, will the CSR movement itself be sustainable.

Moreover, there is a need for scaling up CSR initiatives taken at the level of individual companies. This in turn calls for more emphasis on the following elements:

- A stronger involvement of business organizations (industry associations, chambers

[26] Quoted in Ethical Performance, Vol.5, Issue 7, December 2003, p.3.

of commerce etc.) in CSR advocacy and awareness raising, and in providing CSR implementation support to their SME members. This happens already in a number of developing countries, such as Brazil, India, Kenya and South Africa. In this context, demonstrating that CSR strategies can contribute to long-term employment creation and poverty reduction is a key challenge to be met. “Industry bodies, national chambers of commerce and new business groupings (…) can help ‘raise the bar’ of what business can and should contribute to the goal of poverty elimination by taking collective action, promoting best practice and enforcing collective self-regulation.”[27]

- Deliberate public action seeking to reshape markets and strengthen drivers for the adoption of CSR practices. This will have to work on both the supply and the demand side: by providing financial incentives to companies that take the lead in moving CSR forward (e.g. rewarding the introduction of environmentally friendly processes and products) and by stimulating consumer preferences in support of ‘responsible’ products.
- Finally, good public sector governance itself is essential: It is primarily SMEs that can benefit from transparent rules and the absence of corruption.

In general, the debate on CSR and developing countries is subject to two major suspicions: environmental standards are often seen as restraining growth while social standards are regarded as constraining trade. Both are sometimes conceived as attempts to deny developing countries access to a fast growth track. Furthermore, there is critique, on the one hand, claiming that CSR is based on a misunderstood market paradigm seeking to confer social functions upon profit-driven companies; on the other hand, alleging that CSR is based on voluntarism and ultimately, weakening the regulatory power of the state.

The final jury on the future importance of CSR strategies, i.e. on whether they constitute just an episode or a long-term trend, is still out. However, with more and more evidence that being a responsible producer has lasting economic benefits in many highly competitive markets, CSR practice has powerful incentives and may become increasingly rooted in enterprise strategies.

CSR is not a just a rich man’s luxury. Just as globalization exposes industrialized countries to low-wage competition from developing countries, so it brings the challenge of rising environmental and social process and product standards to exporting companies, including SMEs, in the developing world. Rising to this challenge would imply turning a threat into an opportunity, i.e. considering CSR-oriented strategies as a source of competitive advantage and strength. What may be niche markets today, might will be mainstream markets tomorrow.

[27] M. Forstater, J. Mac Donald, P Raynard: Business and Poverty: Bridging the Gap, The Prince of Wales International Business Leaders Forum 2002, p.118.

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