

# **The Driving Forces for CSR Reporting in China**

**Zuodong Shen**

Supervisors

Lars Hansson

Hanna Roberts

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Tel: +46 – 46 222 02 00, Fax: +46 – 46 222 02 10, e-mail: [iiiee@iiiee.lu.se](mailto:iiiee@iiiee.lu.se).

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## **Abstract**

This thesis deals with driving forces for CSR reporting in China. More and more international companies have published their CSR reports under the concern of sustainable development. Chinese companies are facing the environmental and social challenges in China today. CSR reporting has been taken as a sustainable development strategy by the Chinese Central Government and the pioneering Chinese companies have published their CSR reports.

The purpose of this thesis is to answer the main research question: **What are the driving forces of in relation to CSR reporting by Chinese companies in China?** The background of CSR reporting by Chinese companies in China was analysed based on the literary information from mandatory environmental reporting to voluntary CSR reporting. Then driving forces for CSR reporting by Chinese companies in China have been identified and discussed based on the results of the interviews. The leading driving forces and trends in the future for CSR reporting have been summarised and discussed as a further step to explore the driving forces for CSR reporting.

The results of the survey indicate that the most important external leading driving force is the legislator and the most important internal leading driving force is image in relation to all driving forces. Legislator plays the dominant role in the promotion of the CSR in China today. Then follows the driving forces of image, credit rating and cost reduction.

In conclusion, discussions and suggestions are presented on driving forces for CSR reporting by Chinese companies in China.



## **Executive Summary**

The objective of this thesis is to identify driving forces for CSR reporting by Chinese companies in China, i.e. driving forces for CSR reporting in relation to stakeholders, corporate governance, environmental area, human resources and financial area, as well as to motivate Chinese companies to use CSR reporting as a tool for sustainable development.

For this objective, the following research questions were established: 1. What is the current situation in relation to CSR reporting by Chinese companies in China? 2. What are the driving forces in relation to CSR reporting by Chinese companies in China? 3. Which are the leading driving forces for CSR reporting?

In order to address the research questions above, a qualitative method is used in the thesis study as the main research methodology. Following this method, the thesis is divided into three phases, i.e. literature review, research analysis and discussion. Different methods for eliciting information are adopted in each phase. The methods used include literature reviews, surveys by questionnaires, and personal interviews by telephone and email.

**Phase 1: literature review.** In the first part of this thesis, the author focuses on studying what type of corporate social responsibility (CSR) issues companies take into account in relation to their economic, social and environmental impacts. A literature review is used as the major research method. This is designed to provide a theoretical framework based on international practices to show Chinese companies how they could enhance their CSR performance and promote CSR reporting. The drivers for CSR were analyzed in relation to economic, environment and social concerns.

**Phase 2: research analysis.** In this part, the current situation of Chinese companies' environmental and social reporting is introduced. It also includes a brief introduction of the first CSR report issued by SGCC. From the mandatory environmental reporting in 1989 to the voluntary CSR reporting in 2006, the roadmap of Chinese companies' CSR reporting is explained in terms of the first research question: *What is the current situation in relation to CSR reporting by Chinese companies in China?* Mandatory environmental reporting started from 1989 under the requirements of the Environment Protection Law of P.R.C., and then followed voluntary environmental reporting from 2003 and voluntary CSR reporting from 2006.

A survey was conducted and the interviewees were approached in the form of questionnaires. Open-ended questionnaires were used as the main tool for obtaining information about the driving forces for CSR reporting in China. Three sets of questionnaires had been designed to identify the general awareness of the CSR concept, the driving forces for CSR reporting to companies with CSR reports and the driving forces for CSR reporting to companies without CSR reports. The results of the survey were analyzed based on the return of the questionnaires and were complemented by interviews conducted by telephone. The answers have been categorized into two parts: basic understanding of the CSR and driving forces of Chinese companies for CSR reporting. For companies with CSR reports, the results indicated that the awareness of CSR covers social, environmental and economic concerns. For companies without CSR reports, the respondents mainly focus on the corporate philanthropy. The driving forces for CSR reporting were discussed in relation to stakeholders, corporate governance, environmental area, human resource and financial area. Both of companies with CSR reports and companies without CSR reports considered that the legislator is the most important driving force for CSR reporting in China. The abovementioned analysis answered

the second research question: *What are the driving forces in relation to CSR reporting by Chinese companies in China?*

**Phase 3: discussion.** Based on the actual information collected through interviews and the analysis of the driving forces for CSR reporting, the driving forces for CSR reporting in China were analyzed and compared between the companies with CSR reports and companies without CSR reports. The leading driving forces for CSR reporting were also identified and analyzed. The analysis of the interviews indicated that the legislators play the dominant role for CSR reporting in China today, then follows the image, credit rating, cost reduction and employee relationship. The current situation of the legislation in relation to the CSR concerns and the future trend of legislation has been analyzed for further understanding the most important driving force for CSR in China. The driving forces for CSR reporting from image and credit rating were also discussed in the current situation as well as in the long term. The abovementioned analysis answered the third research question: *which are the leading driving forces for CSR reporting?*





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# **1 Introduction**

## **1.1 Background of sustainable development**

### **1.1.1 Sustainable development**

With the industrialization taking place during the last century, especially the remarkable growth in global economy over the past 30 years, our society is experiencing a period of significant economic growth. However, this also leads to over-consumption of natural resources, uneven economic development and environmental deterioration. (OECD, 2002, p.5)

The 1972 Stockholm UN Conference on the Human Environment established the nexus between economic development and environmental integrity. Environmental issues became trans-national and awareness was generated on the impact of the uncontrolled exploitation of natural resources. (Ifeanyi, 2002-a)

The World Commission on Environmental and Development (WCED), also known as the Brundtland Commission, defined sustainable development in its report “Our Common Future” as “Humanity has the ability to make development sustainable – to ensure that it meets the needs of the present without compromising the ability of the future generations to meet their own needs.” (WCED, 1987, p.43)

The 1992 UN Conference on Environment and Development, often called the Earth Summit of Rio de Janeiro created an action plan for a sustainable development for the 21<sup>st</sup> century. In most developed countries, the principles of Rio de Janeiro have been implemented into instruments and policies. Principle 3 of Rio Declaration on Environment and Development defined sustainable development as “the right to development must be fulfilled so as to equitably meet the developmental and environmental needs of the present and future generations”. (Ifeanyi, 2002-b)

The pillars of the sustainable development are social objectives, environmental objectives and the economic objectives. To keep a balance between the three pillars and integrate the social and environmental considerations into economic growth is a challenge that needs to be dealt with in order to achieve a sustainable development.

### **1.1.2 Sustainable development and natural stocks**

One criterion for strong sustainability (explained by Figure 1-1) is that all types of stocks should be maintained during economic development. Human capital, natural resources stocks, non-marketed natural services, produced capital and human should be taken into consideration at the same time.

## Stocks, flows and wellbeing

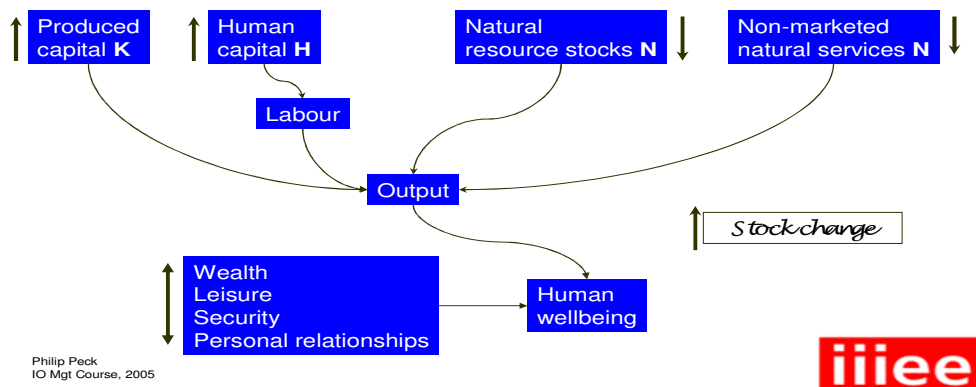


Figure 1-1 The relationship between the environment, social and human

Source: Peck, Philip. (2005). Management course handouts. IIIIEE. Lund University

### 1.1.3 Sustainable development and society

Organizations today interact with different stakeholders in a deeper and broader level than previously. The organizations provide goods and services for our society. They are also involved in the activities in the local community. The stakeholders are not only concerned about the products and services provided by the organizations but also about the process of the production and labour issues among other issues. Environmental performance, social responsibility, risk management and financial performance are issues that the organizations should address to the stakeholders. The relationship between the business sector and society can be illustrated as follows:

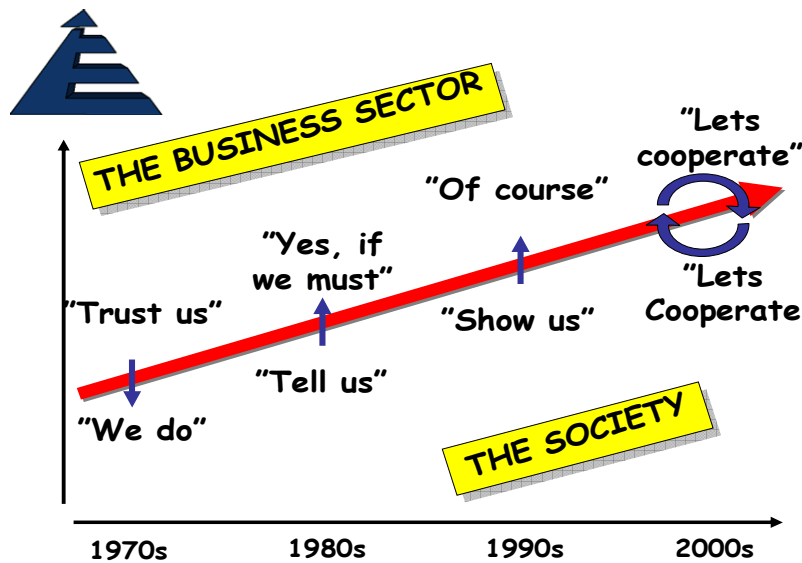


Figure 1-2 The relationship between the business sector and society

Source: Magnus Enell. (2006). *Sustainable Development*. IIEE SEM PASI lecture.

The interaction between the organizations and society forces them to take social responsibility into their day to day business activities in order to meet the public expectations. Some pioneer organizations have taken the corporate social responsibility into their business operations and use it as a strategic tool. For instance, ABB committed to focus on health and safety performance. It implemented the internationally recognized OHSAS 18001 management standard in all business units, including manufacturing, office work, construction projects and service. At the end of 2004, the average level of implementation worldwide was 81 percent. Diversity is also a key topic of ABB's social policy on human resources. ABB was ranked as an employer of choice in surveys in ten countries in 2004. (ABB, 2005, p31-34) Previously there was more focus on environmental issues. Examples of this are when McDonald's invested more than 500 million U.S. dollars since 1990 on recycled products ranging from paper napkins to building insulation and roofing materials; WalMart had its stores designed "green", such as no use of air conditions with freon and the use of recycled building materials. (Hess & Siciliano, 1996, p.15)

Corporate Social Responsibility (CSR) is increasingly associated with business risk management, in which the purpose is to reduce the potential threats to the corporate and brand reputation, or avoid the loss of license to operate. Beyond regarding CSR as primarily a risk minimization process, the integration of CSR into future business strategy could lead to an ability to capitalize on CSR. (Grayson & Hodges, 2004, p.9-11)

The definition of CSR by EU in its Green Book in 2001 is:

*"Integration of social and environmental concerns into the enterprises' daily business operations and in their interaction with their stakeholders on a voluntary basis."* (Trnkova, 2004)



Although there is no uniform criteria that can define CSR and provide quantifiable indicators of what CSR means, some general key elements identified by Hancock & Oulton (2005, p.47) of CSR include:

- Climate change and companies' reduction of CO2 emissions
- Access to drugs for HIV/AIDS
- Food labelling
- Food and drink marketing practices linked to obesity
- Alcohol used by minors, and marketing practices
- Labour standards in supply chains
- Biodiversity
- Child labour in the consumer goods and commodities industry
- Bribery and corruption-particularly for companies operating in high-risk, politically unstable developing countries
- Lending practices for the retail sector and for infrastructure projects
- Corporate governance practices-particularly compensation related
- Health and safety in high risk industries
- Environmental impacts in terms of, for example, energy consumption, waste, emissions and toxic release and management
- Tobacco advertising practices and smuggling

*Box 1-1 Key issues that are being monitored by investors, NGOs, unions, governments and other stakeholders*

*Source: Hancock & Oulton. (2005). p.47*

## 1.2 CSR and sustainable development

Although the international CSR efforts were started in the 1980s, the basic concept of CSR was part of the business ethic code from the 1930s and became mature alongside the development of business and society. With the shift of a company's value recognition from a traditional accounting based on assets to recognizing intangible assets, CSR moved from the margin of business operations to the agenda of a company's business strategy. After the well-known corporate scandals in USA and other countries, CSR moved further to the corporate governance level.

### 1.2.1 CSR as part of sustainable business

Writing 35 years ago, social responsibility was described by Friedman as follows: (Bush, 2005, p.15)

*“If business does have a social responsibility other than making maximum profits for stockholders, how are they to know what it is. Few trends could so thoroughly undermine the very foundations of our free society as the acceptance by corporate officials of a social responsibility other than to make as much money for their stakeholders as possible.”*

Milton Friedman, 1970

When Friedman made this argument about social responsibility, environmental and social considerations played a rather insignificant role for industry compared to what they do today. It indicated the view that the state was the most effective force when it came to social change. But with changes of the role of government and the rapid growth of economic globalization, the impact of companies on society and environment has changed and grown dramatically. With the growth of economic globalization, companies have increased scope to shape and affect the societies in which they operate. CSR has been developed into a deeper and broader level and has been integrated into the business operations. There have also been broader acceptances that there are other stakeholders that companies need to take into account, not only shareholders, which Friedman is referring to.

In 1930s, when Seagram spirits in USA released advertisements like ‘we don’t want bread money’ and ‘drinking and driving do not mix’, it indicated that Seagram spirits has done more than only producing alcoholic products. These advertisements reflected an ethical value in the business. The alcohol beverage company, the consumer and society as a whole can benefit from understanding the need for responsible consumption of alcoholic beverage. This began in the United States and was spread throughout the world as Seagram’s business expanded. (Bush, 2005, p.19) Seagram spirits has taken a responsible commitment through its advertising and other education programs. From this case, one could say that the ethics of CSR can be part of a business. This active interaction with society and consumers has gone further than charitable giving.

In the 1980s, due to the high levels of unemployment and urban rioting, there was trouble in the streets from Brixton to Toxteth in the UK. Companies also had a sense of unrest. There was demand from the society that the companies should have a responsibility to the community. The directors of Seagram, Guinness and Grand Metropolitan (subsequently Diageo<sup>1</sup>) agreed that unemployment was the root cause of the urban unrest. A training program had been provided for jobseekers with skills and qualifications that local employers needed. The companies worked together with the local community, government and the other community support groups to help local people to fight unemployment. The commitment to CSR in relation to the local community built trust between the company and the local consumers. (Bush, 2005, p.16)

In order to reduce the impact on the environment, Diageo focuses on the use of energy, water management, materials and recycling. Refill bottles are used in many markets. In Africa, all of the company’s beer is packaged in this way and nearly 90 percent of bottles are returned.

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<sup>1</sup> Diageo is created from a merger between Guinness and Metropolitan in 1997. In December of 2001, the U.S Federal Trade Commission issued an order permitting Diageo to acquire the Seagram spirits and wine business. (Diageo, 2005-a) It is the world’s leading premium drinks business with alcohol beverage brand across spirits, wine and beer categories. (Diageo, 2005-b)

(Bush, 2005, p.22) Diageo recently has run an awareness program with students on responsible drinking that reached 750 000 students in 55 universities. It has also funded the training company to present workshops to 44 000 secondary school pupils that raise awareness of alcohol issues. Responsible drinking advertisement has also been introduced by Diageo on responsible marketing. A study showed that 76 percent of consumers said they would be more likely to consider drinking sensibly after seeing the advertisements placed by Diageo in Ireland. (Ethical Performance, 2006, p5) As alcohol is the main business of Diageo, it focuses on responsible production and consumption. It is also a member of the Alcohol Task Force of International Life Sciences Institute Europe and has funded a range of research overviews and publications. (Bush, 2005, p.22)

Diageo now operates in 180 markets around the world and employed more than 24 500 employees. The annual turnover is nearly 10 billion pounds. (Bush, 2005, p.25) The integration of CSR elements into the business of Diageo illustrates the relationship between the social responsibility and the long term corporate interest.

### **1.2.2 CSR as part of company assets**

The biggest conceptual breakthrough in analyzing a company's financial situation is the invention of the double-entry book-keeping by the Italians in the 15<sup>th</sup> century. It has been used for more than 500 years. The financial figures generated by companies are the primary materials for stakeholders and companies themselves to value the company's financial performance. For the company's tangible assets, such as land, factories, physical labor and financial capital, this traditional valuation method is effective to capture the market's value of companies. As recently as in the 1980s, financial statements could still capture 75-80 percent of the true market value of major businesses. At the beginning of the 21<sup>st</sup> century, the growth of wealth is primarily due to knowledge and other intangible capitals. So the traditional financial statements can only capture about 20 percent of market value on average. (Kiernan, 2005, p.69) It indicates that the proportion of non-financial value accounts for the major part of a company's assets.

The growth of socially responsible investment (SRI) policies and investments has given companies the impetus to commit to the principles of corporate responsibility. More and more investors are addressing the issues of non-financial risk measurement and are seeking tools to identify the risks and profit opportunities. Such as Social Investment Forum (SRF), a national nonprofit membership organization promoting the concept, practice and growth of socially responsible investing in Washington DC, has established their guidelines on to help the individual investors to integrate personal values and social concerns with investments. (SRF, n.d.) Total socially responsible investing assets managed by SRF amounted to USD2.29 trillion in 2005. SRI assets rose more than 258 percent from USD639 billion in 1995 and to the amounts in 2005. Ten- year trends summarized by SRI in USA indicate that socially and environmentally screened mutual funds have experienced substantial growth in the number and diversity of products and screens offered and mainstream money managers are increasingly incorporating social and environmental factors into their investing. (SRF, 2006)

In the UK, in order to provide a tool for responsible investors to identify the companies that meet CSR elements, FTSE4Good Index Series was launched in July 2001 by FTSE<sup>2</sup>. The

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<sup>2</sup> FTSE is an independent company owned by the Financial Times and the London Stock Exchange. Their sole business is the creation and management of indices and associated data services, on an international scale. FTSE has 11 offices worldwide. FTSE is calculating indices and serving clients in over 77 countries. Two and a half trillion USD of assets are under management using FTSE indices. (FTSE, n.d-b) The indices of FTSE include Global Equity Indices, Regional and

criteria are designed to reflect a broad consensus on what are the main elements of CSR. The criteria have been revised annually since 2001. The environmental criteria were strengthened in 2002 and human rights criteria were strengthened in 2003. During 2004-2005, supply chain labor standards criteria were introduced and countering bribery criteria were introduced during 2005-2006. (FTSE, n.d. -a)

In order to analysis the non-financial value of a company, CSR indicators play an increasingly important role in the investment sector. The shift from the traditional accounting based analysis to the new approach with regards to intangible assets, could be done by using CSR criteria as it provides a set of quantitative indicators that can be measured as other tangible company assets.

### **1.2.3 CSR as a proactive business strategy**

From a sustainable business perspective, CSR is the integration of values and principles into day to day business. The recent corporate scandals in the USA and Europe have caused a growing distrust and have spurred tighter rules and legislation. The recent anti-globalization campaigns also highlighted a company's need to create a proactive business strategy to avoid potential risks.

**Anti-globalization campaign:** With the expansion of the multinational companies (MNCs) globally, there is a growing body of evidence that multinational companies should carry out their business in a way that is a contributing factor for the development of local society. The trends of globalization is that labor and raw material intensive business sectors have moved to the developing world due to new market opportunities, cheaper labor, lack of regulations and lower environmental standards. Although from an economic perspective, the investments of MNCs can help the local society to improve living standards, there is still long way to go towards sustainable development for these MNCs. Anti-globalization protests such as those which took part in Seattle, Davos and Cancun indicate the same: there is an opinion among NGO's that MNCs are not considering corporate social responsibility, i.e. there is an unacceptable social and environmental damage while they search for economic benefits. Faced with this global pressure, MNCs need a three-tier strategy: (Barring, 2005, p50-53)

- Assessing their global responsibility and managing their global impact;
- Ensuring that there is global consistency to their local approaches;
- Ensuring their local approaches are appropriate.

**A new set of sustainable business codes:** Dow Jones Sustainability Index (DJSI), Social Responsible Forum (SRF) and FTSE4Good are all well known social responsible investment indices which focus on the social and environmental concerns in their investment guidelines. For instance, a new set of criteria "Supply Chain Labor Standards Criteria" was announced in 2004 by the FTSE4Good Policy Committee as a result of increasing concern about how companies live up to supply chain labor standards. The reporting criteria will be implemented on 1<sup>st</sup> January 2007. Supply chain management which is also called value chain management includes the whole distribution channel of a product, from its sourcing to the end consumers. The FTSE4Good "Supply Chain Labor Standards Criteria" uses the International Labor

Organization (ILO) standards as a starting point. The criteria focus on the following core areas: (FTSE, n.d.-c, p.11)

- Equality/discrimination;
- Forced and child labor;
- Worker representation;
- Health and safety;
- Working hours and wages;
- Disciplinary procedures.

Companies are exposed to supply chain labor risks when their business mainly lies in labor intensive sectors such as agricultural products and consumers' products.<sup>3</sup> Companies who operate their business in countries with weak labor standards are also considered to have high labor risks. As labor rights are a cornerstone of CSR, supply chain labor risks could be avoided by integrating CSR into a sound business strategy. Furthermore, "countering bribery criteria" has been developed by the FTSE4Good Policy Committee and they will be implemented by 1<sup>st</sup> July 2007 and 1<sup>st</sup> January 2008 depending on the business sectors. All these benchmarking disciplines will enhance the driving force for companies to go further in relation to CSR.

### 1.3 Purpose and Research Questions

Mandatory environmental reporting started in the beginning of 1990s required by the Environmental Protection Law of People's Republic of China (P.R.C.) The State Grid Corporation in China (SGCC) published its first CSR report in 2006. (SGCC, 2006) It is the first time that a state owned company releases a CSR report to the public in China. After that other company followed and there were in total 5 CSR reports issued publicly during the first six months of 2006.

Profitability is a cornerstone of corporate development strategy. If there is no profit for a company, the company may cut corners on environmental management and social responsibility in order to reach profitability. An alternative strategy to this defensive approach is to adhere to best practice in CSR and take advantage of opportunities inherent in CSR at improving business performance. As explained by Grayson and Hodges, "getting many more sustainable successful businesses is the best route to optimizing the contribution that business can make to sustainable development and to some of the world's seemingly intractable social, economic and environmental challenges of poverty, inequality and disease." (2004, p.16)

This thesis aims to identify the driving forces for CSR reporting of Chinese companies in China today.

For this objective, the following questions are addressed in this thesis:

1. What is the current situation in relation to CSR reporting by Chinese companies in China?

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<sup>3</sup> Agricultural products include cane sugar, coffee, and tea, cocoa, tropical fruit, fresh vegetables, flowers. Consumer products include clothing, accessories, footwear, and toys. (FTSE, n.d.-b)

2. What are the driving forces of in relation to CSR reporting by Chinese companies in China?
3. Which are the leading driving forces for CSR reporting?

## 1.4 Methodology

In order to address the research questions above, a qualitative method is used in the thesis study as the main research methodology. Following this method, the thesis is divided into three phases, i.e. literature review, research analysis and discussion. Different methods are adopted in each phase, such as literature review, survey by questionnaires, and personal interview by telephone and email.

**Phase 1: literature review.** In the first part of this thesis, the author focuses on studying what type of corporate social responsibility (CSR) issues business take into account in relation to their economic, social and environmental impacts. The author also reviews the general pathway from the commitment to CSR to sustainable business development. A literature review is used as the major research method. This is designed to provide a theoretical framework with international practices to Chinese's companies in how they enhance their CSR performance and promote CSR reporting.

**Phase 2: research analysis.** In this part, the current situation of Chinese companies' environmental and social reporting is introduced. It also includes a brief introduction of the first CSR report issued by SGCC.

A survey was conducted and the interviewees were approached in the form of questionnaires. Unstructured questionnaires were used as the main tool for obtaining information about the driving forces for CSR reporting in China. Three sets of questionnaires had been designed to identify the general awareness of the CSR concept, the driving forces for CSR reporting to companies with CSR reports and the driving forces for CSR reporting to companies without CSR reports. In order to compare the driving forces and identify the leading driving forces, the results were placed on a scale ranging from 1-3 with 3 being first priority, 2 being second priority and 1 being last priority.

The results of the survey were analyzed based on the answers from the respondents and were complemented by interviews conducted by telephone. The answers have been categorized into two parts: basic understanding of the CSR and comparisons of driving forces of Chinese companies for CSR reporting.

**Phase 3: discussion.** Based on the actual information collected through interviews and the analysis of the driving forces for CSR reporting, the driving forces for CSR reporting in China were analyzed and compared between the companies with CSR reports and companies without CSR reports. The leading driving forces for CSR reporting was also identified and analyzed. Based on the results of the analysis, suggestions were presented for the promotion of CSR reporting for Chinese companies today.

## 1.5 Scope and limitations

### 1.5.1 Scope

The scope of the thesis focuses on Chinese companies with CSR disclosures.

The geographic scope is focused on China. As the biggest developing country in the world, China has been experiencing an economic boom in the recent 20 years. During this rapid economic growth as well as the transition from a planned economy to a market economy, more and more Chinese companies have expanded their business world wide. However, this paper only focuses on the CSR disclosure of domestic companies in China.

In addition, the concept of CSR is a very broad topic, so discussions in relation to issues such as the contents of CSR reporting will not be included in this thesis.

### 1.5.2 Limitations

The lack of transparency of CSR activities by Chinese companies and the public literature about CSR issues in China are obstacles to this study.

CSR includes a wide range of complex environmental and social issues such as labor rights, climate change, supply chain management, occupational health and safety and so on. And for the individual company some issues will be more critical than others depending on the nature of business, the country where they operate and the size. As explained by Griffiths, “There is no one size fits all guide for all companies on what CSR should mean for them and what they should be doing” (2005, p.2). Thus it has not been possible to address every elements related to CSR reporting. This thesis only aims to identify the *driving forces* of Chinese companies in relation to CSR reporting.

## 1.6 Outline of the thesis

According to the methodology introduced above, this thesis is composed of 7 chapters.

**Chapter 1** introduces the background, purpose of the thesis, research questions, methodology as well as the scope and limitations.

**Chapter 2** consists of a theoretical review that provides an overview of CSR. It begins with the definition of CSR, followed by a presentation of the background of CSR. Then it analyzes the key drivers of CSR reporting as well as the Global Reporting Initiative (GRI) reporting guidelines.

**Chapter 3** introduces the situation of driving forces for environmental and social concerns in China.

**Chapter 4** focuses on the current situation of CSR reporting in China. It begins with the mandatory environmental reporting to the legislator, followed by the voluntary environmental reporting to the public and the current voluntary CSR reporting.

**Chapter 5** explains the driving forces of Chinese companies for the CSR reporting based on the results of the survey.

**Chapter 6** analyzes and compares the driving forces for CSR reporting between the companies with CSR reports and the companies without CSR reports.

**Chapter 7** analyzes the leading driving forces for CSR reporting in the future, followed by suggestions and final conclusions.

## 2 Theoretical review – the driving forces for CSR reporting

In this section, driving forces for CSR reporting are presented to explain why international leading companies engage in CSR reporting. The theory framework used in the thesis is based on *Investing in Corporate Social Responsibility*. (Hancock, 2005, p1-197)

### 2.1 What is CSR

#### 2.1.1 Definition of CSR

The concept of CSR defined by WBCSD in 1998 is: *“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, 2000, p.8) It includes human rights, community citizenship, business development and the principles adopted in the business.

There are also other descriptions, such as *“CSR – those elements of a company’s responsible business practice that enhance the quality of life of society and the working environment of its employee.”* (Llewellyn, 2005, p.112)

From the above mentioned examples, we can understand that the general concept of CSR covers social and environmental concerns of a company’s business operations and the interaction with stakeholders. It means that long-term profit-making for companies today also is a function of to what extent they engage themselves for the value of society and the environment in which it operates.

#### 2.1.2 The background of CSR

The principles of the CSR concept have long been part of business strategies. The traditions of CSR can be traced back to the Victorian era with the activities of Quaker families in the UK who sought to improve the employees’ living standard as well as enhancing the local communities. In the United States, foundations set up by Rockefeller and Carnegie has gone a new level in corporate philanthropy<sup>4</sup> through establishing research and educational programs all over the world. Active companies adopted socially and environmentally responsive policies and made more than a solely economic contribution to the community. It is argued that CSR can help manage the social and environmental risks, reduce environmental costs and enhance the relationship with stakeholders. Research published by the UK’s Institute of Business Ethics indicates that companies clearly committed to ethical behavior perform better financially in the long run than those lacking of such commitment. (Tim Clement-Jones CBE, 2005, p.6)

In recent years, pressure from stakeholders with widespread popular support has successfully campaigned on companies that have broken CSR norms and standards, especially with regard to labours and employment practices. Examples are the strong criticism of Nike’s use of

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<sup>4</sup> Corporate philanthropy defined by Fritz is *“corporate philanthropy or corporate giving is the act of corporations donating some of their profits, or their resources, to nonprofit organizations.”* Donation is often handled by the corporation directly or it may be done through a company foundation. Donations may be cash, facilities, property, services or advertising support. Corporations give different kinds of nonprofit groups, from education to human services and environment. (Fritz, n.d.)



sweatshop labour in Indonesia and Cambodia and Shell's disposal of the Brent Spar oil platform and conduct in Nigeria. For instance, Shell had been challenged by Greenpeace for planning to sink the Brent Spar, a unique station for oil storage and tanker loading located in the North Sea, into the North Atlantic. The station was installed in 1976 and ceased operating in 1991. Shell eventually abandoned the deepwater disposal plan in 1995. (Shell, n.d.) Shell operated a joint venture with the government in Nigeria in the Ogoni homelands of Niger delta. Shell's oil operations in Nigeria came to the fore in October 1990 when a peaceful protest against the environmental damage associated with the oil operations in Umeuchem escalated. Eighty people were killed by the police and 495 homes were destroyed. Shell stated that it merely asked for police protection. In January 1993, another campaign against environmental damage was held and around 300,000 Ogoni people attended the peaceful marches. Shell ceased operations in the Ogoni region at the same year. (WIKIPEDIA, n.d.) Shell has been criticized by environmental and human rights groups for its operations in Nigeria over the years. These campaigns marked a sharp increase in expectation about the performance of companies in their social and environmental practices. Furthermore, following the scandals of Enron, WorldCom, and others, there is a greater recognition by the public and businesses that CSR can help business avoid risks and build trust.

There is also a shift in investor attitudes. FTSE launched the FTSE4Good Index Series<sup>5</sup> in July 2001 as the result of an increasing CSR concern by investors. The index is a method to identify and measure the non-financial risks of a company and their impact on the shareholder value. (FTSE, 2006-d)

CSR has rapidly grown in the last 20 years; it is now on the business agenda of a significant number of companies. "Some 2 000 international companies regularly report on their environmental and social impacts, and in some countries, such as France and Australia, reporting is mandatory." (Grayson & Hodges, 2004, p.8) The positive trend shows that CSR has shifted from the margins to the mainstream of business practice. According to the Business in the Community<sup>6</sup> (BITC) in UK, more than 70 percent of business leaders believe that the companies can benefit from responsible business practices. CSR can contribute to the company's competitiveness and profitability. (Tim Clement-Jones CBE, 2005, p.9)

For a company to engage in CSR there are four forms of contribution: traditional philanthropy, low partnership, high partnership and eco-business: (Hess & Siciliano, 1996, p.56-58) Traditional philanthropy, also called hand free philanthropy<sup>7</sup>, the charitable giving of a company's resource is the main form of social responsibility; at the low partnership level, a company takes active in the local community activities; at the high partnership level, a company focuses on the way it functions to the interests of employees and other stakeholders; at the eco-business level, a company not only involves employees but also incorporates the consumer's interest and the public concerns into its day to day business. It may adopt approaches to green business or eco industry and take consideration of incorporating environmental and social responsible elements into the company's practice.

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<sup>5</sup> FTSE Group (FTSE) is a world wide leader in the creation and management of indices. It calculates and manages the FTSE Global Equity Index Series, which include world recognized indexes ranging from FTSE All-World Index to the FTSE4Good Series as well as other indices. (FTSE, 2006-d)

<sup>6</sup> A wide network of major business established Business in the Community (BITC) in the beginning of 1980s which is a respected and influential force within the business community in UK. (Tim Clement-Jones CBE, 2005, p 6)

<sup>7</sup> Hand free philanthropy usually means charitable giving and patronage of charities decided by the chairman or a board committee. (Tim Clement-Jones CBE, 2005, p 6)

## 2.2 Main elements of CSR

CSR is linked to environmental, social and economic consideration. The key pillars of CSR are described by Kiernan as follows:

<b>Stakeholder Capital</b>	<b>Strategic Governance</b>
Regulators and policy makers	Strategic Scanning Capability
Local communities and NGOs	Agility/Adoptions
Customer relationship	Performance Indicators/Monitoring
Alliance partners	Traditional Governance Concerns
	International 'Best Practice'
<b>Human capital</b>	<b>Environment</b>
Labour relations	Brand equity
Recruitment/retention strategies	Cost/risk Reduction
Employee motivation	Market Share Growth
Innovation capacity	Process Efficiencies
Knowledge development and dissemination	Customer Loyalty

Figure 2-1 Key pillars of CSR

Source: Adopted from Kiernan, 2005, p.70

From the above figure, we can see the basic elements of CSR include a company's environmental performance, practices in labor issues and corporate governance. It also covers the interaction between the company's operations and its stakeholders. Behind the four pillars, as we move deeper into the area of intangible values, you will find a company's financial capital. Today, a company's true value can not be explained totally by traditional accounting based indicators. More and more investors focus on the company's future value and innovation capacity as well as competitive advantages.

## 2.3 Key drivers for CSR

### 2.3.1 Global drivers for CSR

Business operates in society. A company's involvement in CSR is the result of a complex interaction of changes in technology and science, of social, political and economic developments and of risk management and innovation. These forces can be organized into four categories: (Grayson and Hodges, 2004, p.24-53)

- The revolution of technology and communication;
- The revolution of markets;
- The revolution of demographics and development;

- The revolution of values.

### **The revolution of technology and communications**

A revolution of communication and technology changes the way in which business operates and the company's competitive advantages. For instance, the internet and other new media permit home working, automation and global supply chain management. It means easier global access to information about the activities of companies. It is harder to keep secrets than it was before the emergence of the internet. So consumers and activist NGOs can easily organize powerful campaign against a company's activities if they violate company environmental, health and safety and/or labor standards and regulations. The global campaigns or boycotts can also be co-coordinated via the internet.

### **The revolution of the markets**

With the process of the liberalization and globalization, more and more companies are setting up sub-branches worldwide and are facing different cultures, national policies and business environments in diverse markets. Sound corporate citizenship involved in local community can contribute to improving the company's business in local markets.

### **The revolution of demographics and development**

As with the uneven development of the world economy, there are also demographics issues at the global level. The population of European countries will decrease from about 450 million today to 400 million in 2050 without immigration. (Grayson & Adrian, 2004, p.29) In developing countries, they are facing AIDS (acquired immunodeficiency syndrome) alongside with poverty and unrest. All these issues can threaten the stability and capacity of the business. All these are challenges that need to be taken into account from a CSR perspective into the operation of the business.

### **The revolution of values**

With a significant increase in knowledge and wealth all over the world, large numbers of people across the globe are free to express their own values in a spontaneous way. Goods should not be produced under unacceptable working conditions for starvation wages. Business trust has to be earned and maintained especially after the well-known corporate scandals of the past couple of years. Value of CSR has been recognized by more and more stakeholders. Companies can benefit from the above four pillars of CSR and enhance their image and reputation with the public.

## **2.3.2 Corporate level drivers for CSR**

There are many drivers for CSR. Seven key drivers were discussed by Tim Clement-Jones CBE Lord in 2004: bottom line effect, lower equity risk premium, further investment case, reputation management, personal, influence of the corporate disasters and customer loyalty.

**Bottom line effect:** Incorporating a socially responsible element into corporate practice is the most relevant to business so far.

**Lower equity premium:** A survey conducted by CSR Europe and Euronext indicated that 51 percent of fund managers and 37 percent of financial analysts would lower a company's equity risk premium to socially responsible companies. moreover, a research conducted by Business

in the Community (BITC) and Research International in 2003 indicated that 86 percent of consumers agree that they have a more positive image of a company if they see that it is doing contribution to the society when the price and quality are equal. (Tim Clement-Jones CBE, 2005, p.11)

**Further investment case:** CSR can contribute to avoiding law suits and provide information of potential environmental and social risks to the relevant stakeholders.

**Reputation management:** Non-financial information from CSR reporting can enhance the company's intangible values. The intangible value is correlated with the share prices. A model based on the *Fortune/Management Today* 'Most Admired' survey of 500 US and 250 UK companies shows that reputation, on average, accounts for 27 percent of a FTSE 250 company's market capitalization. (Tim Clement-Jones CBE, 2005, p.11)

**Personal:** The implementation of CSR depends on the top management and/or the board of a company. But the mid-level managers and staff are also important to add value to the program.

**Influence of the corporate disasters:** The business scandals such as Enron, WorldCom and the likes have increased distrust to senior officials in the corporate. There has been a movement towards a deeper alignment of CSR to business strategy and corporate governance since the scandals.

**Customer loyalty:** Most importantly, CSR reporting can build loyalty with customers as more and more customers require that goods and services should be produced or delivered in an ethically way.

## 2.4 History of CSR reporting

A brief history of corporate social reporting was summarized by Alice and John in 2003. The term CSR was in common use in 1970s. CSR reporting was grouped into three phases. The first phase of CSR reporting was composed of advertisements and annual reports sections in the 1970s and 1980s based on the respect to the environment. The report was not linked to the company's performance. For instance, a company might add the environmental report to its annual financial reports. The concept of CSR was also limited to environmental pollution and there were no international standards for external audits.

The second phase of CSR reporting began with the social auditors to work with company's staff on CSR report in the late of 1980s. The social audit covered the company, supplier and local community. The stakeholders of CSR report were categorized into communities, employees, customers, suppliers and investors. But the audits lacked a set of generally accepted standards against which a company's performance could be measured.

The third phase of CSR reporting introduces not only third-party certification of the reports, but certification by bodies that are accredited to certify against social or environmental standards. The Social Accountability International (SAI), which was founded in 1997, is the leader of the new phase. Together with other pioneers such as Forest Stewardship council, FairTrade, these groups have formed the International Social and Environmental Accreditation and Labelling (ISEAL). The ISEAL is a set of international environmental and social standards which is widely recognized and of a high quality. (Alice and John, 2003)

## 2.5 Future trends in CSR reporting

### 2.5.1 Global Reporting Initiative – GRI

GRI, a collaborating centre of the United Nations Environment Program, aims to set a standard for a common global Sustainability Reporting Framework. The core of the framework is the Sustainability Reporting Guidelines. This is the result of a multi-stakeholder collaboration that occurred over 2004 and 2005. The third version of guidelines (G3) is planned to be released in final form in October 2006. To date, nearly 1000 organizations in over 60 countries have used the GRI Framework as the basis for their reporting. (GRI, n.d.-a)

The GRI is aiming to develop a globally applicable framework for reporting on an organization’s sustainability performance. The framework presents reporting principles and specific content indicators to guide the preparation of reports such as Sustainability Reports or Corporate Social Responsibility Reports. (GRI, n.d.-b)

The aspects of disclosure proposed by G3 cover the environmental, social and business performance. It aims to provide a transparent and credible framework for sustainability reporting. It can be explained as follows:

*Table 2-1 Disclosure contents proposed by G3*

Environmental aspects	Social aspects	Economic aspects
Materials	Employment	Economic performance
Energy	Labour/Management relation	Market presence
Water	Occupational Health and Safety	Indirect economic impacts
Biodiversity	Training and Education	
Emissions, Effluents, and Waste	Diversity and Equal Opportunity	
Products and Services		
Transport		

*Source: Sustainability reporting guideline. (GRI, n.d.-c)*

### 2.5.2 Trends in CSR reporting

According to a KPMG survey of 100 of the largest companies in selected countries, there has been an increase of companies that publish voluntary CSR reports to their stakeholders. In 1993, approximately 12 percent of the companies published environmental reports. In 2002, 28 percent of the companies had environmental reports in place. Throughout the last decade, companies have started including social and economic performance in their environmental reports which are converted into corporate social responsibility reports or sustainability reports. The annual sustainability assessment of 996 companies which were the candidates of the Dow Jones Sustainability Indexes (DJSI) showed that one third of the companies disclosed environmental and social performance in 2001. (Park & Brorson, 2004, p1095)

Today CSR is firmly on the business agenda for more and more companies. About 2000 international companies regularly report on their environmental and social performance. It is also common for “Fortune 500” companies to have a manager or department which focuses on CSR. (Grayson & Hodges, 2004, p.8)

### 3 Driving forces for environmental and social concerns in China

With a sustainable development strategy adopted by the Chinese central government during the 11<sup>th</sup> five year plan (2006-2010), CSR has been highlighted by the central government in China. This includes drivers for social and environmental concerns in relation to the current situation as well as China's future policy.

#### 3.1 The current environmental situation in China

##### 3.1.1 Inefficient usage of natural resources

The current situation is that Chinese companies have a high natural resources usage and low recycling rates to the discharges, which can not achieve sustainable development in the long run. For instance, the energy consumption/GDP of Chinese industry is approximate 6 times higher than for Germany industry. The energy efficiency of a Chinese industry is about 33 percent, which is 10 percent less than the average level in the developed countries. (Zhang, 2005)

##### 3.1.2 Environmental pollution

Besides the natural resources consumption, the environmental pollution is also a serious challenge for China today. As commented by the Chinese vice Minister of the State Environmental Protection Administration (SEPA), the cost of environment pollution and the exploitation of natural resources will hinder the Chinese economic development. (Pan, 2006)

According to the Environmental Annual Statement issued by SEPA, the waste discharge still kept growing in 2004 due to the heavy investment in steel, electricity and cement industry. (SEPA, 2005-a) Different waste discharges are illustrated as following:

Table 3-1 Quantity of waste in 2004 and growth rate compared with 2003 (million ton)

	Quantity	Growth rate	From industry	Growth rate	From urban household	Growth rate
Waste water	48,240	4.9%	22,110	4.1%	26,130	5.5%
SO2 emission	22.55	4.5%	18.91	5.6%	3.64	-1.0%
Smoke (dust)	10.95	4.4%	8.87	4.8%	2.09	3.0%
Solid waste	1,200	19.5%	1,200	19.5%	No statistics	No statistics

Source: Environmental annual statement. (SEPA, 2005-b)

From table 3-1, we can see that the quantity of waste in 2004 kept growing compared to the discharges in 2003. (SEPA, 2005-b)

### 3.1.3 Waste water

The investment in environmental protection amounted to 190.86 billion Chinese Yuan (equal to USD23 billion).<sup>8</sup> The proportion of the investment accounted for 1.4 percent of the total annual GDP. (SEPA, 2005-c) But it is still not enough to control the pollution. All seven main river basins in China were more or less polluted, and less than one third of river basins comply with the national quality requirement. The major lakes are facing an eutrophication problem. Over-pumping ground water by industry in cities leads to the drop of the ground water level. (Liu, 2004, p.37) Total amount of discharged wastewater in 2004 was 48.24 billion tons, of which the discharged industrial effluent was 22.11 billion tons and domestic sewage 26.13 billion tons. The annual growth rate total waste water discharges is 4.80 percent from 2000 to 2004. The quantity of waste water discharged from 2000 to 2004 is summarized in figure 3-1. (SEPA, 2005-d)

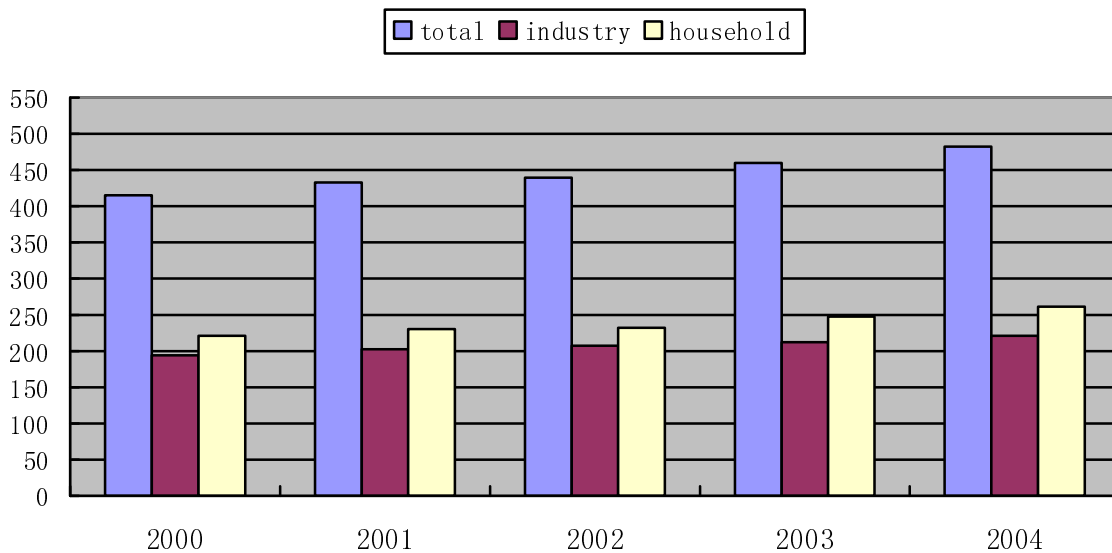


Figure 3-1 Annual growth of waste water (Unit 100 million ton)

Source: Compiled by author based on SEPA annual report (SEPA, 2005-d)

### 3.1.4 Air emissions

According to the SEPA Annual Report (2005), the air quality in 2/3 of the cities in China did not reach the national quality standard required for normal activities. Among the monitored cities and counties (343), 107 of the cities were heavily polluted and the others slightly polluted. In 2002, acid rain occurred in 279 cities among the monitored 555 cities. (Liu, 2004, p.38) From SEPA's Annual Report (2005), it shows that emission of sulphur dioxide is still growing compared with the last years. Sulphur dioxide is the main contributor to acid rain. Besides this, industry dust and smoke dust make the air quality even worse. The total amount of sulphur dioxide emission was 22.549 million tons across China in 2004. The emission of

<sup>8</sup> According the exchange rate: 1USD=8.27 Chinese Yuan

soot was 10.95 million tons and the total emissions of industrial dust was 9.04 million tons. The annual growth rate of sulphur dioxide and emissions of soot is 4.5 percent and 4.4 percent respectively. (SEPA, 2005-e) The details figures of the emissions from 2000 to 2004 can be illustrated in figure 3-2.

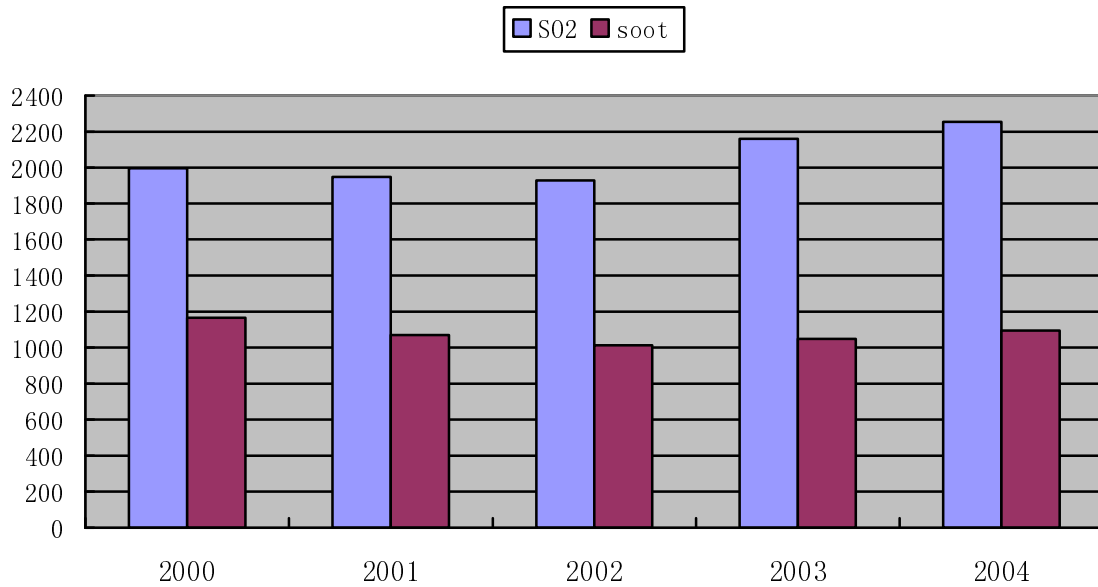


Figure 3-2 Annual growth of emissions of SO2 and soot (Unit 10 000 ton)

Source: Compiled by author based on SEPA annual report (SEPA, 2005-e)

### 3.1.5 Solid waste

The growth rate of solid waste is the highest one in the waste stream during 2004, almost amounting to 20 percent. Besides the traditional solid waste from industry and construction section, there is now more and more concern from the environmentalists and scholars about the large quantity of electronic waste (e-waste) generated by domestic consumers and illegal e-waste smuggling from USA. 80 percent of the world’s e-waste is exported to Asia and 90 percent flows to China. Since 2003, 1.1 million tons e-waste has been generated annually by the domestic consumers. The treatment of e-waste is very unsophisticated and unsafe. The e-waste is dismantled in a very simple way, in order to dissolve the metals acid baths are used, and the residues are burned in the open, releasing toxic emissions to the air. (Liu, 2006) the quantity of industrial solid waste is illustrated as follows:



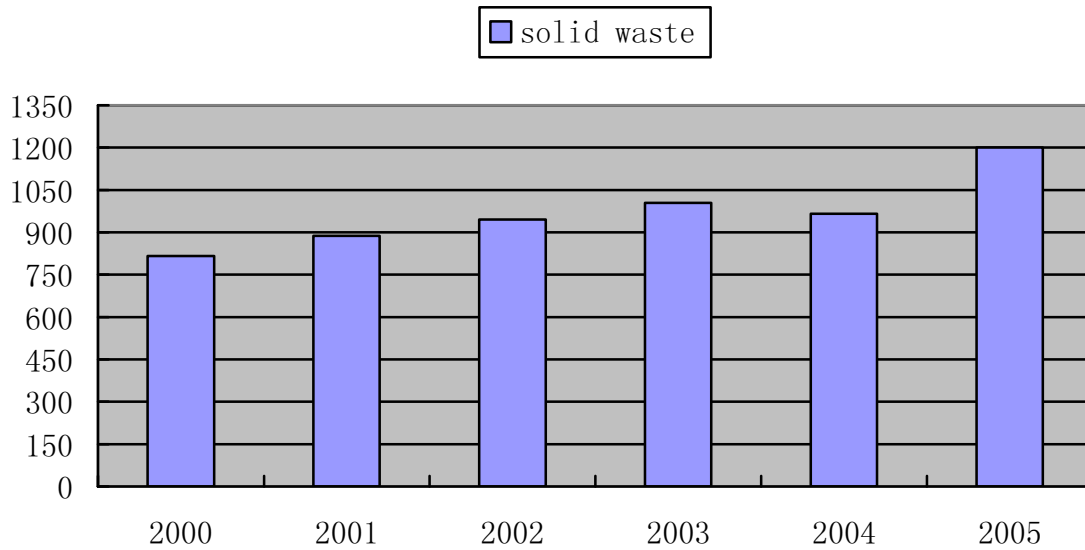


Figure 3-3 Annual growth of emissions solid waste (Unit 10 000 ton)

Source: Compiled by author based on NBSC statement (NBSC, 2003) and SEPA annual report (SEPA, 2005-g)

## 3.2 Increasing social concerns in China

### 3.2.1 Unemployment

From 1991 to 2004, the registered unemployment rate has grown annually. The unemployed amounted to 8 270 000 in the end of 2004 and the unemployment rate was 4.2 percent. This figure did not include labors from the farm lands. (China net, 2005-a) Although the government has made lots of efforts to alleviate the burden of the unemployed, the situation of unemployment is still tough.

### 3.2.2 The wealth gap and disparities in human development

The gap between the high income population and the low income population has expanded dramatically. The 20 percent of low income population accounted for 4.7 percent of the total national income whereas the 20 percent of high income population accounted for 50 percent of the total national income. (Wei, 2005) Besides the gap between the high and low income populations, the uneven economic development between the Southeast region and the West region of China also further hinder social development in the West region. In the early 1980s, China's repaid economic growth contributed the reduction of in rural poverty. In the 1990s, although the economic growth still was in a high speed, the reduction in poverty slowed down as the income inequality.

Significant disparities in human development also exist between urban and rural areas, between the eastern regions and the western regions. For instance, according the 2000 national census data, the average life expectancy was 5.60 years for urban residents more than rural residents. The life expectancy in West regions such as Tibet, Guizhou, and Yunnan

province was 9 years less than the East regions such as Jiangsu and Hainan province. The disparity also exists in education, for instance, 2.5 percent of the urban population aged 15 to 64 never received any education, while the figure was 8.7 percent in rural areas. Urban per capita income in 2003 was 3.23 times that of rural region and urban per capita consumption was 3.6 times rural per capita consumption. (UNDP, 2005)

### 3.3 Laws and policies on environmental and social aspects in China

Facing the above environmental and social challenges, the Chinese government shifted from focusing on only the economic growth to sustainable development. The balance between economic development, environmental protection and social improvements are highlighted in the policy making process.

Government agencies, NGOs and a number of universities have launched initiatives to promote CSR in China, such as China Enterprise Confederation (CEC), China Business Council for Sustainable Development (CBCSD) and the Chinese Institute of Certified Public Accountants (CICPA). There is a program on CSR at the Guanghua School of Management at Peking University, the School of Economics and Management at Tsinghua University and the School of Business at Renmin University. (Peng, Long and Pamlin, 2005, p.25)

The initiatives taken by the authorities to promote CSR reporting are explained below.

#### 3.3.1 The Environmental Protection Law

Article 27 of the Environmental Protection Law of P.R.C. stipulates that “*Enterprises and institutions discharging pollutants must report to and register with governments in accordance with the provisions of the competent department of environmental protection administration under the State Council.*” It entered into force on the 26 December 1989. (SEPA, n.d.-a) The law aims to protect the environment and ecological resources as well as human health without holding back on economic development.

Besides the Environmental Protection Law of P.R.C., there are other Acts which specify the reporting standards such as the Prevention and Control of Air Pollution Act, the Prevention and Control of Water Pollution Act, the Prevention and Control of Solids Waste Act and the Prevention and Control of Noise Act. All the emissions and discharges in the manufacturing process are required to report to the local environmental protection bureau. (SEPA, n.d.-b) The National People’s Congress (NPC) and its standing committee have published nine laws on environmental protection and 15 laws on the protection of natural resources. They cover natural resource protection as well as waste management systems. The laws related to environmental protection such as cleaner production, renewable energy and biodiversity are also in place. The State Council has formulated over 50 administrative regulations for the implementation of laws as well as for regulating specific issues such as the management of dangerous waste operations licenses, regulations on the protection of wild plants, etc. (SEPA, 2006-d)

Both national and local level environmental protection standards have been established in China. National level standards cover environmental quality standards, pollutant discharge standards and environmental samples standards. Local standards also include environmental quality as well as discharge standards. As of 2005 the State Council has published 800 national environmental protection standards. There are over 30 local environmental protection standards published by local cities and provinces. (SEPA, 2006-e)

SEPA, on behalf of State Council, is in charge of the management of China's environmental protection system. The governments of the provincial level, the city and the county level have set up environmental management bureaus responsible for local environmental management issues. (SEPA, 2006-f)

### **3.3.2 The Corporate Law and Security Law**

The new Corporate Law of P.R.C.<sup>9</sup> (Article 5 of Chapter 1) stipulates that the corporation must be responsible for social responsibility during the operation of the business. The new version of the Security Law of P.R.C.<sup>10</sup> also enhances corporate governance especially in relation to the listed companies accompanying the Corporate Law.

### **3.3.3 The Labour Law**

The release (on March 19, 2006) of this draft law on labour contracts can be seen as a further step towards the protection of labour rights and interests. In order to avoid employers abusing labour rights, the draft details the establishment, revision and termination of labour contracts, is the first of its sort for China. (Hills, 2006, p.179)

### **3.3.4 CSC9000T – the Social Responsibility Management System**

CSC9000T – China Social Compliance 9000 for the textile and apparel industry is a voluntary social responsibility management system drafted by China Information Center. It is based on Chinese laws and international labor standards. (CSC, n.d.) The aim of CSC9000T is to improve the employees' legal rights and working conditions in the textile and apparel industry.

### **3.3.5 The Policy on Philanthropy Tax**

In order to encourage individuals and corporate charitable donation, the Ministry of Finance of P.R.C. published a favorable policy in 2006 on philanthropy. The donation from individuals, corporations and other organizations can be exempted from taxation to eight charitable funds approved by the Ministry of Finance and the State Taxation Bureau. The regulation came in force from 1 January 2006. From April to June 2006, there were seven pieces of regulations from the State Finance and Taxation Department on the taxation and donations. 22 charitable funds can benefit from these regulations. It is the first time in China philanthropy is regulated. (Sun, 2006)

### **3.3.6 The 11<sup>th</sup> Chinese Five Year Plan**

The 11<sup>th</sup> Chinese Five Year Plan (2006-2010) was adopted by the Chinese Central Government. It includes economic and social development policies and puts forward new thinking and new moves. The key points of the 11<sup>th</sup> Five Year Plan include:

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<sup>9</sup> The new Corporate Law of P.R.C. was entered into force on 1 January 2006. It has been revised two times. One of the changes of the second version is that corporate responsibility has been highlighted. (Lawyer, n.d.-a)

<sup>10</sup> The new Security Law of P.R.C. was entered into force on 1 January 2006. (Lawyer, n.d.-b)

## **Innovation**

In order to achieve sustainable development, innovative capacity of the industry has been considered as a strategic basic point of sustainable development in China. It indicates that industrial development will shift from high energy and material consumption with high discharges to cleaner production with low discharges through raising the level of industrial technology. (Xiao, 2005)

## **The recycling economy**

The recycling economy is highlighted in the new Five Year Plan as a way for building a resource-saving economy and to reduce discharges. The drafting of the Recycling Economy Law is one of goals in the 11<sup>th</sup> Five Year Plan. The first local regulation that promotes the Recycling Economy was made in Shen Zhen Economic District of P.R.C. and has been in force since 1 July, 2006. (Sina Net. 2006-a)

## **Efficient usage of natural resources**

The goal regarding energy consumption in the 11<sup>th</sup> Five Year Plan is to reduce it with 20 percent/GDP compared with end of the 10<sup>th</sup> Five Year Plan. (Xinhua Net. 2005) The energy saving strategy has been promoted by the administration. Besides energy saving, over-consumption of other natural resources such as land and water will also be banned by the regulations from the central and provincial governments.

## **Even development**

One aim of the plan is to construct a “*harmonious society*” which focuses on the balance between economic development, environment and society. It is called “*Five balances*” by the Chinese Central Government. It stands for the balancing of urban and rural development, development among regions, economic and social development, development of human and nature, and domestic development and opening to the outside world. (People’s Daily, n.d.-a)

All these initiatives indicate that in the future legislation will focus on environmental improvements such as reducing the discharges and improving resources usage rate. Market based instruments in relation to environmental protection will also be enhanced such as pollution levy system. The pollution levy system provides an economic incentive to abate by charging a levy on pollution in excess of standards. The system has been implemented in the south eastern regions in recent years. The Ministry of Construction of P.R.C. are planning to implement the levy on waste water in all cities and small towns before the end of 2006. (Sina Net, 2006-b) Company’s social performance will also be taken into consideration by the legislator. For instance, The Shenzhen city government said that the government purchase contracts will not be given to the companies that do not meet social responsibility standards. It indicates how CSR can influence the decision makers in China now. It is reported that a set of CSR guidelines is to be produced by the end of 2006 by the local city government, which may include the provisions relating to the terms on which the government would grant contracts to private firms with sound CSR performance. (Mallenbaker.net, 2006) The best practice will be promoted through building up CSR into the public spending. The companies will be motivated on CSR under the award system.

## 3.4 Driving forces from global market actors

### 3.4.1 International environmental legislation

In recent years, the environmental legislation has become more and more stringent especially from the European Union. For instance, the ROHS Directive and WEEE Directive influence the Chinese legislation and companies directly through the requirements on products in the European markets.<sup>11</sup> For instance, one of the respondent interviewed in this study declared that they started to work with these regulations from 2004. The Ministry of Information Industry of P.R.C. (MII) published a provision about management of waste of electronic products on 28 February 2006. (MII, 2006-a) The hazardous substances banned in this provision are the same as in the ROHS. The Chinese version of “ROHS” will be in force by March of 2007. International best practice in environmental legislation and management will be used as references by the Chinese legislators. A proactive strategy can help Chinese companies manage their risks in relation to environmental and social performance. International cooperation in environmental protection is also stressed by China central government in recent years. The cooperation with United Nations Environment Programme (UNEP) has been conducted in the fields of environmental protection and education, cleaner production and cyclical economy. So far, China has signed more than 50 international conventions on environmental protection such as the United Nations Framework Convention on Climate Change and its Kyoto Protocol, the Stockholm Convention on Persistent Organic Pollutants, the Montreal Protocol on Substances that Deplete the Ozone Layer, etc. (SEPA, 2006-l)

### 3.4.2 International supply chain management

CSR auditing required by the overseas business partners mainly focuses on the legal labor standards such as hours of work, minimum wages, health and safety, forced and child labor, etc. Serious non-compliance means losing the order as both the international and national business partners are facing the risks of boycotts or protests by consumers. Usually inspections are conducted in two steps. First, audits are conducted by the company's own staff against the code of the inspection. Second, the audits are conducted by the specialist on behalf of the buyers. Third party certification is another way that the Chinese companies to get the license to export products. One standard is SA8000, others are individual industry standards. (China net, 2005-b) One example of this is the recent news about the labor rights group reports riot at a Chinese factory producing toys for McDonald's. It was reported that more than 1 000 workers rioted over poor working conditions as well as the low salaries of the workers (ranging between 75 and 100 USD a month) (AFX, 2006) To McDonalds, the risks are the anti campaign or boycotting organized by the concerned unions, labor organizations and consumers. To the Chinese factory, the risks are business lost or penalty as the violation of labor laws by the Chinese legislator.

Besides direct influence on companies, CSR concerns in the supply chain management can also exert pressure to the government through media, NGOs and international trade negotiations.

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<sup>11</sup> The directives stand for the restriction of the use of certain hazardous substances in electrical and electronic equipment. It bans heavy metals and brominated flame retardants exceeding the agreed level on EU markets of new electrical and electronic products. The ROHS Directive came into force 1 July 2006. (ROHS, n.d.) The WEEE Directive aims to reduce the amount of electrical and electronic equipment waste being disposed of to landfill by promoting separate collection, treatment and recycling. It will be in force in August, 2006. (SEPA, 2006)

### **3.4.3 Socially Responsible Investment**

There are socially responsible funds and investment organizations in the international market. The focuses of Socially Responsible Investment (SRI) shifted from environmental pressures to sustainability in the 1990s. According to the Social Investment Forum, the volume of assets under SRI management grew from the USD 529 billion in 1997 to USD 2.16 trillion in 2003. SRI has been viewed as an investment strategy with more emphasis on a broader view of performance encompassing environmental, social and finance performance. (Roberts, 2006, handouts) Some international financial institutions use Dow Jones Sustainability Index (DJSI) or FTSE Index series as a method of identifying and measuring the non-financial risk of a company and its impact on shareholder value.

Traditional accounting based statements were capable of capturing 75-80 percent of the true market value of major corporations. The figure has dropped to less than 20 percent on average since the beginning of 2000s. (Kiernan, 2005, p.69) This change reflects the transformation of developed economies to a stage where knowledge and other intangible assets, rather than land, factories, physical labor or even financial capital, are being valued.

So the SRI assessment system with social and environmental indicators can contribute to the Chinese financial industry by helping them to manage risks. It also can promote CSR reporting at the same time. With more and more international financial investors becoming shareholders of Chinese financial institutions such as the ICBC and Bank of China, Chinese financial institutions will pay more attention to SRI in order to reduce environmental and social risks and seek new market opportunity.

China will also open its financial market at the end of 2006 based on the WTO agreement, which will lead to more and more international financial institutions establishing branches in China. Best practice on CSR will therefore be introduced by the international financial institutions. The international standards regarding environmental and social risk assessment will influence Chinese companies and financial institutions in the future.

International institutions can influence the Chinese companies through two channels. One channel is that more and more Chinese companies are expected to become listed on international stock exchange markets. The international investors can influence these companies in a wide variety of areas, from financial performance to corporate governance. The second channel is through legislation, for instance the Sarbanes Oxley Act in the US aims to strengthen corporate governance as a result of a number of major corporate and accounting scandals. The Act went in force to overseas companies on 15 July 2006. There are 44 Chinese companies that are listed in the stock exchange market in USA. The Act will influence listed companies in financial performance and corporate governance. (Liao, 2006)

## 4 The current situation of CSR reporting in China

During the transition to a market economy over the last two decades, besides the economic boom, a series of social and environmental achievements have also been gained at the same time in China. One of the results of the about 9 percent growth rate per annum is that China alone has accounted for 75 percent of poverty reduction in the developing world. The adult illiteracy rate fell from 37 percent in 1978 to less than 5 percent in 2002 and the infant mortality rate fell from 41 per 1000 births in 1978 to 30 in 2002. (World Bank, 2005) From the SEPA Annual Report (2005), one can see that the public expenditure on environmental protection is rising steadily. The investments on waste water treatment and reduction of gas emissions in 2004 grew more than 20 percent compared with the previous year. (SEPA, 2005-f)

Nevertheless, China also faces ongoing and emerging challenges. The social challenges include uneven economic development between the western and the eastern regions, growing income inequality, and the emergence of increasing urban poverty, as well as environmental challenges, such as unsustainable resource exploitation, excessive toll on the rural natural resource base and urban environment.

Both the central and the local governments see sustainable development as a priority for China, and they encourage sustainable development through building the legal, social, human and institutional infrastructure. One of the initiatives adopted by the Chinese Central Government to tackle the abovementioned challenges is CSR reporting. CSR reporting guidelines has been published by the Ministry of Commerce of P.R.C. (MCC) in 2006. The guidelines are based on the GRI and SA8000 reporting indicators as well as best practice of multinational companies. The guidelines cover corporate responsibility to society, environment and stakeholders. Corporate philanthropy is not the main content of the guidelines. The first priority of corporate responsibility is instead towards the stakeholders, which covers the employees, suppliers, customers and the local community, etc. Environmental responsibility covers efficiency of resource consumption, reducing discharges and promoting recycling. CSR has been seen as a “*soft competitive advantage*” by the Chinese central government. (SGC, 2006-a)

Today stakeholders in China pay more and more attention to a company’s social and environmental performance. As environmental and social performance are related to corporate financial performance, the investors and institutional investment analysts need environmental and social information to evaluate overall performance and risks. Government needs information to evaluate the implementation of its environmental policies and regulations. There are also concerns from the NGOs and consumers about environmental issues. Proactive companies in China have taken responsibility for environmental and social reporting. As a result of the abovementioned pressure, companies provide information about environmental performance and sometimes corporate social responsibility and sustainable development in different forms. (Guo & Welford, 2005, p.2) The roadmap of the Chinese companies on CSR reporting can be traced from the mandatory environmental reporting in 1989 to the first CSR report in 2006.

## 4.1 The current situation of environmental reporting

### 4.1.1 Corporate environmental reporting and disclosure

According to the Environmental Protection Law of P.R.C. published in 1989, enterprises and institutions discharging pollutants must report to the local government in accordance with the provisions of the competent department of the Environmental Protection Administration under the State Council. (SEPA, 2006-a) At the same time, Article 11 stipulates that the competent departments of the Environmental Protection Administration under State Council and the governments of provinces, autonomous regions and municipalities under the central government shall issue bulletins on the environmental situation to the public.<sup>12</sup> Furthermore, the Waste Water Pollution Act of P.R.C., Article 4, states that all enterprises should report to the competent local environment protection agencies with the details information about their discharge of pollutants. If the pollutants exceed the national or local standards, the enterprises must identify the reason and assure a deadline to deal with them. (SEPA, n.d.-c)

The authorities are the only audience of the mandatory environmental reports in relation to the abovementioned environmental legislations. The public can only access the environmental information from the authorities rather than from the individual enterprises. Furthermore, the public can only get regional environmental information and will therefore not be able to identify the pollutants from any local individual company. There is a lack of channels which can link the local enterprises and the public directly. The relationship of different stakeholders to the environmental reporting and disclosure can be explained as follows:



*Figure 4-1 Relationship of different stakeholders in the mandatory environmental reporting and disclosure*

*Source: Compiled by author based on the SEPA laws and regulations.*

The basic characters of the relationship are as follows:

- Mandatory reporting to the SEPA;
- Regional environmental disclosure to the public by the SEPA;
- Single way of communication between enterprises, authorities and the public;

<sup>12</sup> The Environmental Protection Law of P.R.C. was promulgated by the State Council on 26<sup>th</sup> December 1989 and went into effect on the same date. It is the basic law of all other individual environmental protection regulations in relation to waste water, noise, gas emissions and solid waste, etc. (SEPA, 2006,-a)



- Lack of participation of the public in the environmental legislation.

Besides mandatory environmental reporting to the local SEPA, the listed companies in the Chinese stock exchange market are also required to issue annual reports to the public by the China Securities Regulatory Commission (CSRC). The legislator and the company's primary focus are on corporate financial performance. Although the Chinese Central Government has published several regulations aimed at improving corporate reporting and disclosure since the founding of stock exchanges at the beginning of 1990s, most of the terms and conditions mainly concentrate on financial performances rather than environmental and social performance. So the annual reports of listed companies and other companies rarely cover environmental and social issues. The information disclosed by listed companies only concentrated on disclosure of financial performance and corporate governance. (CSRC, 2006)

In recent years, progress has been made in the area of disclosure and reporting. In 2003, the Bulletin on Information Disclosure for Corporate Environmental Performance was issued by SEPA. The Bulletin stipulates that non-compliance enterprises should disclose their environmental performance to the public. The local environmental protection bureau should publish lists of non-complying companies periodically to the public via local media. Enterprises have to disclose their environmental performance if they have been put onto the list. From 2004, non-complying companies must report their environmental performance information of the previous year by March 31 every year. Complying companies are also encouraged to report their environmental performance to the public on a voluntary basis. (Guo & Welford, 2005, p.11) The relationship of the relevant stakeholders can be explained as follows:

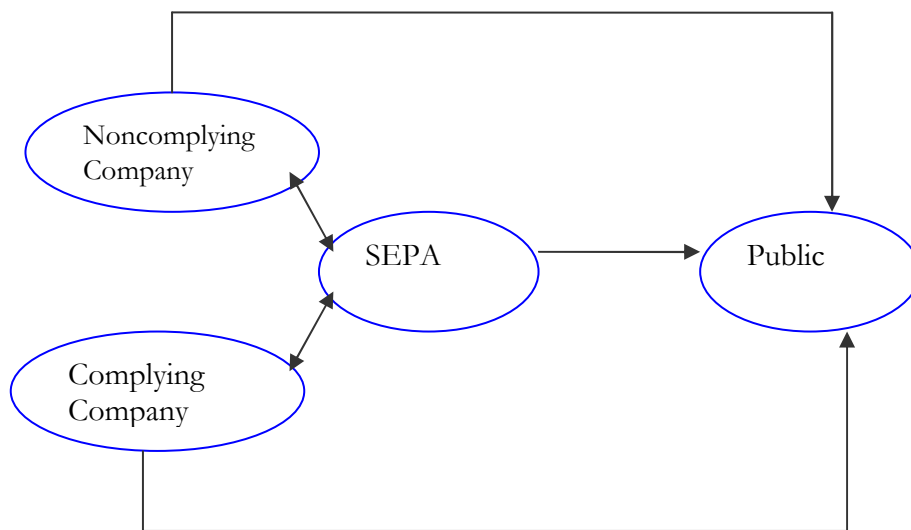


Figure 4-2 Relationship of different stakeholders in environmental reporting and disclosure

Source: Compiled by author based on the bulletin on information disclosure corporate environmental performance.

The basic characters of the relationship are as follows:

- Mandatory reporting to the SEPA by complying company and non-complying company;
- Regional environmental disclosure and non-complying individual company's environmental performance reports to the public;
- Single way of communication between authorities and public;
- Lack of participation of the public in the environmental legislation.

The progress in relation to environmental reporting made by the companies:

- Non-complying companies must disclose their environmental performance to the public through media;
- Compliant companies are also encouraged to disclose their environmental performance to the public.

The progress in relation to environmental reporting made by the SEPA:

- The local environmental protection bureau discloses individual non-compliant companies to the public via media periodically.

The trend of the changes indicates that the legislator has realized the role of the public in environmental management. The local public is informed by the local environmental protection bureau about the regional and local environmental situation. Non-complying companies are pressed to put more effort on the environmental management and reporting.

The environmental communication channels are now diversified. The companies are under the pressures from the local environmental protection bureau as well as the public.

The requirements of Bulletin on Information Disclosure for Corporate Environmental Performance (2003) <sup>13</sup>are explained as follows: (Guo & Welford, 2005, p.11)

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<sup>13</sup> The "Bulletin on Information Disclosure of Corporate Environmental Performance" was issued by the State Environmental Protection Administration (SEPA) on 5 November 2003. According to this regulation, the non-compliant companies should disclose their environmental performance to the public; the local environmental protection bureaus (EPB) should release the list of non-compliant companies via local media. From 2004, the non-compliant companies should disclose their environmental information of the previous year by 31 March every year. Compliant companies are encouraged to report their environmental information on a voluntary basis. (Guo & Welford, 2005, p.63)

The environmental information of non-compliant companies should cover:

- Corporate environmental policy
- Gross emission including:
  - Total amount of waste water and content of pollutants
  - Total amount of air emissions and content of pollutants
  - Total amount of solid waste produced and the discharges
- Companies' solutions to pollutions:
  - Investment on protection projects
  - The emissions that meet or do not meet local/national standards
  - The amount of disposed or reused solid waste
  - The amount of dangerous waste
- Compliance with laws and regulations
  - Records of non-compliance with laws and regulations
  - Documents of administrative punishment
  - Details of accidents and other reported incidents
- Environmental management
  - Emission charges related to laws and regulations
  - Emission charges that have been submitted so far
  - Reports to government about emissions
  - Applications for emissions permits
  - Installation of automatic monitoring equipment
  - Normal operating rate of the environmental facilities

*Box 4-1 Compulsory disclosure to the public for non-compliant companies*

*Source: Adopted from Guo & Welford, 2005, p.11*

Further achievements have been made in environmental reporting and disclosure from a legislative perspective. The Provision of Public Participation in Environmental Impact Assessment states that the public is encouraged to participate in environmental impact assessments (EIA) under the duration of the authorities' decision making process. "The

public” covers local habitants, corporations and non-government organizations (NGOs). The significant progresses in this provision are illustrated as follows:<sup>14</sup>

- Companies should involve the abovementioned stakeholders in the EIA before reporting to the local environmental protection bureau;
- The local Environmental Protection Bureau can also hold stakeholders meetings during the decision making process;
- Companies should report the results of these meetings to the local environmental protection bureau.

According to the requirement of this provision, the companies should communicate with stakeholders in the EIA before starting up the project. The public can access the environmental information of the companies and the impacts on the local environment caused by the project during the decision making process. The relationship between stakeholders during the EIA can be explained as follows:

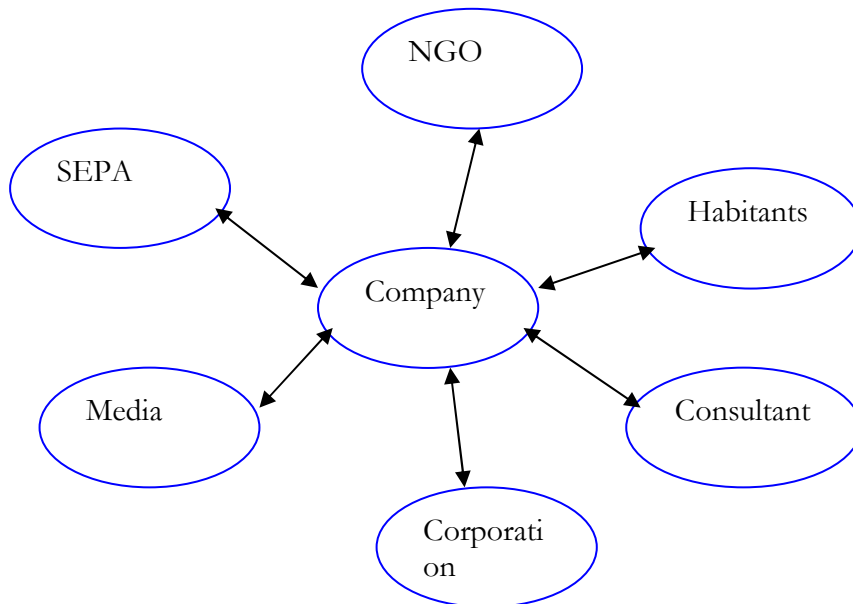


Figure 4-3 Relationships of different stakeholders in EIA reporting

Source: Compiled by author based on the Provision of Public Participation in Environmental Impact Assessment. (SEPA, 2006-b)

<sup>14</sup> The Provision of Public Participation in Environmental Impact Assessment was issued by SEPA on 14 February 2006 and entered into force on 18 March 2006. One purposes of the provision aims to promote the public participation in the environmental impact assessment during the decision making process. The provision stipulates the details terms and conditions of the stakeholders participation. The companies should report to the local EPB the result of meeting with stakeholders and other required documents. In this provision, the rights and responsibilities of NGOs and other corporations who could be harmed by the environmental impacts and local citizens are clearly defined and protected. (SEPA, 2006-b).

### 4.1.2 Environmental reporting in practice

Companies have to report their details on emissions and or environmental impact assessments to the local environmental protection bureau regarding the mandatory environmental regulations of the SEPA and other administrative authorities, such as emissions and discharges reports or EIA report. Besides these mandatory environmental reports, voluntary environmental reports are also encouraged by regulations such as Bulletin on Information Disclosure Corporate Environmental Performance to the local communities.

From a worldwide perspective, voluntary environmental reporting started in the 1990's, when businesses in heavy pollutants sectors such as the petroleum and chemical industry were criticized by the public for their environmental impacts. Environmental reporting was used as an internal as well as external communication tool with stakeholders such as trade unions. In the US, incentives for voluntary environmental reporting came from external pressure groups. Companies in heavy pollutants sectors attempted to gain legitimacy by reporting their side of the environmental story. Stakeholders impact companies in various ways, for example via investments, sales, governmental pressure and also the size of future business profits. (Reuterswård, Suikkanen, Sinnisov, Resnik, 2006, p.13)

In recent years, corporate environmental reporting and disclosure is increasing as the result of the central and local mandates and voluntary guidelines in China. Currently, the percentage of reporting companies listed in the stock exchange market was 34 percent in 2002 and 37 percent in 2003.<sup>15</sup> Heavy polluting industries such as mining, pulp and paper making, painting and oil sectors show more interest in environmental reporting than finance and other sectors. The trend of heavy polluting industry sectors in China for environmental reporting is the same as with similar international industries. The companies with significant environmental impact are more likely to report than others in China. (Guo & Welford, 2005, p.23) The following table shows the result of environmental disclosure by different type of Chinese companies.

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<sup>15</sup> The result was compiled based on three surveys: One is a questionnaire survey in 2001 covering 124 companies including 10 industrial enterprises, 81 banks, 5 securities firm and mutual funds, and 28 accounting firms. (Hereafter referred to survey 2001); A research in 2003 focused on the annual reports of 1195 listed companies in the Chinese stock markets and a analysis was conducted of the current situation of listed corporate environmental disclosures. (Hereafter referred to survey 2003); A questionnaire survey by a Japanese institute in 2004 researching corporate environmental management in China from 61 responding listed companies. (Hereafter referred to survey 2004) (Guo & Welford, 2005, p23)

Table 4-1 Corporate environmental disclosure in different Chinese industries (Survey 2004)

Industries	Companies	Disclosed 2003	Disclosed 2002	Percent 2003	Percent 2002
Mining	16	14	14	87.5	87.5
Paper making and painting	22	17	16	77.27	72.73
Power, steam and water supply	48	35	25	72.92	52.08
Fossil fuel and plastic	132	86	82	65.15	62.12
Metal and non metal	115	70	62	60.87	53.91
Bio medicine	74	40	37	54.05	50
Food and beverage	52	28	26	53.85	50
Wood and furniture	2	1	2	50	100
Agriculture, forestry, fishery	29	14	13	48.28	44.83
Textile	54	26	24	48.15	44.44
Electronics	33	9	13	27.27	39.39
Conglomerate	82	21	19	25.61	23.17
Other manufacturing	20	5	4	25	20
Heavy industry	207	43	43	20.77	20.77
Construction	20	4	3	20	15
Service	45	9	10	20	22.22
Transport	49	5	7	10.20	14.29
Real estate	41	4	3	9.76	7.32
Sales	95	9	8	9.47	8.42
Media and cultural	12	1	0	8.33	0
Information technology	38	1	0	2.63	0
Finance	9	0	0	0	0
Total	1195	442	411	36.99	34.39

Source: Guo & Welford, 2005, p.24

The following table shows the percentage and what form of reports of Chinese companies' corporate environmental reports. (Guo & Welford, 2005, p.25) The companies without environmental reports account for 41 percent of the total samples and the most popular form of report is by using their websites for their environmental disclosure.

Table 4-2 The Percentage of companies which publish environmental report or sustainability report (Survey 2004)

Responses	Environmental reporting	Percent	Publish in annual report	Publish on website
A. Yes	10	16.4	37.7	44.3
B. Planning	6	9.8	23	26.2
C. No.	41	67.2	32.8	23
D. Other	3	4.9	1.6	0.0
No answer	1	1.6	4.9	6.6
Total samples	61	100.0	100.0	100.0

Source: Guo & Welford, 2005, p.25

The survey also showed that the requirements from the authorities are the first priority to companies for environmental reporting. The authorities play the dominant role in promoting environmental disclosure for both mandatory and voluntary reporting. The results of the survey indicated that there is lack of public participation in environmental reporting.

Table 4-3 The driving forces for environmental reporting (Survey 2001)

Driving forces	Percent
Government mandates	70
Market pressure	44
Public or NGOs pressure	21
Investors pressure	19
Accordant with parent companies outside China	27
Reputation	55

Source: Guo & Welford, 2005, p.31

The contents of these reports usually include the environmental policy, environmental related financial information, environmental impacts, information about the discharge of waste, recycling and improvements of environmental performance. (Guo & Welford, 2005, p.26)

## 4.2 Corporate social responsibility reporting

There are five pioneering Chinese companies that have published CSR reports. These are Aluminium Corporation of China, State Grid Corporation, Shanghai Bao Steel, China Ping An Insurance Company and China Mobile Company.

The vice minister of Ministry of Commerce of P.R.C. (MCC) declared that MCC will take CSR as one of the major measurements for promoting the growth of foreign trade oriented company's business during 2006. (GOV, 2006-a) This positive attitude from the government will promote CSR reporting further in China.

### 4.2.1 CSR reporting – from the government's perspective

MCC has been authorized by the State Council of P.R.C. as the leading department to draft the standards and criteria of CSR reporting guidelines for Chinese companies. The guidelines

can be used a reference source for individual companies to work with their own CSR reports. (Li, 2005) Besides MCC, SPEA is also an active department of the government in relation to promoting CSR reporting. SEPA encourages companies to provide corporate responsibility reporting especially for their environmental performance. The promotion of corporate responsibility is considered as an important tool in the environmental management besides SEPA's mandatory laws and regulations. (GOV, 2006-b)

MCC made the full contents of the draft of guidelines on CSR reporting public to solicit the public opinion in February 2006. The theme of the framework is that the company shall be responsible for shareholders, environment and society. (Mnc People, 2006-a) The CSR reporting framework is aiming to improve corporate governance and competitive advantage to achieve sustainable development. The voluntary framework of the CSR reporting guidelines is based on the GRI sustainability reporting guidelines and the SA8000 standard. The contents of the guideline are explained in the following box:

<p><b>The purpose of the CSR reporting criteria:</b></p> <ul style="list-style-type: none"><li>● Compliance with the national sustainable development goal;</li><li>● Improving corporate governance;</li><li>● Enhancing competitive advantage especially for companies with multinational business;</li><li>● International trends of the CSR reporting.</li></ul> <p>The framework of CSR reporting:</p> <ul style="list-style-type: none"><li>● Sustainable development strategy, the value of the company's development and the director's commitment to the company's CSR engagement;</li><li>● Reporting boundary , identification of stakeholders, remuneration and background of company;</li><li>● Corporate governance;</li><li>● Business responsibility;</li><li>● Sustainable development and financial indicators;</li><li>● Social responsibility;</li></ul> <p>Right of employees, training opportunities, occupational health and safety, prohibition of child labour, local citizenship, anti-corruption, philanthropy and supply chain management.</p> <ul style="list-style-type: none"><li>● Environmental responsibility:</li></ul> <p>Record of environmental accidents, improving efficiency (raw material, energy and water), reducing discharges, recycling of water and waste, biodiversity protection, reducing green house gases, environmental policy and management and supply chain management.</p>
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Box 4-2 The framework for CSR reporting

Source: The outline of corporate social responsibility reporting for Chinese company. (Mnc People, 2006-b).



## 4.2.2 CSR disclosure – from the company’s perspective

Besides the official CSR reports, in practice, companies disclose information about their CSR activities in different ways. The company’s website is one of the most popular ways to disclose information about CSR activities. Ten companies (See Appendix 1) have been selected randomly by author and their CSR performance on the internet (Sina, n.d.-a) can be explained in the following table:

### CSR disclosure on website

Table 4-4 Disclosure of CSR activities on websites

	Social Perspective	Environmental Perspective	Business
East Hope Group	Philanthropy in education Investment in underdevelopment region		
China Huaneng Group		Environmental friendly innovation	
Jigang Group		Expansion grass land and planting area	
Shanghai Motor Group			Customer service Development of Euro I standards motor
First City group			
China Petroleum & Chemical Corporation			Corporate governance
Zhjiang Medicine Co Ltd			
China South Air			
Strong Food Company			
Haier Group	Establishment of education fund Sponsor of sports Charitable giving	Environmental innovation Non-use of ozone depleting substances	Customer services High Product quality Energy saving products

Source: Compiled by author based on information collected from websites.

There may be other channels for disclosure and reporting, so the information collected from the companies’ websites could be only part of the CSR activities disclosed by companies. Six out of the ten companies have published their social or environmental activities on their websites. The activities range from corporate philanthropy, environmental friendly innovation to corporate governance.

A good example is the Haier Group<sup>16</sup>, one of the biggest household electronic appliance manufacturers in China. They have been active in CSR activities during the recent decade. One of the major social corporate concerns of the company is children education, which

<sup>16</sup> Haier Group is one of China’s top 100 electronics and IT companies and the world’s 4<sup>th</sup> largest white goods manufacturer. It has 240 sister companies and 30 design centers all over the world. The number of employees exceeds 50,000. Haier was ranked 1<sup>st</sup> of China’s top 10 global brands by Financial Times in 2005. One of their goals in corporate philanthropy is to fund 100 primary schools in China. (Haier, n.d.-a)

started in 1995. As of today, there are 47 primary schools in rural areas founded by Haier Group. The company declared on their website:

*“Haier is sincerely devoted to promoting education. The issue of children education has become a major concern for CEO Zhang Ruimin, who believes that the growth of a business can’t be accomplished without the support from the community and a socially responsible business should make every effort to repay the community. For this purpose, Haier have been devoted to children education from the very beginnings.”* (Haier, n.d.-b)

The company also considers sustainable development as its aim of business. The concepts of supply chain management and product lifecycle management are also adopted into the company’s daily business management. (Haier, n.d.-c) Alongside the social concerns, the company’s CSR activities include climate change issues and have done so since 1995. Haier Group was invited as a representative from Asia to attend the 7<sup>th</sup> meeting of the parties to Montreal Protocol on Ozone Depleting and Substances<sup>17</sup> in 1995. From that time, different kind of energy savings and ozone depleting free products has been developed. (Haier, n.d.-d)

### CSR disclosure in annual reports

Another channel for CSR disclosure is a company’s annual report. For instance, Chapter 6 of Annual Report (2003) of China Petroleum and Chemical Corporation (CPC) is about health, safety and environment. The following table shows the contents of the company’s disclosure.

Table 4-5 Contents of CPC CSR disclosure in annual report (2003)

	Environmental perspective	Corporate governance	Business perspective
CPC	<p><b>Promoting</b> cleaner production;</p> <p><b>Water</b> saving management;</p> <p><b>Reduce</b> pollution discharge.</p>	<p><b>Establishment</b> of health, safety and environment management system;</p> <p><b>External</b> audit the management system.</p>	<p><b>Implementation</b> precautionary policy;</p> <p><b>Risk</b> assessment in new project;</p> <p><b>Development</b> of environmental friendly standards of products</p>

Source: CPC annual reports of 2003. (CSRC, 2004)

### 4.2.3 The first CSR report

The first official CSR report (2005) came from the State Grid Corporation (SGC)<sup>18</sup>, a state owned company under the State-owned Assets Supervision and Administration Commission of the State Council. The company issued its CSR report publicly on 10 March 2006. The general content related to CSR in the report were:

- Commitment to sustainable development;

<sup>17</sup> The Seventh Meeting of the Parties to the Montreal Protocol on Substances that Deplete the Ozone Layer was held by UNEP Vienna from 5-7 December 1995. (UNEP, 1995)

<sup>18</sup> The operational revenue accounted for 721.40 billion Chinese yuan in 2005. Total assets amounted to 1176.70 billion Chinese yuan and the ratio of assets to liability was 61.96%. Their number of employees exceeded one million. (SGC, 2006, P.7)

- Harmonization between the company's development strategy and the national energy policy;
- Corporate governance;
- Profitability;
- Customer service;
- Employee well-being;
- Innovation in energy saving and environmental protection;
- Compliance with the laws and regulations;
- Enhancement of citizenship in local community. (SGC, 2006, p.8)

Compared with performance indicators designed by the GRI guidelines (G3), this CSR report covered economic performance indicators (EC1, EC8 and EC9) such as revenues, operating costs, employee compensation, investments, donations and taxation to the government. Indirect economic impacts were also mentioned such as infrastructure investments that provide electricity to the rural villages. To the environmental dimension, this CSR report included the innovation and management improvements on energy saving and environmental considerations in their business (EN7, EN8 and EN15). But there was no indicator related to input (material, energy and water) and output (emissions, influent, waste). Other environmental issues such as the environmental impacts of products, biodiversity and climate change were also not covered in their CSR report. To the social dimension of this report, it included employee training and welfare, donations, adding value to the customer, contribution to the rural areas' access to the electricity and providing job opportunities for society (LA11, LA12 and LA13).

#### **4.2.4 Sustainability reporting – the GRI guidelines and external auditing**

The second CSR report was a Sustainability Report from the Aluminium Corporation of China (ACC).<sup>19</sup> Their report was published on 18 April 2006. (China Enterprise Confederation, n.d.-b) It is the first sustainability report based on the GRI guidelines. The report covers social, environmental and business indicators based on the GRI reporting indicators. For instance, the company will promote cleaner production and material recycling with the objective of reduction energy consumption by 5 percent in 2007 and 30 percent in 2010 compared with the energy consumption of 2004. They also want to improve the recycling rate of solid waste. This report has been audited by external auditors including specialists from university, trade union and administrative governments. (CEC, n.d.-c) Credibility can be viewed as a fundamental element in sustainability reporting. A survey on the 100 highest-revenue companies conducted in 2004 showed that accountability is at the core of business and 15 of the companies published sustainability reports with external assurance. (Park & Brorson, 2005, p.1096)

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<sup>19</sup> Aluminum Corporation of China (a state owned company under the State-owned Assets of Supervision and Administration of Commission of the State Council) is the biggest producer of aluminum and alumina in China as well as the second producer of alumina in the world. In the end of 2005, the total asset of ACC amounted to 110 billion Chinese Yuan. (China Enterprise Confederation, n.d.-a) (Chinese)

The main achievements of ACC’s sustainability report are explained as follows: (CEC, n.d.-d)

- The report is based on the GRI framework guidelines (2002);
- Indicators about the environmental and social performance based on the G3;
- Detailed figures about the social and environmental indicators;

For instance, the electricity consumption for aluminium was indicated by the following figure:

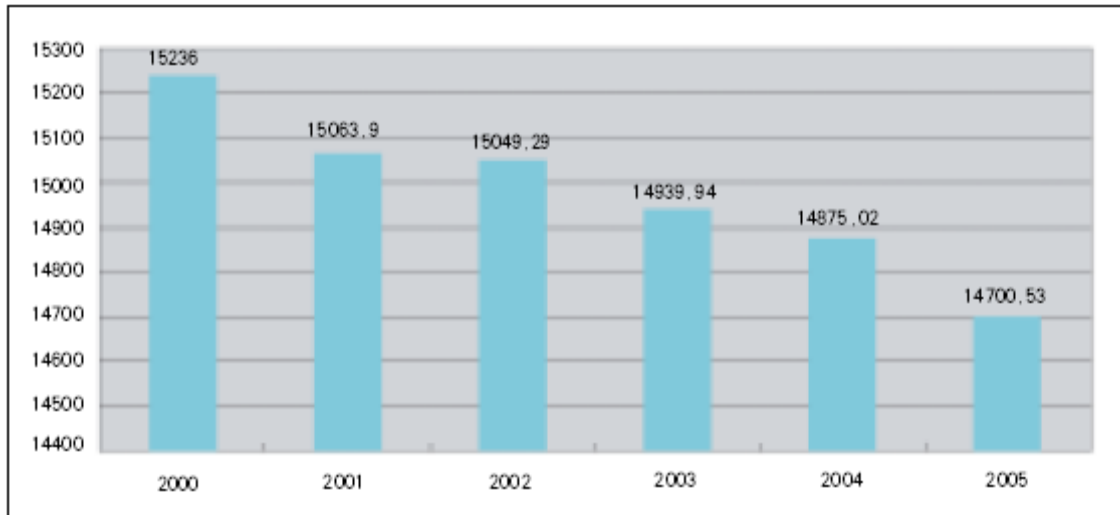


Figure 4-4 Electricity consumption (KWh) per ton (aluminum)

Source: ACC sustainability report (2005) (CHALCO, n.d-c)

- External audit;
- Commitment to integration of sustainability into policy-making.

The ACC’s sustainability report can be viewed as milestone for Chinese companies in CSR disclosure and reporting.

### 4.3 The pathway to voluntary CSR reporting

From mandatory environmental reporting required by the Environmental Protection Law in 1989 to voluntary CSR reporting in 2006, the situation on CSR reporting has changed dramatically in China. Based on the above analysis of CSR disclosure and reporting, the progress of Chinese companies on CSR reporting can be illustrated as follows:

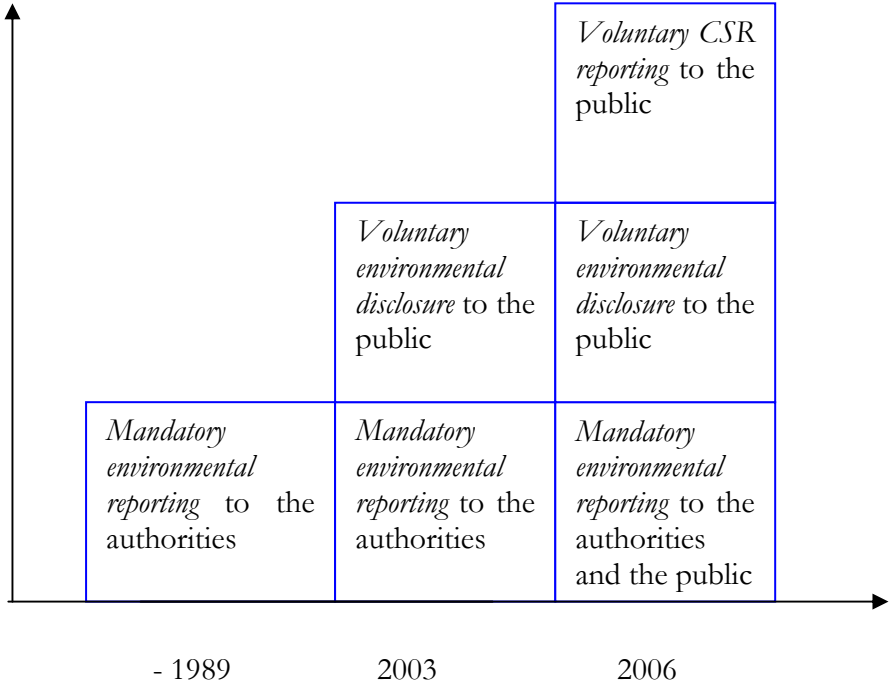


Figure 4-5 Progress of Chinese companies on CSR disclosure and reporting

Source: Compiled by author based on analysis

## **5 The results of the interviews**

A survey was designed with the aim to identify the driving forces for CSR reporting of Chinese companies. Two types of questionnaires have been designed for the survey. The first one, with open ended questions, was designed to understand the general awareness of the concept of CSR. The other questionnaire, with unstructured questions, aimed to identify the driving forces of companies with official CSR reports or CSR disclosures in other forms. (See Appendix 3)

The interviews were conducted by both email and telephone. In order to get spontaneous responses, all the interviews started with general questions. Based on the response of the general questions, a second interview and questionnaire was used for a deeper understanding of what driving forces the companies believed were important in relation to CSR reporting.

### **5.1 Criteria of samples for the interviews**

In order to identify the driving forces for the Chinese companies' CSR reporting and disclosure, the companies were grouped into two categories. One group was companies with official CSR reports, the other group was the companies with CSR disclosure in other forms. In practice several companies disclose their CSR performance in different ways such as annual reports or website as explained in Chapter 4.2. Totally 37 Chinese companies were selected as potential interviewees, each applicable to one of following criteria:

- Companies with CSR or Sustainability report;
- Companies with disclosure of CSR engagements on the websites or annual reports.

There might be companies that have already engaged in CSR activities but they do not report it publicly. However, as it is difficult to identify these companies, they were not included in this survey.

As of today, all the companies which have issued a CSR report are state-owned companies. The backgrounds of these companies are characterised as follows:<sup>20</sup>

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<sup>20</sup> The five companies with CSR reports are Shanghai Baosteel Company, China Ping An Insurance Company, and China Mobile Company Jiangxi Branch, State Grid Corporation of China and Aluminum Corporation of China. All of these four companies and the head office of China Mobile Company Jiangxi Branch are under supervision and administration of the State Owned Assets Supervision and Administration Commission of State Council. (Mnc, 2006-b)

Table 5-1 The list of companies with CSR reports

	Report	Sector	Issuer
State Grid Corporation	CSR report	Electricity	Head office
China Ping An Insurance Company	Corporate citizenship	Finance	Head office
China Mobile Company Jiangxi Branch <sup>21</sup>	CSR report	Communication	Sub-branch
Shanghai Baostell Corporation	Sustainability report	Manufacturing	Head office
Aluminum Corporation of China	Sustainability report	Manufacturing	Head office

Source: Compiled by author

Five companies with CSR reports were contacted by telephone, two of them did not want to be interviewed. Only three of the companies with CSR reports were chosen as interviewees from Table 5-1. The companies without CSR reports were chosen randomly. This covers both state owned companies and private companies as well as companies within both the domestic business and international business.

## 5.2 Methods of questionnaire design

An unstructured questionnaire is a more flexible tool than a structured questionnaire, since the respondents are free to say whatever they choose. It is likely to be a more probing tool to find out the reasons for certain answers (Hague, 1993, p.21). Unstructured questionnaires were adopted for the interviews in order to leave the respondent free to give spontaneous answers to the questions.

## 5.3 Results of the interviews

Seven companies returned the questionnaire by email and six other companies were interviewed by the telephone. An NGO which specializes in CSR, the SEPA and MCC as well as staff from a Chinese bank, were also interviewed in order to get a broader understanding of the driving forces for CSR Reporting. The list of participating companies is attached in Appendix 2. The analysis of the results of the survey also contains comments from the interviewees.

Each respondent had different priorities in ranking the driving forces. Due to the limit of number of sample selected and the response rate, the results will mainly be described in a qualitative way.

### 5.3.1 Participating companies

From the overall number of interviewees, 35 percent came from State Owned Companies (SOC) with domestic business, 25 percent came from SOCs with international business, and

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<sup>21</sup> As the CSR report usually goes hand in hand with the company's strategy and policy, the CSR report from the sub-branch is an interesting phenomenon. The author tried to get in contact with the sub-branch. (China Mobile, n.d-a) There is corporate citizenship responsibility report for 2005 on the website for the head office. The main contents of the report cover the company's effort in extending mobile access to the villages and a green box initiative (a program on discharged hand set and cells recycling) with other mobile companies to recover the discharged mobile handsets and accessories. There is also a commitment to the corporate citizenship responsibility in the future. Financial and business reporting are the main focuses. (China Mobile, n.d.-b)

30 percent came from private companies with international business. 10 percent came from private companies with domestic business only.

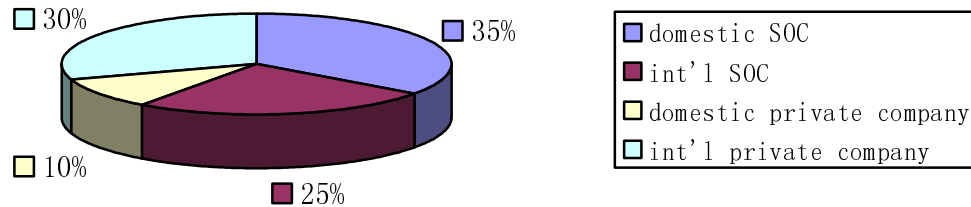


Figure 5-1 Property of interviewees

The companies were asked to categorize themselves according to state owned vs private, as well as domestic vs. international<sup>22</sup>. A relatively high response rate came from the state owned companies and private companies with international business.<sup>23</sup>

### 5.3.2 Definition of CSR by companies without CSR reports

70 percent of the companies interviewed declared that they knew about the CSR concept. The following key words from the answers however indicate that the companies have different interpretations of the international triple bottom line concept.

The definition of CSR mainly covers the following key words:

- Environmental laws and regulations;
- Reputation of the company;
- Donation and charity;
- Employee benefits.

Based on the comments from the companies interviewed, a Chinese CSR definition could be generalized as follows: A company with good reputation in the society through working with corporate philanthropy and taking environmental laws and regulations into consideration as well as the employee benefits.

<sup>22</sup> An international company is defined as a company making business both on the Chinese and international markets

<sup>23</sup> In practice, the respondents with international companies also do business in the domestic market and their focuses are on the international market.



### 5.3.3 Definition of CSR by respondents with CSR reports

The definition of CSR by the respondents with CSR reports covers the environmental, social and economic concerns. It does comply with the triple bottom line concept. There is a person or department in charge of CSR reporting. The concepts of CSR cover the following contents:

- Corporate philanthropy;
- Commitment to the environmental management beyond environmental legislation;
- Employee welfare;
- Image;
- Strategy on corporate governance.

The corporate responsibility can be traced back to the planned economy policy in China. Before the economic reform, all enterprises were owned by the government, and at that time, the enterprise's responsibility covered almost all employee issues. The enterprise itself was responsible for employee's health care, education and housing, etc before 1990s. During the transition to a market economy, the enterprise responsibilities such as health care, education and housing were reallocated based on the market mechanism and with flexible labour contract. The concept of a company's responsibility was also changed. Especially in recent years, the new social and environmental challenges were emerged in the beginning of 2000s. Some pioneering companies realized that a company should engage itself for the good of the society and build up an image and a reputation in the market through its products and services. At the same time, the modern CSR concept has been introduced to the Chinese companies in very recent years, so the understanding and application of the CSR concept of Chinese company is still very new.

### 5.3.4 The contents of CSR reports

In order to identify the contents of the Chinese companies' CSR reports, the SGC and ABB have been chosen as bench marking examples. The two companies have similar business in the electric grid facilities.

In Table 5.2 main differences between the SGC CSR report in relation to corporate governance, social and environmental performances.(SGC, 2006, p.1-52) and the sustainability report of ABB Ltd<sup>24</sup> (ABB, 2005, p.1-40) are illustrated.

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<sup>24</sup> ABB is a global leader in power and automation technologies. Sustainability is integral to all aspects of ABB's business. They focus on the integration of economic, social and environmental objectives into their daily business. ABB operates in more than 100 countries and has offices in 87 of those countries. Minimizing environmental impact is one of important objectives of ABB for its products and services. (ABB, n.d.)

Table 5-2 Difference between the SGC and ABB reporting

	State Grid China	ABB Ltd
Governance structure and stakeholder engagement	<p><b>management</b> structure of the company;</p> <p><b>Business</b> principles statements;</p> <p><b>Employee</b> engagement.</p> <p><b>Group</b> function to the society;</p> <p><b>Commitment</b> to the sustainability development;</p> <p><b>Enhancement</b> of the internal management system.</p>	<p><b>Governance</b> structure of the organization;</p> <p><b>Independent</b>, non-executive directors;</p> <p><b>Expertise</b> of board members;</p> <p><b>Board-level</b> processes for overseeing sustainability;</p> <p><b>Organizational</b> structure for sustainability policies;</p> <p><b>Business</b> principles statements relevant to sustainability performance;</p> <p><b>Mechanisms</b> for shareholders to give recommendations to the board;</p> <p><b>Stakeholder</b> consultation.</p> <p><b>Environmental</b> policy;</p> <p><b>Social</b> policy;</p> <p><b>Occupational</b> health and safety policy;</p> <p><b>Group</b> function sustainability;</p> <p><b>EMS</b> to cover manufacturing and non-manufacturing facilities;</p> <p><b>Implementing</b> occupational health and safety management systems group wide based on OHSAS 18001 ILO Guidelines</p> <p><b>Internal</b> and external auditing;</p>
Environmental performance	<p><b>Innovation</b> in products and manufacturing process;</p> <p><b>Implementation</b> renewable energy policy;</p> <p><b>Products</b> and services;</p> <p><b>Training</b> program energy saving practice.</p>	<p><b>Total</b> materials consumption;</p> <p><b>Use</b> of hazardous material;</p> <p><b>Energy</b> use;</p> <p><b>Initiatives</b> to use renewable energy;</p> <p><b>Water</b> consumption;</p> <p><b>Biodiversity</b>;</p> <p><b>Emissions</b>;</p> <p><b>Waste</b>;</p> <p><b>Transportations</b>;</p> <p><b>Climate</b> change;</p> <p><b>Products</b> and services;</p> <p><b>Commitment</b> to CO2 neutrality;</p> <p><b>Supply</b> chain management in climate change.</p>
Social performance	<p><b>Community</b>;</p> <p><b>Health</b> and safety;</p> <p><b>Political</b> contributions;</p> <p><b>Value</b> of customers;</p> <p><b>Donations</b>;</p> <p><b>Employee</b> weal;</p> <p><b>Employee</b> training (accounts for 78% of the total employees in 2005);</p> <p><b>Entertainment</b> centres (1448 centres);</p> <p><b>Labour</b> law;</p>	<p><b>Employments</b>;</p> <p><b>Labour</b> management relations;</p> <p><b>Health</b> and safety;</p> <p><b>Diversity</b> and opportunity;</p> <p><b>Non-discrimination</b>;</p> <p><b>Child</b> labour;</p> <p><b>Forced</b> and compulsory labour;</p> <p><b>Disciplinary</b> practices;</p> <p><b>Community</b>;</p> <p><b>Bribery</b> and corruption;</p>

	<p><b>Criteria</b> of safety in operation in place;  <b>Establishment</b> of Labour union in 2005.</p>	<p><b>Advertising</b>;  <b>Political</b> contributions;  <b>Program</b> of the business leaders initiative on human rights;  <b>Developing</b> human rights rules for business based on the UN norms;  <b>21</b> death in operations in 2004;  <b>47</b> people injured in incidents in 2004;  Increased training and better communication;  <b>5</b> health and safety workshops designed for leadership training;  <b>Corporate</b> level-twice a year;  <b>Country</b> level-once a year;  <b>Sustainability</b> controllers in 15 of 48 countries and regions;</p>
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*Source: Compiled by author based on the companies' reports*

### **International environmental and social reporting standards**

There are differences between the two CSR reports especially with respect to the international environmental and social reporting standards. The international standards such as Global Reporting Initiative (GRI), Environmental Management System (EMS), Occupational Health and Safety Management System (OHSAS 18001) and International Labour Organization (ILO) guidelines are adopted as guidelines for the company in the ABB sustainability report.

Although these international standards have been used as references for the framework by the SGC in its CSR report, there is lack of environmental and social indicators, and therefore evidence that the company have really adopted the standards.

### **Awareness of triple bottom line concept**

In ABB's sustainability report, the Chairman and CEO declared that to ABB, sustainability is not additional cost, it is an essential part of ABB's business. (ABB, 2005, p.1) The company considers that it is ABB's way of making a difference as an active participant for sustainability. The understanding by ABB about the triple bottom line is that a sustainable approach can contribute to business competitiveness, and thus its profitability.

From the SGC's report, there is lack of commitment to integrate CSR into the policy making and sustainable development strategy from the top management level.

### **Commitment to transparency of environmental and social performance**

There are detailed figures about the environmental and social performance in ABB's report. Global issue such as climate change is also considered in the company's business.

In SGC's report, there is no information about global issues such as climate change. It lacks detailed figures about the environmental performance such as material and energy consumption, discharges and emissions.

### 5.3.5 Position of the person interviewed by phone and questionnaire

None of the companies that participated in the survey has one employee who solely focuses on CSR issues. Even the large size companies have not set up a special position for CSR issues. The person who filled out the questionnaire is illustrated as follows:

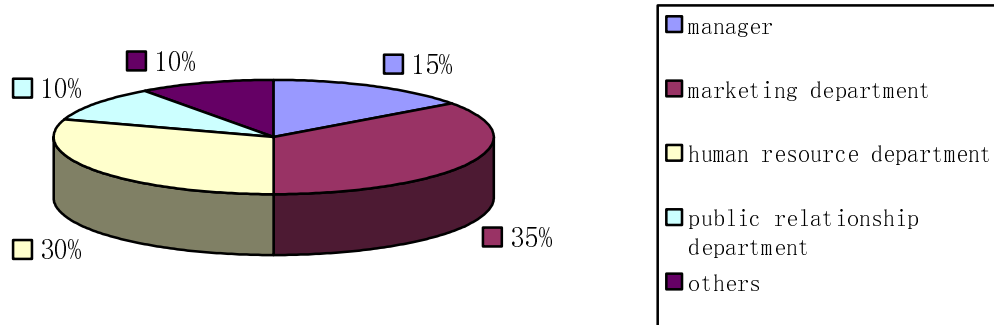


Figure 5-2 Persons/Departments who completed the questionnaires

### 5.3.6 CSR and the business

80 percent of the participants consider CSR being relevant to the business. The benefits from CSR range from getting a license to operate, image, and customer relationship to motivations for the employees. Besides these benefits, the companies with international business also mentioned that CSR can help them get more orders from their foreign partners.

### 5.3.7 The activities that companies already engaged in

70 percent of the participating companies provide training and education programs for their employees. The activities also cover pension insurance and vacations.

90 percent of the participating companies consider CSR activities as an opportunity for building up the corporation’s reputation. The answers show that corporate philanthropy is the most popular way of doing this. Examples are charitable giving to the funds, donation to undeveloped areas and funding primary schools in rural villages. Three respondents operate their own corporate foundations which specialize in philanthropy. Companies want to be considered as a reliable and trustworthy partner by their business alliance in the local community.

Environmental legislation was ranked with highest priority by the participating companies. The respondents with CSR reports mentioned that environmental protection programs had been conducted through innovation in manufacturing process and reducing consumption of energy and natural resources as well as improving waste recycling rates, etc. The respondents from the manufacturing industry declared they have already been certified by ISO 14001.

### 5.3.8 The way to report CSR activities

For companies without CSR reports, the most popular way to disclose CSR activities is to put the information on the company website. Other channels include annual reports, meetings

and local media. Three respondents published sustainability reports for the first time. The percentage of the different channels can be illustrated as follows:

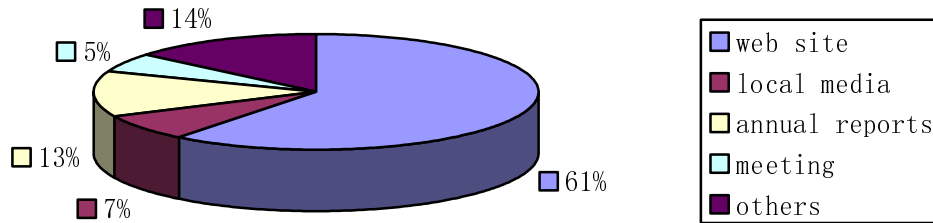


Figure 5-3 Different channels to CSR disclosure

## 5.4 Driving forces for companies with CSR reports

Three companies with CSR reports were interviewed by phone. The answers was divided along a scale ranging from 1-3 with 3 being first priority, 2 being second priority and 1 being the lowest priority.

### 5.4.1 Stakeholders

All three respondents emphasized the relationship with the regulators and government agencies such as the local SEPA and the legislator is the first priority for the driving forces from stakeholders. The shareholders are also considered as important driving forces by the companies as two of them are listed on the New York and Hong Kong stock exchange markets. Customers are at the bottom of the list. The list of driving forces is illustrated as follows:

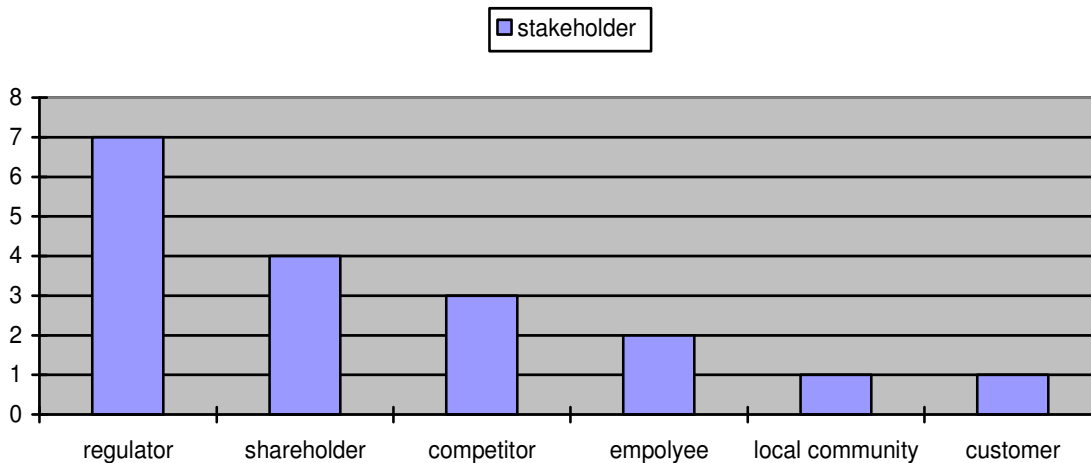


Figure 5-4 Driving forces for CSR reporting from stakeholders

### 5.4.2 Corporate Governance

The respondents declared that international best practice in the implementation of policies and reporting managements to manage a company’s risks is the first priority in relation to corporate governance driving forces. The concept of modern corporate governance started in the beginning of 1990s with a reform of stated owned companies in China. The framework of corporate governance has been introduced from international companies such as board of committee, supervision committee. The stock exchange markets also emerged in the 1990s as a further step for the reform of corporate governance. All the listed Chinese companies are required to improve corporate governance from the financial perspective. The respondents declared that the effective management of a company’s sustainability issues by international companies is an interesting topic that they want to learn more about.

The list of driving forces is illustrated as follows:

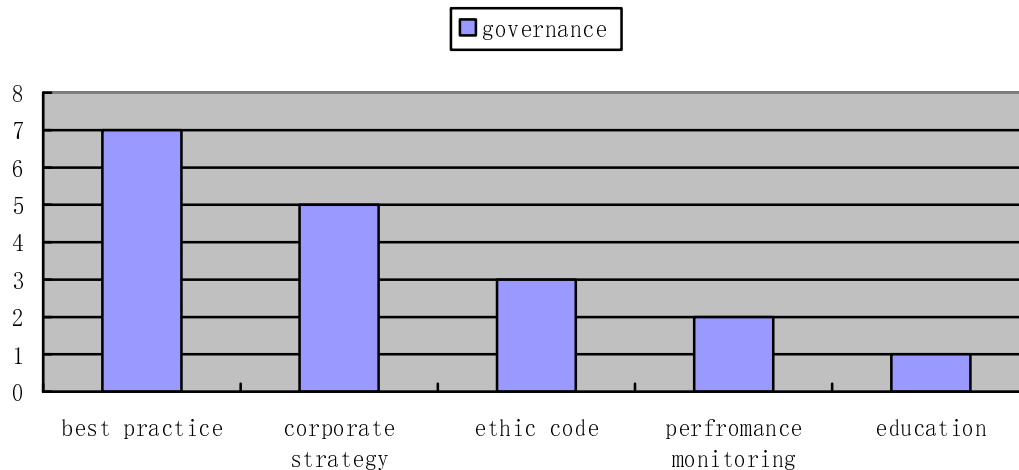


Figure 5-5 Driving forces for CSR reporting from corporate governance

### 5.4.3 Human resources

Health and safety is the first priority declared by the respondents in relation to the human resources driving forces. The results from the participating companies also show that they consider CSR relevant to employee motivation and recruitment. Furthermore, they consider CSR as a useful tool for employee motivation besides salary and dividends. It can enhance employee loyalty and improve the relationship between the employee and the company.

The answers from the respondents comply with the current situation of CSR in China. CSR is one of the major themes in the 11<sup>th</sup> Five Year Plan (from 2006-2010) approved by the Chinese Central Government. (Zheng, 2006, p.4) The campaign is aiming to build up a society where the majority of the population can benefit from the economic development. The campaign calls for more attention to social justice for ordinary people in society. The priorities of the different factors are illustrated as follows:

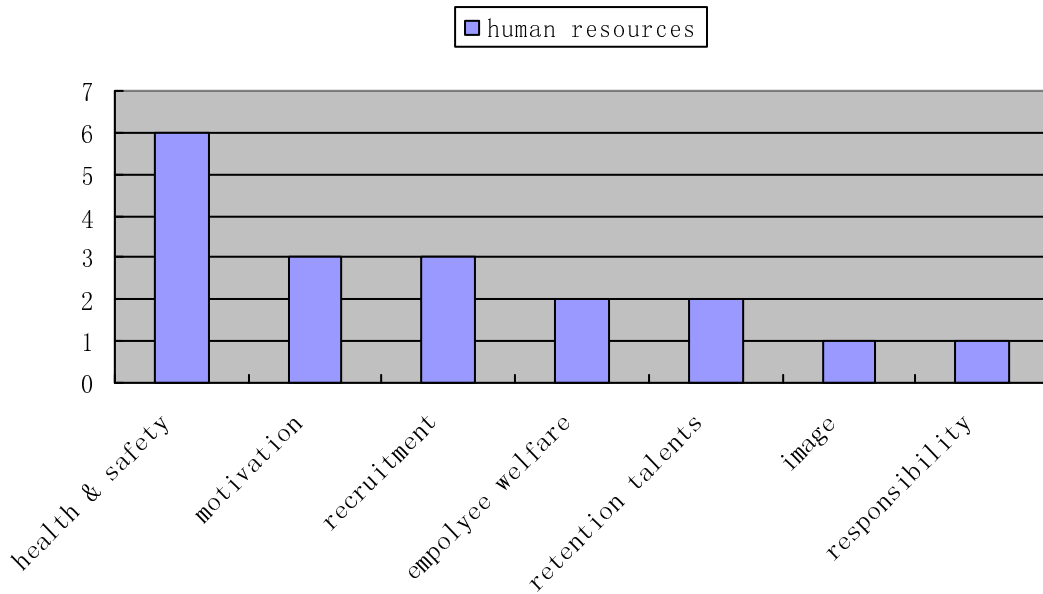


Figure 5-6 Driving forces for CSR reporting from human resources

#### 5.4.4 Environment

Cost reduction is the first priority declared by the respondents in relation to environmental driving forces. The respondents also highlighted benefits from environmental management. The respondents declared that the continuous progress in environmental performance can contribute to a company's profitability. (Brorson & Larsson, 1999, p.20) Besides the mandatory requirement for disclosing environmental performance, the respondents declared that the voluntary environmental reporting can contribute to the company's image. The companies declared that ISO 14000 is the most popular tool used for environmental management. They also want to build up their image through an ISO certification. The ranking of environmental driving forces are illustrated as follows:

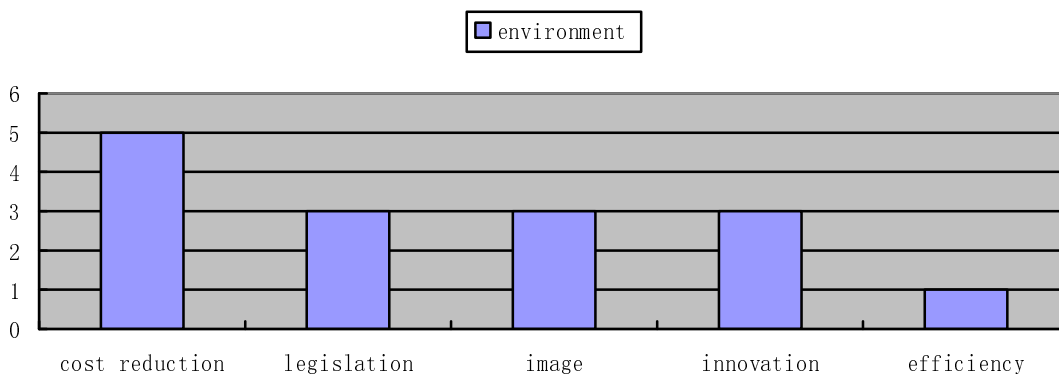


Figure 5-7 Driving forces for CSR reporting from an environmental perspective

### 5.4.5 Finance

Credit rating is the most important driving force in relation to the financial driving forces declared by the respondents of which two of them are listed companies in the international stock exchange market. The respondents declared that there are concerns from the international financial market to the listed companies, which makes this area important.

There are also incentives from the national commercial institutions such as Environmental Impacts Assessment reports for project financing. But the indicators adopted by the national financial institutions mainly focus on financial performance such as profitability, liquidity and the ratio of assets to liability. “As one significant part of credit risk management, however, environmental risk management has still been the weakness of commercial banks of China.” (Guo, 2005, p.27) The driving forces from financial perspective are illustrated as follows:

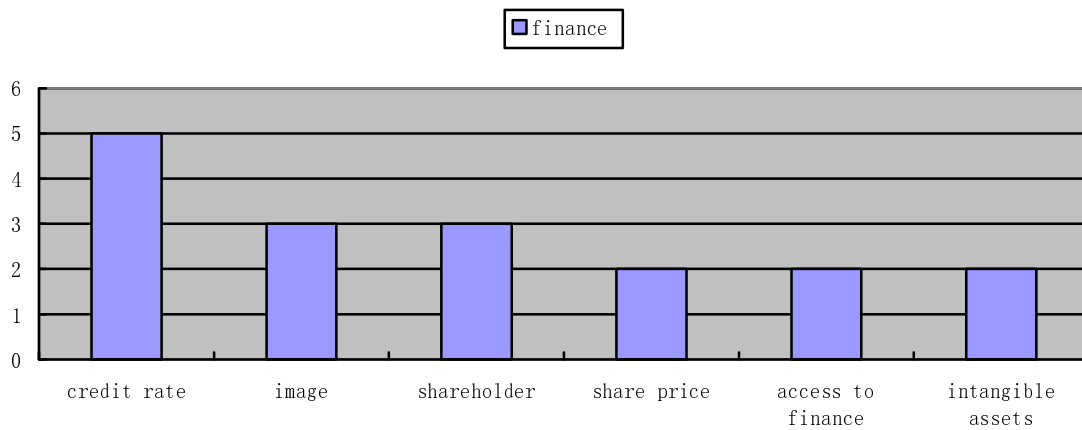


Figure 5-8 Driving forces for CSR reporting from financial perspective

## 5.5 Driving forces for companies without CSR reports

Based on the size of the company, the respondents without CSR reports can be grouped into small and medium sized companies. The respondents disclose CSR engagements in different ways, such as their website, annual reports, media and meetings. The result of the survey shows that respondents focus on corporate philanthropy, such as donations and charitable giving. To the majority of the respondents, corporate donation is their first priority. Seven respondents were chosen as samples for deeper study to identify the driving forces for CSR disclosure.

### 5.5.1 Stakeholders

The answers show that the legislator is the first priority for CSR disclosure. It indicates that the government plays a dominant role in relation to CSR reporting, and then follows employee and international business partner. The respondents with international business mainly focus on labor intensive manufacturing industries such as clothing, accessories, toys and electronic products, etc. Most of these companies are suppliers or workshops of international buyers.

A survey conducted by Welford (2004, 2005) shows that the driver for CSR in the Asia region tend to be the result of external driving forces and supply chain management associated with



trade and procurement of semi-manufactured materials. Supply chain management usually involves a process of factory inspection and auditing. (Welford & Frost, 2006, p.168)

The respondents also mentioned that today in China the majority of the consumers mainly focus on the price and quality of the products. Most consumers do not take a company's social and environmental performance into consideration in their decision-making.

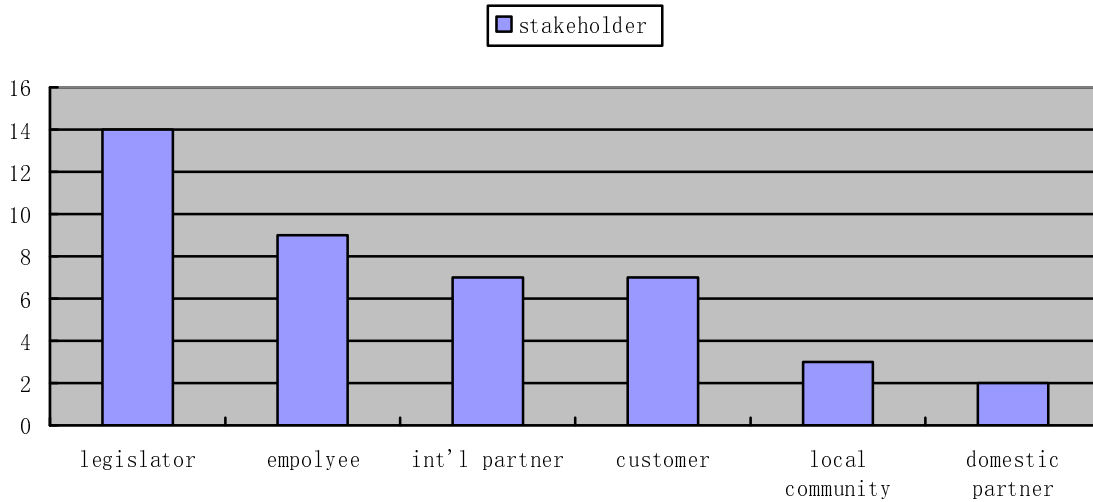


Figure 5-9 Driving forces for CSR reporting from stakeholders

### 5.5.2 Corporate governance

The answers show that the main driving force for corporate governance is corporate strategy. The participating companies declared that CSR can be used as an ethic code for corporate governance. They declared that sound CSR performance in corporate governance could build up the trust with the business partners. International best practice in implementation of policies and reporting practices for corporate governance was ranked as second most important following the corporate strategy. Respondents from both groups recognized CSR as international best practice in relation to corporate governance.

One of the respondents declared that they are willing to commit to CSR practice in relation to corporate governance. At the same time they are worried about their less responsible local competitors. They indicate that if CSR become the rule of the business game, they will play with the game. The different driving forces are illustrated as follows:

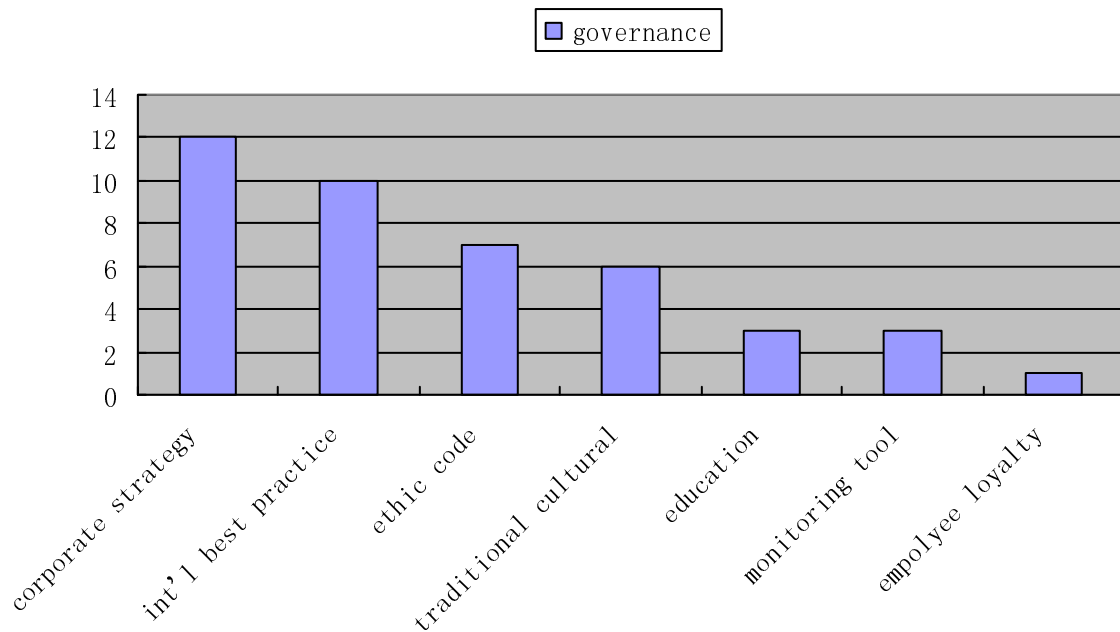


Figure 5-10 Driving forces for CSR reporting from corporate governance

### 5.5.3 Human resources

Motivation is the most important human resources driving force for the respondents, such as salary, vacations and training opportunities. These are used as incentives to motivate skilled employees. Recruitment is ranked in second position by the respondents. At the same time, they declared that the investment in employee training is not enough for improving the quality of the employee. One respondent declared that the company is a second tier of an international supply chain, and as a workshop in the manufacturing process, there is not much profit left for them. The profit margin is not enough to improve the employees' working conditions and health care and safety, etc.

The respondents considered that cheaper labor is one of the competitive advantages in the market. Generally speaking, they lack other comparative advantages such as technical advantage, know-how or patent protection compared with international companies.

The situation of Chinese companies in relation to health and safety is sometimes criticized by the public, especially to high risk industries such as mining and manufacturing with hazardous substances in the manufacturing process. For instance, in 2003, the death rate per million tons of coal production in China was 30 times that of South Africa. (Zheng, 2006, p.6)

The driving forces from human resources are illustrated as follows:

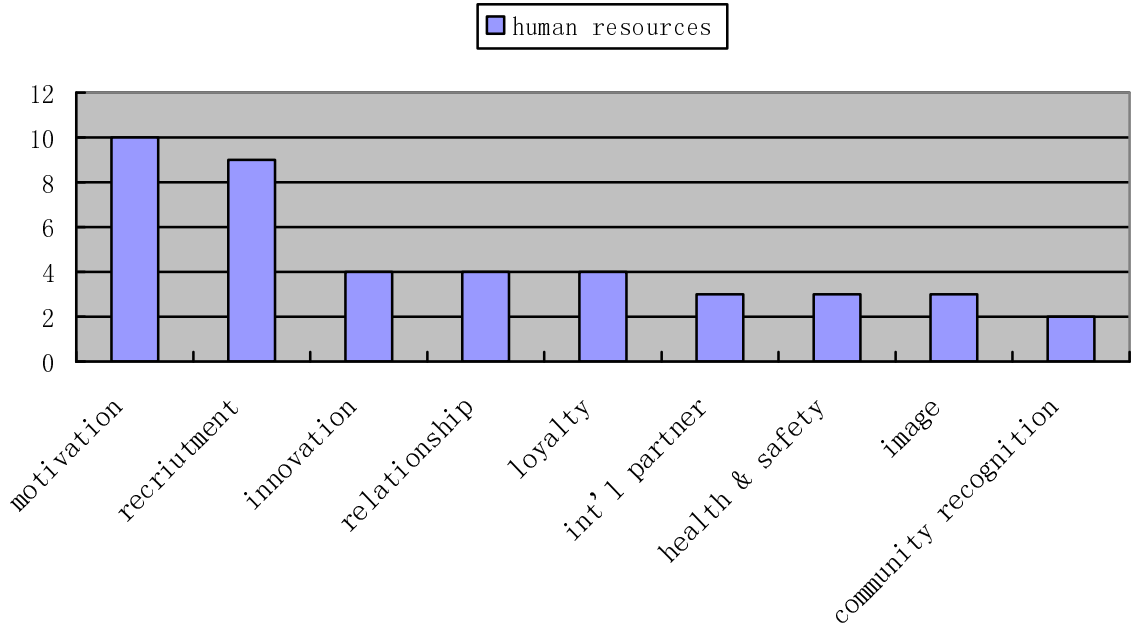


Figure 5-11 Driving forces for CSR reporting from human resources

### 5.5.4 Environment

The participating companies declared that legislation and brand equity are their driving forces for CSR disclosure in relation to environmental reporting. Then follows cost reduction and customer requirements. The respondents declared that sound environmental performance can contribute to brand equity. Three respondents declared that ISO 14000 is the best tool for environmental management. The driving forces are illustrated as follows:

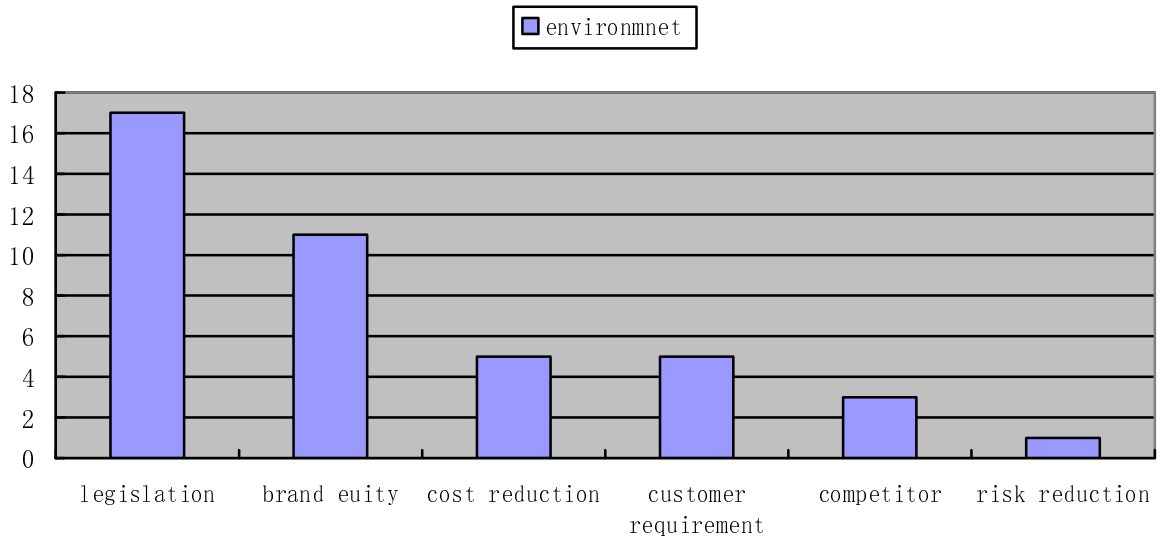


Figure 5-12 Driving forces for CSR reporting from environmental perspective

### 5.5.5 Finance

The result shows that credit rates are the main driving forces within the area of finance. Then follows cost reduction. The first priority is the same as with the driving force from state owned companies in relation to finance.

The incentives for CSR reporting comes from the local commercial banks as they have flexible interest rates and criteria depend on the individual customers. The interest rates for loan vary from customer to customer, based on the company’s tangible and intangible assets such as their reputation. The respondents declared that the reputation of the company is one factor when they apply loan from the local commercial banks. For small and medium sized companies, usually they do not have enough tangible assets for pledging a loan from local commercial banks.

Chinese commercial banks will pay more attention to a company’s intangible assets in the future. According to the WTO agreement, China will open its financial market totally on 1 January 2007. More and more international financial institutions will expand their business in China as they will get the same treatments as national financial institutions (Wang, 2006). The best practice in CSR performance and risk management tools adopted by these international institutions will also influence Chinese financial institutions. The driving forces from financial factors are illustrated as follows:

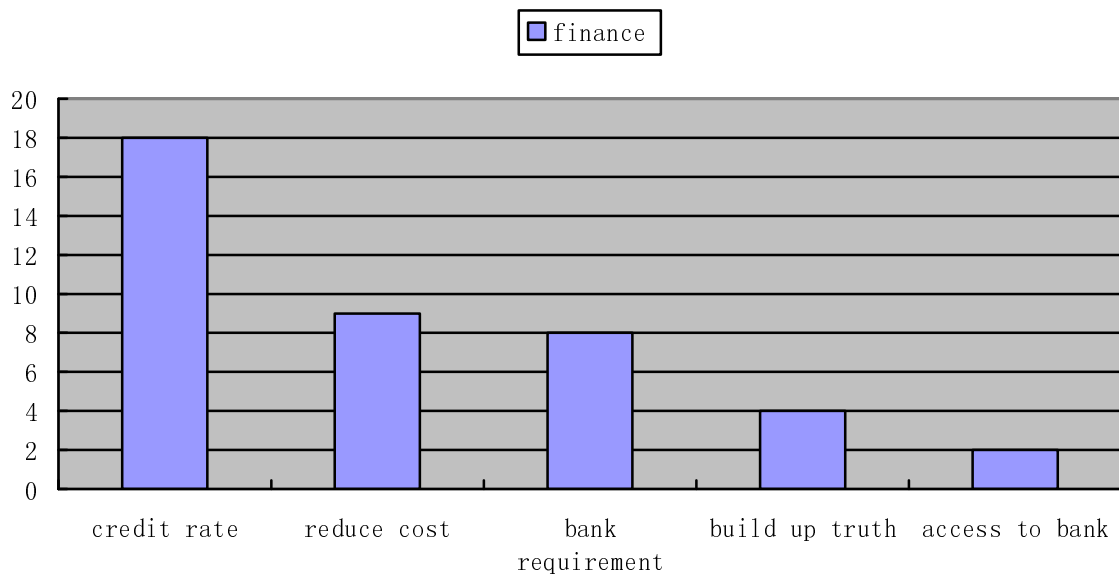


Figure 5-13 Driving forces for CSR reporting from financial perspective

## 6 Analysis of survey results

The results of the survey indicate that CSR has not become a prevailing topic for Chinese companies. There are five state owned companies who have published CSR reports since the beginning of 2006. This is a good start for promotion of CSR in China.

### 6.1 Awareness of the CSR definition

To **companies without CSR reports**, although 80 percent of the respondents declared awareness of the CSR concepts, they usually focus most on corporate philanthropy. Donations and charitable giving are the most popular ways for companies to engage in CSR. All the respondents agreed to that engagement in the local community is part of CSR activities. Three respondents declared that they considered ISO 14000 certification as the most important environmental management tool. Half of the respondents mentioned that improvement of the employee's welfare as well as health and safety as future aims within CSR.

The answers of the respondents indicate that the application of CSR lacks a commitment to the responsible business in relation to the triple bottom line concept. There is lack of environmental concerns beyond legislation by respondents.

To the **companies with CSR reports**, there are different names of CSR reports such as:

- Corporate Social Responsibility Report published by SGCC;
- Sustainability Report from ACC;
- Corporate Citizenship from China PING AN Insurance Company.

However, the principles of the reports are the same; disclosing information on responsible performance in relation to society and environment. The definition of CSR by the respondents with CSR reports is based on the triple bottom line concept.

Besides the commitment to social and environmental performance, all of the respondents mentioned the links between CSR to corporate governance and financial performance. The contents of the reports cover the following substances:

- Employee health and safety;
- Beyond the environmental legislation;
- Involvement in local community;
- Financial performance;
- Corporate philanthropy;
- Corporate governance.

## 6.2 General description of answers from the respondents

The personal interviews by telephone were conducted with the companies with CSR reports. Usually there was a person or department in charge of the CSR reporting in the head office of the company. It was easy to interpret the respondents' answers by telephone. They are open for comments about their sustainability report to the public. One respondent declared that they are planning to publish the sustainability report next year (2006) in Chinese and English at the same time. The respondents with CSR reports are more transparent than the respondents without CSR reports.

To the respondent without CSR report, there was no special person who was in charge of the CSR issues. Furthermore, the answers from the respondents without CSR reports indicated that the understanding of the concept of CSR is different from the companies with CSR reports. During the interview, the respondents focused on the following key words:

- Laws and regulations;
- Donation.

In order to get an operation license, companies must comply with the laws and regulations. For instance, one respondent declared that they started to work with ROHS in 2004 as they have sister companies in the European market.

When it comes to social performance, usually their understanding to a large extent is that it means the same as donation. One respondent commented on social responsibility that it means investment in the local community. CSR has been understood as an extra cost rather than responsible business. This differs from the view of companies with CSR reports. The commitment to responsible business is more important than the investment, i.e. how much money has been spent on CSR activities. All respondents declared that charitable giving is also part of the Chinese traditional culture.

## 6.3 Analysis of the driving forces for CSR reporting

### 6.3.1 Stakeholders

For **companies with CSR reports**, generally the stakeholders cover legislators, employees, international business partners, shareholders and the local community. The legislators and shareholders are the company's most important driving forces for CSR reporting. For the state owned companies, the respondents consider the legislator as the leading driving force for voluntary CSR reporting. All the respondents declared that CSR reporting complies with the national policies in the 11<sup>th</sup> Five Year Plan which focuses on sustainable development. One respondent declared that as a state owned company under the State Assets Administration and Supervision of State Council, the respondent is expected to follow the call for CSR by the Chinese central government.

Another leading driving force is the shareholders. Two of the three respondents are listed companies in international stock exchange market, and they declared that CSR can enhance the company's image in the international financial market. The consumer was of low priority. This indicates that there is not much pressure from the consumers in relation to CSR.

For **companies without CSR reports**, the legislator is also the most important driving force for CSR disclosure. Even if the CSR reports are based on a voluntary basis, the respondents of

the two groups still consider the legislators on the top of the list. It indicates that the legislators play the dominant role in the current CSR situation in China.

The second highest driving forces are the employees. It indicates that the respondents realized the role of the scarcity of skilled labours and relationships between the owners and the employees, this is followed by the role of foreign partners. Two respondents with international business put their foreign business partners on the top of the list of stakeholders. Usually these companies are manufactures in the international supply chain. The consumers have still the lowest priority with the same position as prioritized by the respondents with CSR reports.

The high level of priority awarded to the legislators indicates the pressure for CSR comes from the legislation related to environmental and social issues. From the national policy perspective, in the 11<sup>th</sup> Five Year Plan, the indicators of development shift from a single economic growth rate to a multi-balance including the environmental and social considerations. From the micro legislation perspective, there are requirements regarding CSR in the new Corporate Law of P.R.C. and the draft of the new Labour Law of P.R.C. For instance, in article 5 of the new revised Corporate Law of P.R.C., it stipulates that the corporation must follow social and commercial norms and take social responsibility into consideration. It indicates that besides profit making, the corporation should also contribute to the society. (Ma, 2006)

In practice, in order to protect the competitive advantage in the international market, the Chinese legislators balance between strict legislation and its implementation. On one hand, the legislators are facing the pressures from international trade negotiations as well as environmental and social concerns. The international financial institutions and international environmental legislation also exert pressure to the Chinese legislators. On the other hand, the legislators worry about the competitiveness of Chinese companies. In order to protect Chinese companies, the laws and regulations are not implemented in practice. For instance, as the companies' implementation and compliance in relation environmental regulations are weak in practice, it is difficult for companies which are complying with environmental laws to compete with companies which do not follow the laws. They are not on the same playing ground. The result of the survey indicates that the respondents consider environmental legislation as the first priority. But in practice, non-compliance is still very common. The comment from one respondent said *"if CSR become the role of the game, we will play with it."*

The traditional opinion of Chinese legislators is that the strict standards can limit a company's competitive advantage. Higher standards on environmental and labor issues mean higher cost of processing. The survey indicates that some respondents already are complying with the requirements of the ROHS and WEEE standards in the European market. They gain another sort of competitive advantage in the national and international market under the stricter environmental legislations. The idea that legislation actually can lead to innovation and gain competitive advantage should be taken into consideration when the Chinese legislators implement the regulations.

A similar result came from a survey by WWF in China in relation to the 182 largest Chinese companies in 2005. This survey indicated that only 3 percent of the respondents declared that their companies did not follow the environmental standards during the manufacturing process. The majority (62 percent) claimed that they follow the standards and 22 percent claimed even to go beyond the existing environmental standards. A surprising result was that some respondents suggested tougher regulations. But the result of the survey also indicated that 57 percent of the respondents felt that their fellow companies were trying to lower current environmental standards. (Peng, Long & Pamlin, 2005, p.28) The result of the WWF

China survey indicates that companies need the same playing ground in relation to environmental regulations. The current situation in relation to implementation of environmental standards cannot distinguish the companies with sound environmental and social performance in the market from the ones' without.

The low priority of consumer by both groups indicates that there is not much pressure from the consumers for CSR. The role of Chinese media, trade unions and NGOs on CSR were not either mentioned by the respondents. The situation is different from Western countries, since consumers from these countries are more aware of CSR concepts than the consumers in China. They exert more pressure on companies' environmental and social performances and tend to rely on the media, NGOs and trade unions. The respondents declared that the consumers in China mainly focus on the price and quality of the products. Compared with the legislators, the other stakeholders have been ranked at low positions. The enforcement of CSR reporting guidelines, since they are voluntary standards, will depend on the individual company's willingness and perception of the CSR guidelines. Watch-dogs such as NGOs, media and customers could play important role in the enforcement of voluntary CSR guidelines.

In practice, a factor that hinders the public's knowledge of companies' contribution to CSR is the lack of transparency. The stakeholders do not know how the company's treats to its employees and if they comply with environmental laws or not. If they knew that the treatment of the employees or that the environmental management did not comply with laws and regulations, they could exert their pressure to the companies. The fact that some respondents declared that this is the first time they were interviewed on CSR topics indicates that there is a need for more efforts in relation to informing the public about CSR. This relates both to the legislators and the companies, they have to provide transparent information to the public in an effective and efficient way to promote environmental and social reporting. The purpose of sustainability report is to provide stakeholders with transparent and accountable information about the CSR activities. (GRI, n.d.-d) The results of the survey show that lack of transparency is a weakness. No respondent even mentioned that transparency could be an incentive for CSR.

### **6.3.2 Corporate governance**

For **companies with CSR reports**, the best practice is the leading driving force for CSR reporting within the area of corporate governance. Since mid-1990s, the large sized Chinese companies started to introduce best practices of corporate governance learning from the international companies. All the listed Chinese companies in the Shanghai stock exchange market and Shen Zhen stock exchange market of China have introduced the concept of a board committee including directors and non-executive directors. There is also a supervision committee in place in the listed companies. One respondent declared that CSR as best practice adopted by multinational companies in relation to corporate governance, their company started to work with it from 2003 and published their sustainability report in 2006.

Corporate governance is in a developing phase in China. Before the 1990s, the slogans of Chinese companies focused on the expansion of production. During the middle of the 1990s, profitability was the first priority. From the beginning of 2000s, as the companies and the legislators are facing challenges including environmental and social issues, CSR has been introduced by the government and pioneering companies take CSR as the international best practice in corporate governance under the background of sustainable development. An ethical code is also considered as a leading driving force by the companies with CSR reports. The CSR can be used as a tool for corporate governance by Chinese companies.



For **companies without CSR reports**, corporate strategy is the most important driving force within the corporate governance area. The respondents consider that the concepts of CSR can be used as the company's governance strategy. But in practice, there is still a long distance between the strategy and the implementation of CSR into corporate governance. The answers showed that the respondents have CSR concerns in mind, but there are no detailed measures on how to integrate CSR with the company's governance system and structure.

The answers are different from the respondents with CSR reports. The respondents with CSR reports have integrated CSR within the company's corporate governance system instead of only take CSR as an ethical code of corporate governance. One respondent with a CSR report declared that the department in charge of the CSR issues has a seat in the board in the company's policy making.

### 6.3.3 Human resources

For **companies with CSR reports**, human health and safety are considered as the most important driving forces for human resource issues. For instance, it was declared by the ACC in its sustainability report that the employee health and safety is the first priority in the company's profile. The injury rate of ACC in 2005 is 0.31 per 1000 and death rate caused by accidents is 2.13 per 100 000. Both of the injury rate and death rate are in the middle level compared with world manufacturing industry at the same period. (CHALCO, n.d.-a) All the respondents with CSR reports are state owned companies<sup>25</sup>. In practice, the state owned companies can follow the labour laws and regulations. The employees' welfare such as salary, vacation and pensions are much better than that of small sized private companies.

Employee motivation is ranked in the second position as the state owned companies are facing the same competition as in the market with companies without CSR reports. During the transition from planned economy to a market based economy, the importance of retaining talents is clear even to these large size state owned companies.

For **companies without CSR reports**, motivation and recruitment are the leading driving forces within the human resources areas. They declared that "motivation" is typically connected to improving salary, health and safety insurance as well as vacations. The results indicate that there are changes in the labour market. In recent years, with the rapid development of manufacturing industry, the labour market is changing. On one hand, skilled labour is becoming a scarce resource; on the other hand, new companies are seeking professionals in market.

For the state owned company with CSR reports, traditionally employee health and safety was the most important driving force. The respondents without CSR reports declared that the incentives for human resources come from a business interest. They realized that innovation depends on the talents of skilled technicians.

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<sup>25</sup> State Grid Corporation (CSR Report) is a state owned company which is an electricity producer for the individual households and companies. Aluminum Corporation of China Ltd (Sustainability Report) is a listed company in NEW YORK stock exchange market and HONG KONG stock exchange market owned by the state. Ping An Insurance Ltd (Corporate Citizenship Report) is a listed company in HONG KONG stock exchange market and is a group corporation involved in insurance, banking, securities and investment. It is also a state owned company with foreign shareholders.

### **6.3.4 Environment**

For **companies with CSR reports**, cost reduction is the most important driving force within the environmental area. One respondent declared that they are committed to reduce discharges and improve the recycling rates.

Image is the second most important driving force. High energy consuming and emission discharging companies are criticized by the public in recent years as contributing to the pollution of the environment. As reducing the energy consumption with 20 percent per unit GDP is one objective in the 11<sup>th</sup> Five Year Plan, it will encourage companies to invest in process improvement and innovation to achieve the goals. For instance, ACC has invested more than 3 billion Chinese Yuan (equal to USD 370 million) in process innovation and new technology in order to reduce the discharges and improve the recycling rates from 2002. Now the waste water discharged by its manufacturing factories has been recycled by 100 percent and “zero” discharge of the waste water is one of achievements in the company’s environmental protection. They can benefit from the investment for instance by reducing the production costs and pollution charges. Furthermore, part of the investment will contribute to the local communities, such as investing on re-farming abandoned mining lands for the local communities (the re-farming rate accounts for 98 percent of the entire mining areas). Furthermore, since the company is now recycling 100 percent of the waste water, the previous waste water ponds are cleaned and can be used for breeding fish by the local communities. They have details figures about these achievements in their sustainability report. (CHALCO, n.d.-c)

To the **companies without CSR reports**, the results indicate that getting a license to operate and brand equity are the most important driving forces. One respondent declared that although the requirements of Chinese environmental regulations is lower than the requirements of other regions such as the European Union, the companies are active in process improvements in order to meet the environmental laws from the European Union.

The results of the respondents to the European environmental legislation can be used as an example on how important the legislator is for environmental legislation. However, the challenge is to balance the environmental legislation and protecting a company’s competitive advantage. Traditionally, the authorities in China hold an opinion that a strict environmental legislation could hinder the development of industry and the enterprise would lose the competitive advantages in the international market. The answers of the respondent indicate that strict environmental legislation can lead to process innovation. The companies which meet with the requirements will prevail in the market. This positive loop can contribute to environmental protection and the development of the business.

The difference of both groups is that the respondents with CSR reports have gone beyond environmental legislation and the respondents without CSR reports focused on the getting a license to operate. Significant progress has been made by going beyond legislation, by these companies with CSR reports in regards to their environmental performance.

Both groups emphasised the benefits to the brand equity in relation to the environmental management. Today China is challenged by the serious environmental situation; companies are in the centre of this challenge and are criticized by the public with higher frequency than the past. The growth rate of cases in relation to the environmental pollution to the local community amounts to 29 percent annually. During 2005, there were about 50 000 cases in relation to environmental pollution. (Pan, 2006) Environmental risk management is recognized by more and more Chinese companies especially to companies in the manufacturing industry.

### 6.3.5 Finance

For **companies with CSR reports** credit rate is the most important driving force within the area of finance. Two of the three companies with CSR reports are listed companies, and ACC is a listed company both in the New York Stock Exchange market and Hong Kong Stock Exchange market. The respondents declared that they are facing pressure from international investment institutions.

The second priority is image. As a listed company in the international stock market, CSR performance is one part of the total assets. The respondent declared that besides profitability, environmental and social concerns can contribute the company's credibility with international business partners.

For **companies without CSR reports**, credit rate is also the most important driving force within the area of finance. However, these respondents declared that the incentives come from local commercial institutions. The respondents without CSR reports are small and medium sized companies, and for them, in practice, the Chinese small and medium sized companies have not enough tangible assets to pledge for a loan from the local commercial banks. Therefore, image has to be taken into consideration for the risk assessment by the local commercial banks. However, besides normal business interests, local commercial banks lack commitments to environmental and social concerns. There are also no details indicators related to the environmental and social performance in the credit assessment system. This can explain why the respondents without CSR reports use corporate philanthropy as the most popular way to work with CSR. It is the same as with the national commercial banks. When a company applies for a loan from the national commercial banks such as ICBC, a credit assessment report must be conducted for the bank's credit approval committee. Besides the applicant's financial indicators, they also have to include an environment risk assessment report with any new project. (ICBC, 2002) But in practice, national commercial banks are focused on large sized companies and usually their tangible assets such as factory, lands, and facilities and this is enough for a pledge when they apply for a loan from the national commercial banks. The large sized state owned companies are also backed up by the government and their credit rates are much higher than the small and medium sized companies. Intangible assets such as image or reputation in relation to social and environmental performance are not fully taken into consideration by national commercial banks.

Credit rating is the most important driving force for both groups. But the incentives come from different stakeholders. The incentive to respondents with CSR reports comes from the international financial investors. The incentive to the respondents without CSR reports comes from the Chinese local commercial banks.

Two of the four big national commercial banks are listed on the Hong Kong stock exchange market<sup>26</sup>. The best practice of other international financial institutions in the intangible assets assessment area will influence the Chinese commercial banks' credit assessment systems step by step. The evaluation of the intangible assets such as CSR will become more and more important in the coming years. Another trend which can promote CSR reporting is that more and more international banks invest in Chinese local commercial banks at the city level. The new credit assessment system will also be introduced to these Chinese local commercial

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<sup>26</sup> There are four big commercial banks in China. They are the Industrial and Commercial Bank of China Ltd (ICBC), Bank of China Ltd, China Construction Bank Ltd and Agricultural Bank of China. Up to now, Bank of China and China Construction Bank are the listed companies in Hong Kong stock exchange market. ICBC is planning to go to public in 2006. (China Review News, 2006)

banks.<sup>27</sup> It will promote companies' awareness of CSR and help the implementation of CSR into daily business from the financial perspective in the long term.

Both of the national and local commercial banks are in the transition towards a market based management mechanism. However, risk management systems and marketing strategies are still young and undeveloped. The pathway to sustainable banking will be pursued by the Chinese financial industry with the external incentives such as legislators and internal incentives such as risk reduction and new marketing opportunity on sustainable business.

## **6.4 Conclusion about the leading driving forces**

The results of the survey indicate that the most important external leading driving force is the legislator and the most important internal leading driving force is image in relation to all driving forces.

For the companies with CSR reports, the respondents declared that the legislator is the first priority from a stakeholders' perspective. This indicates that the legislator is one of leading driving forces for CSR issues. One respondent started to work with its citizenship report in 2004, all the others respondents published their CSR reports in 2006 for the first time. The respondents declared that company's environmental and social performance should be compliance with the national sustainable developments policies. One respondent declared that as a state owned company, it has the responsibility to implement the national policy into business.

For companies without CSR reports, the respondents declared that the legislator is the first priority from a stakeholders' perspective, compliance with laws and regulations is their first priority as well from an environmental management perspective. Legislation also included international environmental legislation such as ROHS. From a financial perspective, the answers indicate that there are pressures from the local commercial banks. As CSR can contribute to the company's intangible assets, the local commercial banks are starting to take the company's image into consideration in the credit rate assessment process.

Based on the above analysis, the stated importance of each driving forces are illustrated as follows:<sup>28</sup>

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<sup>27</sup> Local commercial banks usually mean the medium and small sized regional commercial bank in the city level. They focus on the local medium and small sized clients. Most of the local commercial banks are limited to their business in the city region.

<sup>28</sup> The legislator stands for the legislator and legislations.

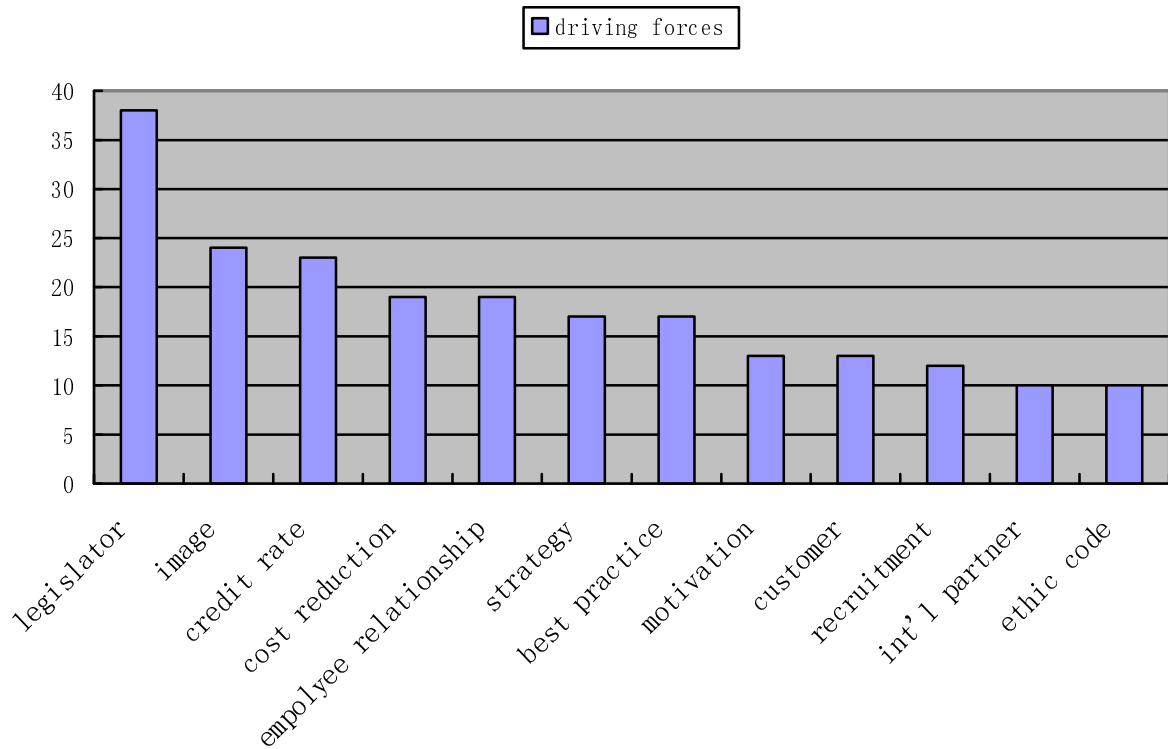


Figure 6-1 the Order of the Driving Forces for CSR Reporting

Figure 6-1 shows that the legislator plays the dominant role in the promotion of the CSR in China today. Then follows the driving forces of image, credit rating and cost reduction. The external leading driving forces come from the government and financial institutions. The internal leading driving forces come from image and cost reduction.

## **7 Discussion and conclusion**

With the economic boom and industrial activities increasing at a rapid pace, the environmental problems that accompanied developed countries during different phases of their 100 year long industrialization, have now occurred in China all at the same time. China is faced with shortages of natural resources, a fragile ecological environment and insufficient environmental capacity. (SEPA, 2006-c) The World Bank has predicted that China's growing reliance on imported oil, its increasing pollution and looming water shortages could hinder further economic development. (WBCSD, n.d-a)

Based on the analysis of the driving forces, we understand that the legislator plays the dominant role in current CSR work. The other external drivers such as financial institutions and employees also influence the respondents significantly. On the other hand, the customers and international business partners have been considered as low priorities by the respondents. The respondents consider CSR as a tool for building image in relation to these holders. Cost reduction and corporate strategy are also internal driving forces for CSR.

The climate of CSR reporting in China is positive today. The legislators are active in promoting CSR in China with different channels, such as legislation, voluntary CSR guidelines and taxation regulations. CSR is also one of the long term themes on sustainable development by the central government. Some of the pioneering companies have published CSR reports and a majority of companies are becoming more awareness of the CSR concepts.

### **7.1 Discussion of driving forces in China**

#### **7.1.1 Stakeholders**

As explained in Chapter 6.3.1., some Chinese companies could not follow environmental standards due to the uneven implementation of environmental legislations in different regions. This situation has been changed in recent years. The implementation of legislation will be stricter in the future. Already from 1996 to 2000, 84 000 small sized enterprises that caused serious pollution have been closed down. During the period 2001 to 2004, the industries with high rates of resources consumption and waste generation, such as iron and steel, cement, electrolytic aluminum, coking and iron alloy, were restructured and 1 900 new projects related to these industries were either stopped or postponed. In 2005, 2 600 companies in the iron and steel, cement, iron alloy, coking, paper and textile industries were closed down for having caused serious environmental pollution and violated industrial policies. The technical transformation and technological innovation has been carried out in these industries to meet the current environmental standards. (SEPA, 2006-g)

Besides the implementation of laws and regulations at the national level, similar measures are also adopted by the government at the city level. For instance Beijing has taken different measures to control air quality since 1998. This includes the use of natural gas, district heating, geothermal resources and energy saving architecture. Regulations of vehicle emissions are tighter than in the past. More than 300 000 old vehicles were scrapped and the national emission standard which equals the European Standard III was adopted by the Beijing city in 2005 ahead of the national schedule. (SEPA, 2006-h) More than 100 enterprises in the center of the city that caused pollution have been closed down or move out. All these efforts contribute to the improvement of air quality in the city. Both the central government and local governments are aiming to enhance the implementation of laws, regulations as well as different administrative measures to improve environmental management.

Legislation will be also tougher than in the past. For instance, as explained in Chapter 3.4.1., the regulation on the management of electronics products was published by the Ministry of Information Industry of P.R.C. (MII) aims to control and reduce the hazardous substances in electronic products looking at the design, manufacturing, and consumption and recycling. This indicates the trends of future legislation in China. (MII, 2006-b)

The industry policies will focus on sustainable development such as reducing consumption and improving recycling rates from the discharges. Three steps have been planned to reach the goals by the national legislators. The first is to engage in cleaner production to improve the efficiency in the usage of material and reduce the discharges. A producer responsibility system will also be established and extended to cover the designing phase in order to improve product design. So far, over 5 000 companies related to chemicals, power generation, coal and building materials have passed the examination for cleaner production. More than 12 000 companies in China are certified with ISO14000. More than 800 companies with 18 000 kinds of products are certified by the Chinese environmental labelling certification. The second step is the promotion of industrial ecology within industrial districts so that the wastes from the upstream companies can be reused as raw materials by the downstream companies. This can improve the efficiency in usage of materials and minimize waste discharges. At present, 17 industrial ecology parks have been set up in China. The third step is to balance consumption and production, industrial and agricultural and the development of cities and rural areas. In order to achieve sustainable production and consumption, the central government has conducted a pilot cyclical economy program in 82 companies. (SEPA, 2006-i) All the initiatives indicate that China is beginning to look at sustainable issues. The concepts of industrial ecology and sustainable consumption and production have gone beyond waste management and recycling and towards preventative environmental strategies.

Besides these environmental initiatives, employee health and safety as well as labour rights are also highlighted by the Chinese labour department. Improving quality of life is one of the major goals of 11<sup>th</sup> Five Year Plan such as increasing income levels, improving housing, transportation and educations conditions. (Kwan, 2005) There is more and more pressure on companies to comply with the labour laws and regulations. From the legislative perspective, a new draft of the Labour Law is a step towards improving labour working conditions. As China is speeding up to a free market economy, the responsibility of companies in relation to housing, education and welfare has been transited from companies to the government or a market based insurance system. The new draft of the Labour Law is aiming to specify the responsibilities of the employers and rights of the employees based on the labour contract and to avoid employers abusing rights. Details terms and conditions related to contracts such as termination of the contract, working hour and wages have been designed in the new draft of the Labour Law. The implementation of these policies will minimize the gap between the high income and low income.

The Chinese central government has recently stressed the need for taking more concern in environmental and social costs of economic growth. China's 11<sup>th</sup> Five Years Plan includes a renewed effort to build a prosperous society in a balanced way and this can be seen as milestone for sustainable development from the legislator perspective. The resources saving, reduction of pollutants as well as the emphasis on putting the human first in the development of society are concrete measures to be taken in the future policy making. Detailed figures targeted in the Five Year Plan such as 10 percent reduction of air emissions, 20 percent incense of forest coverage and an addition of 100 million people access to safe drinking water indicate that the goals are part of sustainable development strategy. (SEPA, 2006-j)

From the abovementioned figures and progress in the implementation of laws and regulations, we can predict that future trends of implementation will be tougher. The survey also indicates that the companies have a willingness to meet national and international standards as legislation is on the top of their agendas. However, what they need is the same level playing ground for all. Both from an environmental and a society perspective, the cost for the legislators to protect the companies with lower environmental and social standards can not be afforded in the long run. Also there is no way for the legislators to protect the Chinese companies in the international market by lowering national environmental and social standards.

The survey indicates that the Chinese consumers do not exert much pressure on companies in relation to CSR activities. The current situation will most probably change in the future. From the legislative perspective, as explained in Chapter 3, the Environmental Impact Assessment Law of P.R.C. stipulates that an environmental impact report must be conducted and reported to the local environmental bureaus. The Provisional Measures for Public Participation in Environmental Impact Assessment assures that there is public participation in the decision making process.

Other initiatives can also improve the public awareness of environmental issues. For instance, the Chinese central government has put development of eco-agricultural on the agenda. The national standards for good agricultural practice (GAP) have been released and GAP certification has been implemented to promote organic food. At present, there are 102 national level eco-agricultural counties and 233 national level eco-agricultural zones. This improves the awareness of food safety directly to the consumer as well as the environmental concerns. (SEPA, 2006-h)

Different environmental education programs have been launched by the central government such as the National Action Program for Environmental Publicity and Education (1996-2010). Local neighborhoods, schools and families are involved in the program and so far 25 000 primary and middle schools have participated the education program. (SEPA, 2006-i) All these efforts can enhance public information and participation. The public can access more transparent environmental information with the implementation of the abovementioned initiatives. The companies with sound environmental and social performance will be rewarded by the market as the consumers become more awareness of environmental and social issues.

The number of domestic NGOs, such as the Center for the Protection of Migrant Worker's Rights and the Institute of Contemporary Observation which focuses on CSR issues in China, is growing. It is reported that the Chinese government is increasingly willing to consult with international NGOs. The international NGOs with sub offices in China grow year by year. Campaigning NGOs such as Oxfam, the Global Alliance for Workers and Communities, Greenpeace and WWF play an important role to improve the environmental and social awareness. (WBCSD, 2005-b) They can introduce best practice from the international level to China and work with local stakeholders on environmental and social issues. There is also more interest from media to cover environmental and social issues especially news on the internet. With the influence of the NGOs and the focus of Chinese government shifted to the environmental and social concerns, the media will be also more open to the sustainability issues.

With the growth of environmental and social responsibility movements in China, the audience of CSR report has broadened. The Chinese government started to value the role of Chinese companies can play in the sustainable development society. The consumers will be more and more aware of CSR concept. The expectations from stakeholders for transparency are rising



and nothing sensitive can stay secret long due to the revolution of communication as explained in Chapter 2.3.1. Chinese companies can use CSR reporting as a useful tool to enhance transparency and build up trust with stakeholders, such as legislators, consumers, financial institutions, business partners, employees and NGOs. As one respondent with a sustainability report declared, they can benefit from their sustainability reporting as it can enhance the understanding with customers and business partners especially the international business partners. Besides this direct commercial interest, the respondent also mentioned the long term corporate benefit in the national and international market with the aim of expanding their business. The respondents without CSR report mentioned that CSR reporting could build up credibility with local commercial banks and enhance the relationship with employees.

### **7.1.2 Corporate governance**

As explained in Chapter 6.3.2, respondents recognized that CSR, as international best practice in relation to corporate governance, can contribute to the implementation of company's policies, reporting procedures into daily business. Respondents also mentioned that CSR can be used as a corporate strategy, ethic code and education tool to the employees in relation to corporate governance.

In China today, with more and more concerns of social and environmental issues by legislators and awareness of CSR concepts by broad stakeholders, Chinese companies can benefit from sound corporate governance which is build on an understanding that a company will be compliant with all laws and regulations in relation to CSR. It can help a company to ensure the long term viability or get a license to operate. The examples explained in Chapter 7.1.1, for these companies had been closed down by SEPA, it is because the violation of environmental legislation instead of non-profitability.

Corporate governance can also used by Chinese companies as a tool for risk management. Especially to the non-financial risks, CSR widens the field of risks and provides effective measurements in relation to a company's risk management. As explained in Chapter 4.2.2., the listed Chinese companies mainly focus on financial performance in their annual reports. Chinese company can benefit from integration CSR into corporate governance and demonstrate its wider role in society than simply making profits, such as secure supply of products and services to improve quality of life for society, investment in environmental technology and provision of employment. It can add value to Chinese companies' business beyond reputation management and through maintaining the license to operate in the long term.

### **7.1.3 Human resources**

The respondents mentioned that a company can benefit from CSR reporting in relation to human resources such as health and safety, recruitment and motivation. All these activities are limited to the necessity of labor laws or minimum requirements such as salary, pension, insurance and vacation, etc. (explained in Chapter 6.3.3.) Chinese companies can benefit from more than recruitment if they can move towards a sound work and life balance<sup>29</sup> by providing a less stressful and happier environment for its staff. This can be illustrated by the fact that 70 percent of all sickness absence in the UK workplace is related to stress and it is equal to 370

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<sup>29</sup> Work-life balance described by Yarnall was the balance between work such as source of income, vocation, purpose, career and life such as family, friends, leisure, learning and self. A sensible balance between work and life can help retain the best workers. (Yarnall, 2005, p.136)

million UK pounds in lost business. (Yarnall, 2005, p.137) Chinese companies can demonstrate their social responsibility if they recognize that their staff have social interests and family responsibilities outside of work. A sound integration of CSR into the human resources area can push productivity up and bring costs down. With today's fluid labor market in China, a company's social concerns on human issues can help retain the best workers and reduce retraining cost.

CSR concerns in relation to human resources area can help Chinese companies to scan labor right risks in international market as well as national market. The case explained in Chapter 3.4.2 indicates that lack of CSR concern to their staff within domestic market can also be affected by international business partners through supply chain management. With the expansion of business world wide, Chinese companies will face human rights issues in a more formal way than might be expected by Chinese stakeholders. In 2005, the new joint ventures and foreign invested companies approved by the MCC amount to 44 001 in China. (Ding, 2006) With the rapid rising levels of foreign investment in China, the flow of China's investment abroad also sparked interest in the world. The United Nations Conference on Trade and Development mentioned in its 2002 World Investment Report that the top 12 Chinese enterprises controlled USD30 billion in foreign assets with over 20 000 foreign employees. The performance of CSR by Chinese companies is also a concern with the international stakeholders. (Frost & Ho, 2005, p158) CSR has been integrated into daily business by more and more international companies. Chinese companies' performance in relation to CSR in the international market is also a concern by international stakeholders. The issues such as human rights will affect company's reputation as well as the share price.

Both from national and international perspective, Chinese companies can benefit from their sound social performance in relation to labor practices and human rights. Internationally well recognized standards such as the Conventions of the International Labor organization (ILO) and instruments such as the United Nations Universal Declarations on Human Rights and its Protocols can help Chinese companies manage human right risks in international market and improve labor practices and rights in national market.

### **7.1.4 Environment**

Chinese companies today are focusing on complying with environmental legislation in relation to environmental issues. (discussed in Chapter 6.3.4) Respondents with CSR reports declared the benefits from integration CSR into environmental management such as enhancement brand reputation and reducing cost through environmental innovation. Beyond complying with legislation, CSR can be used as a tool by Chinese companies to manage environmental risks such as legal risks and "political" risks. Legal risks cover legal requirements on industry such as standards, operation requirements and environmental liability. "Political risks" cover the public concerns about potential environmental and ecological impacts of technology on health and well-beings. (Liu, 2004, p.50) Environmental risk management can help Chinese companies manage intangible assets such as reputation or image.

Sound environmental management such as cleaner production can contribute to a company's direct business interests such as reducing manufacturing cost, improving recycling rate and minimizing discharges as well as indirect interests such as company's image, long term business growth and customer loyalty. For instance, a joint project of the National Environmental Protection Authority (NEPA)<sup>30</sup>, the United Nations Environmental Program

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<sup>30</sup> NEPA became the State Environmental Protection Administration (SEPA) in 1998 to a high administrative level aiming to enhance environmental protection. (SEPA,2006-k)

(UNEP) and World Bank demonstrated that even relatively poor Chinese companies can achieve business benefits by improving environmental managements. The results indicated that annual economic benefits of USD2.9 million had been achieved from adoption UNEP's cleaner production methodology in 27 enterprises that required little or no investment. These enterprises produced an average pollution discharge reduction of 30 percent to 40 percent. The cleaner production audits to these enterprises identified more than USD215 million savings a year on an investment of only USD200 million. (DeSimone and Popoff, 1997, p148) Chinese companies can use CSR reporting as an internal management tool in relation to cleaner production as reporting indicators cover input (material, energy, water) and output (emissions, influents, discharges).

### 7.1.5 Finance

Both groups of respondents declared, CSR reporting can contribute to a company's credit rating (explained in Chapter 6.3.5). This means that Chinese financial institutions are potential drivers for CSR reporting in China. The survey indicates that the local commercial banks are starting to take intangible assets such as image and reputation into consideration in credit risk assessment. The situation is changing rapidly with the policies of the national commercial banks. To the large sized national financial institutions, the policies for lending to companies with high pollution, high energy consumption and low efficiency in natural resources usage is becoming stricter. For instance, the ICBC has started to re-assess the current risks of companies with the abovementioned characters from August of 2006 and new loans to these companies are stricter to industries such as steel, pulp and paper, small sized mining, coal power, etc. (Liu, 2006, interview by email). The trend will continue along this path in the future. In order to assess environmental and social risks, more and more environmental and social indicators will be adopted by national commercial banks such as the environmental risk assessment for the project finance. The trend will be the same for the local commercial banks in the future.

There are also market based incentives in relation to CSR concerns. China has already become one of the world's largest oil importers. It is estimated by the World Energy Council that China will import 400 million tons of petroleum by 2020 in China. The energy consumption will increase to about 4.5 billion tons of coal equivalents by 2020 if the economic growth rate keeps the speed as planned in next decade. The same goes in relation to the raw materials consumption in China. The history of raw materials industries "*rewritten by China*" was the conclusion of the Association of German Industries at the Raw Materials Congress in Berlin in March 2005 (WEC, 2005). Facing such a rapid growth of demand of raw materials, the materials saving targets will have to be tougher in the future, through efficiency and conservation. Energy efficiency remains a key policy objective. Besides the national administrative plans and policies, there are also market-based incentives as the price of raw materials are increasing in recent years in China such as coal, iron ore, etc. More and more companies will probably take the CSR as a business opportunity and create proactive strategy in the coming future.

## 7.2 Conclusion

Chinese companies have achieved progress on CSR reporting in recent years. From the mandatory environmental reporting in 1989 to the voluntary environmental reporting to the public in 2003, the audience of environmental reporting covers the local environmental protection bureaus and the public. In 2006, with the issuance of voluntary guideline of CSR reporting, CSR reports have been published by the pioneering Chinese companies.

The legislator plays the dominant role in relation to CSR today. There are laws and regulations related to CSR as well as voluntary CSR reporting guidelines issued by the legislators and central government. The theme of the national policy such as 11<sup>th</sup> Five Year Plan aims to achieve sustainable development in China. CSR has been highlighted by the central government as a tool to approach sustainable development for Chinese companies. In recent years, the implementation of these laws and regulations is becoming tougher and tougher. Thousands of companies, which caused serious pollutions, have been closed down by the government. Projects which do not comply with the environmental impact assessments have been closed or postponed by SEPA. In 2005, over 2 600 companies were closed down due to environmental pollution. (SEPA, 2006-g) The social issues such as balance of high income and low income, as well as the developed regions and underdeveloped regions are also highlighted by the central government in recent years. Detailed measures have been designed such as a redrafting of the Labor Law, improving working conditions, and minimum salaries.

Chinese financial institutions are also becoming more active in relation to environmental and social concerns. For local commercial banks, the intangible assets such as a company's image have been taken into consideration in the credit assessment process. To national commercial banks such as ICBC, things are changing rapidly. The risks of companies with high pollution, high energy consumption and low efficiency in usage of natural resources started to be re-assessed in August of 2006 and the loans to these companies are limited. The industries with the abovementioned characters are considered as non-compliant with national sustainable development policies by the national commercial banks. In the future, further steps will push broader environmental and social risk assessments and socially responsible investment within Chinese commercial banks.

Chinese companies realize that CSR can enhance the company's image and they can benefit from CSR activities in the local community, with financial institutions and local government agencies. All the interviewees agreed that the company is a part of the local community and the company needs support from the local planet. CSR has been used as a tool to establish public relationships by Chinese companies. The current situation of Chinese companies engaged in CSR activities is in reactive phase. The respondents without CSR reports declared that environmental legislation is their first priority in relation to CSR. It means that the respondents are under the pressure from the legislators related to environmental and social issues. With the enhancement of implementation of environmental and social laws and regulations, beyond legislation will become the mainstream of the Chinese companies under the increasing awareness of the environmental and social concerns. Sustainable development has been a theme of the Chinese economic development in recent years as well as the vision of Central Government of P.R.C. for the 21<sup>st</sup> century. The China's Agenda in 21<sup>st</sup> century is designed by the Central Government of P.R.C. and based on the sustainable development concept which highlights the balance of economic development, environment and society. (China's Agenda, n.d) CSR, as a sustainable development strategy, has been adopted by pioneering Chinese companies to approach the sustainable development. Facing the environmental and social challenges, the Chinese companies are moving towards sustainable development and the pioneering companies published CSR reports on their journey toward SD.

This thesis has focused on the driving forces for CSR reporting. The Chinese central government is shifting from focusing on single economic growth to a sustainable

development. The “*harmonious society*”<sup>31</sup> is the goal of the Chinese economic development in the future proposed by the central government in the 11<sup>th</sup> Five Year Plan. A future research question that would be interesting is how to implement CSR into daily business and how to assure compliance. These are questions that are currently challenging Chinese companies and legislators.

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<sup>31</sup> The words “*harmonious society*” proposed by the Central Government of P.R.C. in the 11<sup>th</sup> five year plan means that the balance of the economic development, the environment and the society. To the society perspective, it stands for the even development between the west and east region, the balance of the rich and the poor in China. (People’s Daily, n.d.-b)

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## **Abbreviations**

AIDS	Acquired Immunodeficiency Syndrome
CBCSD	China Business Council for Sustainable Development
CEC	China Enterprise Confederation
CPCC	China Petroleum and Chemical Corporation
CSR	Corporate Social Responsibility
CSRC	China Securities Regulatory Commission
DJSI	Dow Jones Sustainability Indexes
EIA	Environmental Impact Assessment
FTSE	Finance Times Stock Exchange
GRI	Global Reporting Initiative
MCC	Ministry of Commerce of P.R.C.
MII	Ministry of Information Industry of P.R.C.
MNC	Multinational Company
NGO	Non Government Organization
ROHS	Restriction of the Use of certain Hazardous Substances
SEPA	State Environment Protection Administration
SGCC	State Grid Corporation China
SRI	Social Responsible Investment
WEEE	Waste Electrical and Electronic Equipment



## Appendix-1 The list of companies with CSR disclosure

	Sector	Website	Main Business
East Hope Group	Manufacturing industry	<a href="http://www.easthope.com.cn">http://www.easthope.com.cn</a> (Chinese)	Feed manufacturing Alumina manufacturing Investment
China Huaneng Group	Electricity industry	<a href="http://www.chng.cn/minisite">http://www.chng.cn/minisite</a> (Chinese)	Electricity
Jigang Group	Manufacturing industry	<a href="http://www.jigang.com.cn">http://www.jigang.com.cn</a> (Chinese)	Primary steel products
Shanghai Motor Group	Manufacturing industry	<a href="http://www.china-sa.com">http://www.china-sa.com</a> (Chinese)	Motor
First City group	Real estate development	<a href="http://www.cdfirstcity.com">http://www.cdfirstcity.com</a> (Chinese)	Real estate construction
China Petroleum & Chemical Corporation	Petroleum industry	<a href="http://www.sinopec.com">http://www.sinopec.com</a> (Chinese)	Petroleum exploration refinery
Zhjiang Medicine Co Ltd	Manufacturing industry	<a href="http://www.china-zmc.com">http://www.china-zmc.com</a> (Chinese)	Medicine
China South Air	Transportation industry	<a href="http://www.cs-air.com.cn">http://www.cs-air.com.cn</a> (Chinese)	Air line operation
Strong Food Company	Manufacturing industry	<a href="http://www.strongfood.com.cn">http://www.strongfood.com.cn</a> (Chinese)	Food
Hair Group	Manufacturing industry	<a href="http://www.haier.com">http://www.haier.com</a> (Chinese)	Electronic household appliance

Source: *Company Finance (Sina, n.d.-b)*



## **Appendix-2 The list of participating companies**

Aluminium Corporation of China

Amoi Corporation

China Pingan Insurance Ltd

Continent Strategies and Information Service Ltd

Lunbo Lighting Materials Ltd

Quanqing Tele Ltd

State Grid Corporation

Shandong SSYMB Pulp and Paper Ltd

Shandong Motor Company

Tianhe Import and Export Company

## **Appendix-3 the list of questionnaires**

### **Questionnaire 1** (general questions on CSR reporting)

Question1.

What is the property of your company?

Question2.

What is your definition about CSR?

Question3.

Does your company engage in CSR activities?

Question4.

Do you think your company can benefit from the CSR activities?

Question5.

How does your company report the CSR activities?

### **Questionnaire 2A** (for company without CSR report)

Question1.

Do you think that environmental and social disclosure could contribute to your company's business?

The driving forces for social and environmental disclosure usually come from company's responsible business considerations. It mainly includes environment, human resources, stakeholders and corporate governance.

Question2.

What do you think your company could benefit from environmental disclosure?

First priority:                      Second priority:                      Last priority:

Question3.

What do you think your company could benefit from social disclosure?

First priority:                      Second priority:                      Last priority:

Question4.

Do you think your company can benefit from the social and/or environmental disclosure in the financial market?

First priority:                      Second priority:                      Last priority:

Question5.

Who is the activist for social and/or environmental disclosure according to the company's stakeholders?

First priority:                      Second priority:                      Last priority:

Question6. Do you think social and environmental disclosure can contribute to your company's governance?

First priority:                      Second priority:                      Last priority:

**Questionnaire 2B** (for company with CSR report)

CSR has been used as tool for promoting sustainable business worldwide by multinational companies since 1980s. It has been recognized as an essential part of business by more and more companies instead of an add-on.

Question1.

Do you think that CSR reporting could contribute to your company's business?

The driving forces usually come from company's environmental, social and business considerations. It mainly includes environment, human resources, stakeholders and corporate governance.

Question2.

What do you think your company could benefit from environmental reporting?

First priority:                      Second priority:                      Last priority:

Question3.

What do you think your company could benefit from human resources reporting?

First priority:                      Second priority:                      Last priority:

Question4.

Do you think your company can benefit from CSR reporting in the financial market?

First priority:                      Second priority:                      Last priority:

Question5.

Who is the activist for CSR reporting according to the company's stakeholders?

First priority:                      Second priority:                      Last priority:

Question6.

Do you think CSR reporting can contribute to your company's governance?

First priority:

Second priority:

Last priority: