



FACULTY OF LAW
University of Lund

Jennie Knutsson

Corporate Social Responsibility
The Implementation of Corporate Codes of
Conduct in the Global Supply Chain

Master thesis
20 points

Supervisor
Katarina Olsson

Field of study
International Law & Business Management
(Corporate Law)

Fall 2003

Contents

SUMMARY	1
ABBREVIATIONS	3
1 INTRODUCTION	4
1.1 Presentation	4
1.2 Purpose	6
1.3 Delimitation	7
1.4 Material, methodology and theory	9
1.5 Outline	10
1.6 Definitions	11
2 GLOBALIZATION AND MULTINATIONAL CORPORATIONS	14
2.1 Globalization	14
2.2 The multinational corporation on a global stage	15
2.2.1 Changing forms of business operations	16
2.2.2 Small and medium size enterprises	20
3 CSR AND BUSINESS BENEFITS	21
3.1 Corporate social responsibility	21
3.1.1 The concept and elements of CSR	21
3.1.2 CSR on the agenda	23
3.1.2.1 The ILO's Tripartite Declaration of Principles 1977	24
3.1.2.2 The Global Compact, 2000	25
3.1.2.3 The OECD Guidelines for MNCs, 2000	26
3.1.2.4 The Global Reporting Initiative, 2000	27
3.2 New legal challenges in business management	27
3.3 CSR and the business case	29
3.3.1 Changes in business thinking	30
3.3.2 Society's new demands	32
3.3.3 The business benefits	34
3.4 Concluding discussion	36
4 CORPORATE CODES OF CONDUCT	42
4.1 Historical development	42
4.2 Types of corporate codes of conduct	44
4.3 Code content	46
4.4 Implementation of corporate codes of conduct in the global supply chain	47
4.4.1 Contractual, internal and external monitoring	48
4.4.2 Implementing guidelines	49
4.4.3 Remedial processes	49

5	ANALYSIS	51
5.1	Industry structure and stakeholder attitudes towards CSR and codes of conduct	51
5.2	Implementation of supplier codes of conduct in the global production chain	55
6	CONCLUSIONS AND IMPLICATIONS FOR THE FUTURE	61
	BIBLIOGRAPHY	64
	TABLE OF CASES	72

Summary

Globalization and trade liberalization have altered the premises for international business operations and changed the sources for competitiveness and business success. It has become increasingly important for corporations to build deeper and strategic relationships with business partners, employees and customers, to develop a favorable reputation in social issues and to be trustworthy in the eyes of society. Multinational corporations (MNCs) increasingly focus on their core business competencies and outsource complementary operations. The result is a development of complex networks of MNCs, suppliers and subcontractors; a new business organization characterized by short-term and fast-changing relationships. MNCs are increasingly held legally, socially and economically accountable for inferior labor and human rights practices throughout the supply chain. The growing trend to require corporations to take greater social responsibility for their business operations has resulted in corporations formulating their own corporate codes of conduct in order to achieve better social performance in the global supply chain. This thesis examines the different barriers and challenges present in the current implementing system of voluntary corporate codes of conduct in the global supply chain.

Corporate codes of conduct are principally voluntary initiatives undertaken by the private sector in order to address various social issues. In contrast to legislation the corporate code of conduct requires a positive commitment by the corporation before it applies. Corporations will not adopt codes and work for their implementation only for altruistic reasons. The corporation has to be convinced that being socially responsible makes not only sound ethical, social and legal sense but also business sense. The views whether there is a link between corporate social responsibility (CSR) and enhanced financial performance for the corporation (“the business case”) or not are parting. Mostly this is due to a lack of conclusive research and quantitative data. However, corporations increasingly respond to public pressure as if it has powerful financial impacts. Increasingly corporations are acting like they are convinced that being socially responsible means better financial performance for the corporation – in the long run. Statements declaring the importance of CSR by corporate executives and investors show a change in business thinking. Several factors, evoked by new social expectations and demands from society, indicate that ethical and social consciousness is good for business. Creating a reputation of being socially responsible has become crucial for competitiveness and market positioning of the corporation. Other potential benefits are related to customer satisfaction and loyalty, good investor relationships and access to capital, employee recruitment and decreased risk of litigation.

If corporations realize “the business case” voluntary corporate codes of conduct have the potential to serve good social purpose. The adoption of

corporate codes is relatively wide spread among corporations. The challenge today lies in how companies are to formulate and implement the codes. For corporate codes of conduct to be effectively implemented in the global supply chain it is important to look beyond monitoring procedures. The voluntary corporate code is a flexible tool to address social concerns, which have no “one-size-fits-all” solutions. The code offers the corporation a means to form solutions to the special needs and public concerns of the individual corporation and its stakeholders. However, there are substantial flaws with the inherent system of code development and implementation. The codes are predominantly formulated and applied unilaterally by the MNC authoring the code. Suppliers and their workers need to be more involved in the development and implementation of the codes. Furthermore there is a need for harmonization of codes and increased consensus regarding its application procedures. The multitude of codes imposed on suppliers from different MNCs are also likely to be inconsistent as to their code content and standards. Duplication of codes may cause inefficiency on behalf of the supplier as multiple auditing and inconsistent auditing procedures, management requirements and remedial processes increase transaction costs.

The source of many of the difficulties associated with effective implementation of corporate codes of conduct in the global supply chain is to be found in the structure of the industry. Long and complex value chains with multiple layers of suppliers and fast-shifting relationships characterize the present business model. The nature of the supply chain causes difficulties in building trust between the MNC and its stakeholders.

Abbreviations

ACCA	Association of Chartered Certified Accountants
CEO	Chief Executive Officer
CSR	corporate social responsibility
EBBF	European Baha’I Business Leaders Forum
FDI	foreign direct investment
FLA	Fair Labor Organization
GC	Global Compact
GRI	Global Reporting Initiative
IBE	Institute of Business Ethics
IBLF	International Business Leaders Forum
ICHRP	International Council on Human Rights Policy
IEA	Institute of Economic Affairs
IGO	Inter-governmental Organization
IIED	International Institute for Environment and Development
ILO	International Labor Organization
JSE	Johannesburg Stock Exchange
MNC	multinational corporation
NGO	Non-governmental Organization
OECD	Organization for Economic Co-operation and Development
RIIA	Royal Institute of International Affairs
SME	small and medium size enterprise
TNC	transnational corporation
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
WBCSD	World Business Council for Sustainable Development
WIR	World Investment Report

1 Introduction

1.1 Presentation

“Changes, changes, and more changes.”
Chief Executive Officer (CEO), Chile

“We need to embrace change in a more proactive way. We must get our workforce to welcome change as an opportunity rather than as a threat.”
Chief Executive Officer, United Kingdom¹

Increasingly corporations are under pressure from non-governmental organizations (NGOs), investors and society to impose social standards along their global business operations over which they have some leverage. Particularly this concerns the global supply chain. Corporate social responsibility has become one of the most important topics on corporations' management agendas. Research findings show that the business community, including corporate executives, has strong beliefs in the importance of CSR. According to a global survey from 2003 CEOs emphasize the importance of regaining trust among investors, customers, employees and other key stakeholders. Moreover, 79% of more than 1,000 CEOs in 43 countries agreed that *“sustainability – adding economic, environmental, and social value through core business functions – is vital to the profitability of their companies.”* As many as 71% would even, when implementing CSR practices, consider sacrificing short-term profitability in exchange for long-term shareholder value.²

The concept of CSR and the implementation of social standards in business operations are very complex. Multiple different codes and standards and other initiatives on CSR together with a diversity of different expectations from NGOs, investors and society as a whole create confusion. Even if business leaders agree on the importance of putting social issues on their corporate agendas they are nevertheless confused about what tools or tactics to adopt in order to put theory into practice.

As corporations increasingly have gone global and expanded their operations beyond national borders it has become practically impossible to regulate corporate behavior through national legislation alone. As yet, no legally binding framework of laws or standards has emerged at the international level to hold MNCs accountable for their operations in countries where they conduct business. A binding international framework is a long-term process and perhaps it will be reached in the future. Foreign

¹ Cited in: *“CEO Survey: Leadership, Responsibility and Growth in Uncertain Times”*, 6th Annual Global CEO Survey, PricewaterhouseCoopers, 2003, pp. 31-32.

² *“CEO Survey: Leadership, Responsibility and Growth in Uncertain Times”*, pp. 31-32.

MNCs often have a tremendous impact on the developing countries where they operate. Often the host country is dependent on the MNC for jobs and the inflow of currencies are needed to pay off foreign debts. Many developing countries often lack the democratic institutions necessary to control corporate power and civil society, represented by NGOs and other interest groups, often is weak and repressed. This leaves the MNCs to operate quite freely. Absent global or even national standards, how should a company operating in a developing country behave?

The trend today is to consider corporate or industry self-regulation in the form of voluntary initiatives as an appropriate way to set global standards. Corporate self-regulation is often defined as a voluntary approach to CSR. However, to simply talk about “voluntarism”³, is somewhat misleading. Rather I would like to use the perspective offered by Simon Zadek and Maya Forstater, saying that corporate self-regulation is about companies responding to an organic “civil regulatory framework”.⁴ Corporations are increasingly faced with public pressure to take responsibility for their actions. The sources for success and competition have changed and a corporation’s intangible assets such as reputation and brand image have become crucial managerial tasks. Investors are starting to ask corporations to justify their global operations and the risk those impose on shareholders. Thus the business community is starting to acknowledge that corporate negligence in social issues may be devastating not only for workers and communities in developing countries but also crucial for the survival of the corporation itself. Corporations are increasingly held socially, legally and, consequently also economically, accountable for their operations in developing countries.

The development of complex supply chains and changing social expectations have resulted in companies looking more strategically at supply chain management. Supply chain management has traditionally been considered a control and cost cutting concept. Today the supply chain is a source of risk as well as innovation. Corporations are increasingly held responsible for inferior labor and human rights practices in their own global operations as well as in the operations of their independent suppliers. In a response corporations compose their own corporate codes of conduct in an attempt to channel labor and human rights standards into the operations of suppliers, subcontractors and other business partners where standards are non-existent or incomplete.

³ I will hereinafter, for the sake of simplicity, use the term “voluntary” in my discussions, even if I consider it to be somewhat misleading in a broader context.

⁴ Zadek, Simon and Forstater, Maya, “Making Civil Regulation Work”. In: Addo, Michael K (ed.), *Human Rights Standards and the Responsibility of Transnational Corporations*, 1999, pp.69-75.

1.2 Purpose

The overall objective of this thesis is to make an evaluation of corporate self-regulation in the global supply chain. The aim is to make a general assessment of different types of barriers and challenges present in the current implementing system of voluntary corporate codes of conduct. I seek to move “beyond monitoring” and address implementation barriers, which might prevent achievement of better social performance in the global supply chain, in a broader context.

From the view of the MNC the supply chain constitutes a potential risk. The risk might stem from investor demands, future legislation or consumer dissatisfaction. For a voluntary approach to corporate accountability to be successful the risk of not acting must be high enough to warrant companies to act. Hence, within the voluntary nature of corporate codes of conduct lies that these codes always need a positive commitment by a company before they apply effectively.⁵ Since implementation of voluntary corporate codes of conduct first and foremost is dependent upon a positive commitment on the part of the MNC I have chosen a two step approach for this thesis. First the potential grounds for a positive commitment on the part of the MNCs will be discussed. Thereafter I will assess the development of corporate codes of conduct, their special features and the implementing system.

The voluntary adoption of codes is premised on two beliefs. Firstly, the belief that corporations respond to new social demands. Secondly, the belief that good social performance makes sound business sense as well as social, ethical and legal sense. The growing number of individual and industry codes of conduct shows that corporations respond to new social expectations. The views whether it means enhanced financial performance for the corporation to invest in CSR by adopting and implementing a code of conduct are parting. Mostly this is due to the lack of conclusive research and quantitative data regarding the subject. As yet no strong and casual link has been made between CSR policies and financial indicators (e.g. share price, stock market value, return on assets). In the absence of such quantitative data, most discussions concentrate on the qualitative aspects of CSR, such as risk and opportunities, reputation, access to capital, competitiveness etc.⁶ The thesis will primarily focus on qualitative relationships. The purpose of Part I of the thesis is to examine recent changes in business thinking within the business community regarding CSR and codes of conduct, and to explore the potential business benefits available for corporations that invest in CSR. The aim is to create an understanding of how the legal, social and economic accountability for the

⁵ Justice, Dwight W, “The international trade union movement and the new codes of conduct”. In: Jenkins, Rhys, Pearson, Ruth and Seyfang, Gill (ed.), *Corporate Responsibility and Labour Rights. Codes of Conduct in the Global Economy*, 2002, p. 99.

⁶ “*Corporate Social Responsibility: Is there a Business Case?*”, the Association of Chartered Certified Accountants (ACCA) 2003, p. 18. Available at: <http://www.accaglobal.com>. (Accessed 2004-03-01).

MNC is closely interrelated. The first question to be answered is: *What potential business benefits are there for a multinational corporation to invest in CSR policies?*

Whereas Part I will examine the question *why* business executives start to embrace CSR and corporate codes of conduct, the purpose of Part II is to examine *how* this is done. The purpose is to describe the development of the modern corporate code of conduct, its special features and the present implementing system. The thesis will be concluded by bringing together Part I and Part II in an evaluation of the barriers and obstacles that challenge an effective implementation of corporate codes of conduct in the global supply chain. Hence, the second question to be answered is: *What are the barriers and challenges for effective implementation of corporate codes of conduct in the global supply chain?*

1.3 Delimitation

The concept of CSR is multi-faceted, complex and extremely wide. It is about law, economics and business management as well as politics. This thesis will include all of these areas but not focus on any approach in particular.

Official statements where CEOs emphasize the importance of CSR and extensive adoption of corporate codes of conduct indicate that corporations increasingly are recognizing a certain degree of responsibility for their impact on countries where they do business. In turn this development raises new questions such as how far this responsibility should go and what conditions these corporations reasonably can be held responsible for. Moreover there is the question of how corporate responsibility relate to the responsibility of home as well as host country governments. A deeper discussion concerning these issues falls outside the scope of this thesis.

As yet most corporations operate at two extremes with regard to social issues. Either they make high-level commitments to principles of social responsibility and sustainability, commitments that are rarely implemented in practice, or they get involved in ground-level projects such as donations of money to specific local projects, which often have no real connection to the core business of the corporation. The future needs to focus on “filling the middle ground”.⁷ If CSR is going to become a part of corporate culture and influence the corporation’s daily operational behavior we need to move from high-level commitments and add-on charity to regulations and standards, management, reporting and monitoring systems.

Formal rules and regulations as well as numerous different voluntary codes and principles, developed by corporations, NGOs, governments and other

⁷ Keay, Malcolm, “*Towards Global Corporate Social Responsibility*”, The Royal Institute of International Affairs (RIIA), April 2002, p. 2.

actors are all means to help filling “the middle ground” and perhaps in time clarify the responsibilities of and setting the boundaries between different actors.⁸ The thesis takes a business perspective and concerns the multinational corporation and its potential role and function in reducing the widening gap between market and society. Focus will be on the corporate codes of conduct. Codes of conduct for MNCs will be covered only to the extent necessary for a comprehensive understanding of the corporate codes of conduct.⁹

The thesis does not primarily aim at analyzing how corporations can be held legally accountable for their operations in developing countries. Rather it concerns how companies respond to a “civil regulatory framework”. Civil regulations can, according to Zadek, best be understood as “*non-statutory regulatory frameworks governing corporate affairs*”. He suggests that civil regulations lie in-between public regulatory structures and market signals that stem from individual and collective consumer preferences.¹⁰ Civil regulations have the potential to transform into more stable frameworks of standards and practices. An understanding of the MNC in the light of a civil regulatory framework is best understood through a stakeholder approach. The stakeholders and their different interests that I have chosen for my discussions do not constitute an exhaustive list. In order to get a broad-based view of the difficulties of code implementation in the supply chain Northern as well as Southern stakeholders are represented.

The thesis takes a general approach as to the different types of industries and social issues covered. My intention has not been to focus on any type of industry in particular. However, the apparel (clothing and footwear) and toy industries are often heavily involved in global supply chain activities and have also been subject of significant public concern in relation to labor and human rights issues. Consequently these industry sectors are highlighted.

Generally CSR embraces three areas of concern - environmental, labor and human rights issues. The thesis concentrates on labor and human rights standards leaving out the environment.

Finally it should be pointed out that the thesis gives an overview of some of the challenges of corporate self-regulation in the new global economy. It is not exhaustive in the treatment of the topics covered.

⁸ Keay, Malcolm, p. 2.

⁹ See section 1.6 for a definition of “corporate code of conduct” and how this code is distinct from “the code of conduct for MNCs”.

¹⁰ Zadek, Simon, “*The Civil Corporation. The New Economy of Corporate Citizenship*”, 2001, pp. 55-56.

1.4 Material, methodology and theory

The CSR debate has developed rapidly in only a couple of years. When searching the Internet a myriad of information about CSR in general is to be found. However, it has been difficult to find material that concerns the particular CSR perspective of this thesis. Most research so far about the implementation of corporate codes of conduct focus on the monitoring system. As late as in the end of last year the first major reports (by the international labor organization (ILO) and the World Bank) concerning the challenges of implementation of codes of conduct in the global supply chain were published.

Relatively little literature about CSR is yet published or has reached the Swedish libraries. Most of the material I have found searching the Internet, e-journals and the websites of governments, the United Nation (UN), inter-governmental organizations (IGOs), NGOs and other private actors. Articles and reports have constituted the most updated and valuable sources of information. In relevant situations I have used case law to support the discussions with practical examples.

The thesis is a traditional desk study and to a great extent the work has consisted in selecting and structuring the material found. Both descriptive and analytical methods have been used.

The thesis adopts a stakeholder approach. A stakeholder view focuses on the corporation and its responsibilities towards the groups or interests that are affected by the corporation's operations. Such an approach broadens the understanding of those to whom the corporation is accountable and consequently the nature of the relationships that the corporation develops with these stakeholders is explored. The stakeholder theory is used in a descriptive, instrumental as well as normative manner. By taking into account the various interests of different stakeholders and the nature of the relationships these stakeholders develop with the MNC, the constellation of the business organization is described. A stakeholder analysis also constitutes a useful tool to examine the potential link between stakeholder management and increased corporate performance (e.g. corporate profitability, growth etc.). The normative element of the stakeholder theory suggests that stakeholders have a legitimate interest in different aspects of corporate activity. In the light of those legitimate interests the function of the corporation can be set and ethical standards identified. Conclusively the stakeholder approach intends to explain as well as to guide the structure and operation of the business organization.¹¹

Commonly the theory of civil regulation is underpinned by the general argument that civil action (e.g. NGO and activist campaigns, consumer

¹¹ Donaldson, Thomas and Preston Lee E, "The Stakeholder Theory of the Corporation: Concepts, Evidence and Implications". In: *The Academy of Management Review*, Vol. 20 No. 1, January 1995, pp. 65-91.

boycotts etc.) will cause reputational damage to the corporation severe enough to cause a decrease in the corporation's financial performance. If key stakeholders perceive that the corporation's ethical behavior increases, so does the corporation's financial performance, and vice versa.¹² As mentioned there is a lack of any quantitative data showing on a strong and casual link between CSR and financial indicators (e.g. share price, stock market value etc.). Even if the different opinions among scholars are parting fact remains that corporations respond to public pressure as if it has powerful financial impacts. At the same time the financial markets seem to act as ethical behavior by the corporation has little influence on the corporation's financial performance. Michael Hopkins sums up his findings of the relationship between social responsibility and financial performance by concluding: "*the company that did worst in the social responsibility rankings ... actually had the largest share price rise. Clearly, the public's purchasing of shares is still not greatly affected, as yet, by the companies' level of social responsibility.*"¹³ The thesis will not further apply or discuss the different theories of whether there is a quantitative link between CSR and increased financial performance. However, businesses increasingly seem to believe in "the Goyder Effect"; a theory that consider an inclusive approach (taking different interests into account) as a precondition for a profitable business in a long-term perspective.¹⁴

1.5 Outline

As mentioned this thesis is divided into two parts.

Initially, in *chapter 2*, there will be an introduction to the concept of globalization and how this process has altered the operating scene for MNCs. I will especially focus on how the forms of business operations are changing and examine the concepts of outsourcing and subcontracting. This is to provide a foundation for further discussions concerning the challenge of effective corporate self-regulation in the global supply chain by the means of corporate codes of conduct.

In Part I, *chapter 3*, the concept of CSR and the link between CSR and potential business benefits for the corporation ("the business case") will be discussed. First there will be a description of the different elements that the concept of CSR embraces. This introduction is followed by a presentation of some of the most prominent international frameworks on CSR. The thesis focuses on the corporate code conduct. However, other initiatives and international frameworks on CSR provide a historical basis and authoritative

¹² Zadek, Simon, 2001, p. 57.

¹³ Hopkins, Michael, "*The Planetary Bargain. Corporate Social Responsibility Matters*", 2003, p. 183.

¹⁴ Zadek, Simon, 2001, p. 62. "The Goyder Effect" is derived from Mark Goyder and his father George Goyder who played a significant role in promoting social responsiveness as an argument for long-term business profitability.

sources for corporate codes. The ILO's Tripartite Declaration of Principles (1977), the Global Compact (2000), the OECD Guidelines for MNCs (2000), and the Global Reporting Initiative (2000), will be briefly presented since these instruments are of relevance for my further discussions.

I will discuss the new legal challenges in business management by putting into question the "voluntary" nature of CSR initiatives. Even a voluntary approach to CSR has legal consequences for the corporation, a development resulting in new business incentives for improved social performance. I will, by giving examples of statements made by CEOs and investors, show how there recently has been a change in business thinking concerning the adoption of CSR policies. Furthermore, the new demands of society and the potential business benefits available for a corporation that takes CSR seriously will be assessed. Part I, chapter 3, will be wrapped up in a concluding discussion.

Part II, *chapter 4*, will be an exploration of the voluntary corporate code of conduct. The historical development of the modern supplier code will be described and I will give an overview of the advantages and disadvantages of taking an individual or industry approach when developing the code. The code implementing system to date has principally relied on a system of code formulation, monitoring and remedial processes. These elements will be evaluated. I will discuss code content, different ways of code verification, the new development of implementing guidelines and the methods used to correct unsatisfactory supplier behavior.

Finally in *chapter 5* and *6* Part I and Part II will be brought together in a concluding analysis and some implications for the future will be given.

1.6 Definitions

Many of the terms related to CSR are not very carefully used in the international debate. CSR is a relatively new topic on the agenda and the lack of consensus on clear definitions often complicates the dialogue and easily leads to misunderstandings and confusion in the business world. Therefore I find it important to list some key terms that will be used throughout this thesis, and the definitions that I have chosen.

There is no fixed definition of "*codes of conduct*". According to Ivanka Mamic a code of conduct can generally be understood as "*a statement of business principles defining a set of relationships on a range of topics between an entity and its stakeholders*". Consequently a code may include a broad array of goals, formulations, benchmarks and approaches to implementation.¹⁵ As will be described in section 3.1.2 codes can be divided

¹⁵ Mamic, Ivanka (Research Officer, Management and Corporate Citizenship Programme, ILO), "*Business and code implementation. How firms use management systems for social performance*", ILO 2003, p. 19.

into different categories. For example corporate codes which are unilaterally adopted by corporations, intergovernmental codes (e.g. the ILO's Tripartite Declaration, the OECD Guidelines) and multi-stakeholder initiatives (e.g. the Ethical Trading Initiative). Subject for this thesis is principally the corporate code of conduct. The term "*corporate code of conduct*"¹⁶ has no authorized definition and a code may be drafted in various ways. Throughout my discussions the ILO definition of corporate codes of conduct will be used, which refers to "*companies' policy statements that define ethical standards for their conduct.*"¹⁷

The concept of "*corporate social responsibility*" is defined and described in various ways. According to Hopkins the concept of CSR is concerned with "*treating the stakeholders of the firm ethically or in a responsible manner.*"¹⁸ Even if there is no generally accepted definition, the CSR concept normally includes a voluntary and balanced approach to business management. The corporation's social and financial performance has to be balanced against ethical, legal, commercial and stakeholder expectations.

A "*stakeholder*" is normally defined as someone that can be considered to have an interest (a "stake"), indirect or direct, in the company's operations. The UN defines "stakeholder" as "*any group or individual which is affected by the operations of the company*".¹⁹ A few examples are shareholders, customers, employees, suppliers, and communities.²⁰

Throughout the thesis the terms "*company*", "*corporation*" and "*enterprise*" will be used interchangeably, referring to any business enterprise regardless of the legal form used to establish this entity or the nature of ownership. Furthermore, by a "*multinational corporation*" or "*transnational corporation*" (*TNC*), I will refer to a corporation that own or control production, distribution, services or other facilities outside the

¹⁶ It is important to clarify the difference between "corporate codes of conduct" and "codes of conduct for MNCs". Corporate codes of conduct are voluntary corporate policy statements developed by corporations individually or as an industry, and which declare that company's/industry's ethical standards. The codes for MNCs are externally generated codes (e.g. the OECD Guidelines and the ILO's Tripartite Declaration) which impose moral, not legal, obligations on companies. See further "*Codes of Conduct for Multinationals*", Bureau for Workers' Activities, ILO. Available at: <http://www.itcilo.it>. (Accessed 2004-02-01); "*Corporate Codes of Conduct*", Bureau for Workers' Activities, ILO. Available at: <http://www.itcilo.it>. (Accessed 2004-02-08).

¹⁷ "*Corporate Codes of Conduct*", Bureau for Workers' Activities, ILO.

¹⁸ Hopkins, Michael, p. 1. For a more thoroughly discussion of the CSR concept and what it embraces see section 3.1.1. Numerous concepts are associated with CSR, e.g. "corporate citizenship", "corporate social responsiveness", "corporate governance", "corporate sustainability" etc. (See Hopkins, p.10 for an overview). Often these terms are used interchangeably. The differences are slight, nevertheless important. A reckless use of the terms often causes confusion and misunderstanding in the debate.

¹⁹ Proposed Draft Human Rights Code of Conduct for Companies. UN Doc. E/CN.4/Sub.2/2000/WG.2/WP.1, pp. 2-3.

²⁰ For further readings see Buchholtz, Ann K and Carroll, Archie B, "*Business & Society. Ethics and Stakeholder Management*", 2003, p. 68-75; Sims, Ronald R, "*Ethics and Corporate Social Responsibility. Why Giants Fall*", 2003, pp. 72-75; Waddock, Sandra, "*Leading Corporate Citizens. Vision, values, and value added*", 2002, p. 49.

country in which they are based. A “*small and medium size enterprise*” (*SME*) is only defined as such because of its size.²¹ Consequently SMEs are also MNCs if the requirements for such are fulfilled.

The terms “*subcontractor*”, “*supplier*” and “*licensee*” are used to express any natural or legal person who contracts with MNCs in order to carry out its mission.

“*Outsourcing strategies*” involve decision-making whether certain activities should be carried out by the company itself or contracted out to independent suppliers and subcontractors. The activities that are outsourced range from administrative services to entire functions such as information technology and manufacturing.²²

The terms “*Northern*” and “*Southern*” will occasionally be used referring to the terms “*developed countries*” and “*developing countries*” in a general sense.

Precise definitions of the terms above are not required to serve the purpose of this thesis.

²¹ See section 2.2.2 for the European Union (EU) definition of SMEs based on the number of employees.

²² Daniels, John D, Radebaugh, Lee H and Sullivan, Daniel P, “*Globalization and Business*”, 2002, pp. 168-169.

2 Globalization and multinational corporations

2.1 Globalization

We have moved from internationalization to globalization. It is no longer accurate to simply talk about national economies being engaged in external transactions. Today the world is our market, the actors are global and new technology results in economic transactions flowing across borders.

The process of globalization is usually defined as involving unparalleled movement of capital, goods and services, technologies, and people across the world. It is driven by factors such as intense global competition, technologies of communication, transportation and production, and the opening of markets in the developing countries.²³

The growth of globalization creates both opportunities and threats for individuals, corporations and countries. Whether the pros or cons of globalization outweigh the other is a dividing issue among scholars. In 2001 the Center for the Study of American Business published a report on different views on the effects of globalization.²⁴ According to the report supporters of globalization focus on productivity and growth by pointing out that countries integrating rapidly with the global economy on average enjoy higher economic growth rates than countries with closed economies. By lowering tariff barriers developing countries have gained increases in employment and national income. Globalists argue that companies that move to poor countries besides provide jobs also export higher wages and working conditions compared with those in domestic companies that operate in these countries. Furthermore an open market facilitates trading of goods and services at lower costs resulting in lower prices and higher living standards for the consumer. Additionally, globalization and greater economic freedom encourage an increase in political freedom. An efficient open market requires creation of legal institutions, which is also important in order to protect the human rights. An example is the case of South Korea where the political freedom expanded rapidly as the country developed economically.²⁵

Critics of globalization argue that liberalization of trade inevitably leads to inequalities. The gap between the rich and the poor in the world increases as

²³ Tavis, Lee A, "The Globalization Phenomenon and Multinational Corporate Developmental Responsibility", In: Williams, Oliver F (ed.), *Global Codes of Conduct. An Idea Whose Time Has Come*, 2000, p. 13.

²⁴ Batterson, Robert and Weidenbaum, Murray, "The Pros and Cons of Globalization", 2001. Available at: <http://www.globalchicago.org>. (Accessed 2003-12-15). See also Buchholtz, Ann K and Carroll, Archie B, pp. 272-274.

²⁵ Batterson, Robert and Weidenbaum, Murray, pp. 2-16.

globalization benefits the wealthy and further impoverishes the poor. Large corporations tend to invest in developing countries since low wage levels result in greater profits. Anti-globalists argue that corporations, by moving their operations into countries where labor and human rights abuses are common, contribute to a development of depressed wages, displacement of workers and further violations of human rights.²⁶

The globalists and anti-globalists are poles apart, which is much a result of different ways of interpreting statistics and how comparisons in wealth are measured. Nevertheless, the opposition towards globalization grows as the divergence between global markets and national communities increases. For the development to be sustainable and fair it is important that all parts of the world are included since unequal distribution of resources gives rise to tensions between regions, countries and groups. Globalization is, in Bauman's view, about concentrated freedom to move and act. He says: "*What is free choice for some descends as cruel fate upon others.*"²⁷ There is also an imbalance in global rule making. Whereas rules that favor global market expansion have become stronger and more enforceable, rules that are intended to promote labor standards and human rights have come to lag behind.²⁸ The corporations play a significant role in reducing the gap between market and community. The inherited freedom of conducting business in the new global economy needs to be carefully managed by the corporations; a task just as important for the survival of the corporation itself as for the improvement of the living conditions of the people in the world.

2.2 The multinational corporation on a global stage

Globalization and trade liberalization have led to a constantly changing scene and altered the premises for international business operations. The sources for success and competitiveness have changed. As business has to be adapted to the new global economy new factors have become imperative to survive competition. It has become increasingly important for corporations to build deeper relationships with business partners, employees and customers; to develop a reputation for trust and social responsibility; to be customer-oriented and prominent in quality and reliability; and, to quickly develop new quality products for a global market.²⁹ This development has resulted in a revolution in supply chain networking.

²⁶ Batterson, Robert and Weidenbaum, Murray, pp. 2-16.

²⁷ Bauman, Zygmunt, "*Globalization. The Human Consequences*", 1998, pp. 69-71.

²⁸ Ruggie, John Gerard, "The Theory and Practice of Learning Networks. Corporate Social Responsibility and the Global Compact". In: *the Journal of Corporate Citizenship*, Issue 5, Spring 2002, pp. 29-30.

²⁹ Starcher, George, "*Socially Responsible Enterprise Restructuring*", European Baha'I Business Leaders Forum (EBBF), p. 2. Available at: <http://www.ebbf.org>. (Accessed 2003-12-19).

Instead of vertical integration, where the MNC own most of its supply chain, corporations focus on core competencies and outsource complementary operations. This development raises the question of what role the corporation has in the globalization process. There is a growing trend to require MNCs to take greater social responsibility. Corporations are expected to contribute to the communities where they operate and to take responsibility for both success and failure, perform according to general accepted ethical standards and clarify their own values and guidelines. This new role of the corporation is particularly emphasized in situations where the local government lacks the capacity or will to secure the observance of national and international laws³⁰. The social expectations of what corporations are and how they should behave are changing.

2.2.1 Changing forms of business operations

According to data published by the United Nations Conference on Trade and Development (UNCTAD), world foreign direct investment (FDI) inflows have continued on a downward trend from a peak of about US\$ 1400 billion in 2000 to about US\$ 700 billion in 2001. However, it should be noticed that FDI has remained relatively strong in developing countries, while it has slowed down more significantly in developed countries.³¹

The MNCs play an important role regarding how FDI is controlled and distributed. It is estimated that there are approximately 65.000 MNCs today with about 850.000 affiliates around the world. Foreign affiliates account for about one-third of total world exports. To the MNCs and their affiliates are in turn linked numerous non-equity relationships such as subcontracts, licensing agreements and contract manufacturers.³² Hence, international production systems range from traditional foreign subsidiaries to non-equity-based networks of independent suppliers, for example international subcontracting and contract manufacturing.

According to the World Investment Report 2002 mainly three factors have contributed to the expansion of international production. Firstly increased *policy liberalization* means that national markets have opened up for different kinds of FDI and non-equity relationships. Secondly it has become important for corporations to share the costs and risks that come with *rapid*

³⁰ Horn af Rantzen, Mia, "Företagens sociala ansvar- den internationella utvecklingen i ett svenskt perspektiv", 2003, pp. 1-3. Available at: <http://utrikes.regeringen.se/ga/index.htm>. (Accessed 2004-02-15).

³¹ World Investment Report 2002. Transnational Corporations and Export Competitiveness (WIR02) Overview, UNCTAD; World Investment Report 2003. FDI Policies for Development: National and International Perspectives (WIR03) Overview, UNCTAD. Available at: <http://www.unctad.org>. (Accessed 2004-02-15).

³² WIR02 Overview, pp. 1-2.

technological change. Thirdly *increasing competition* makes it important for corporations to find new ways to efficiency.³³

Intensified global competition makes it necessary for production to be efficient. International outsourcing and subcontracting has become standard practice in many industries, especially with regard to low-skilled labor intensive production of consumer goods such as the apparel, footwear and toy industries. For production to be efficient flexibility has become a crucial factor. To remain competitive in a time when demand is volatile, production cycles for design, manufacture and delivery, have to be reduced. The toy industry is a good example of “just-in-time manufacturing”. Before placing a large order with a subcontractor, companies often wait to see whether a certain toy will be a success. Once the companies decide to order the toys they want them delivered quickly in order to meet the high demand and to avoid the risks that keeping large stocks involve. In this way subcontracting enables the corporation to adjust the level of production more flexibly. Moreover, subcontracting reduces the corporation’s need for working capital and also provides the corporation with higher return on assets and cost advantages with regard to low labor costs.³⁴

Suppliers and subcontractors, on the other hand, have found themselves being competitive in labor intensive manufacturing. They can focus on production only and leave marketing aside. Sales are often guaranteed within a certain time frame. Increased outsourcing offers an entry door into the world markets and an insight into the latest management trends and practices.³⁵

Globalization and advancements in computing, telecommunications and other technologies as well as management expertise, has resulted in corporations finding new ways of running their core business and managing relations with business partners. To remain competitive large corporations increasingly concentrate on their core areas of expertise for example marketing, distribution or design. Manufacturing is left to other companies with expertise in that area. The new business organization experiences a shift from relatively independent foreign affiliates towards more integrated international production systems. In the new network type of business organization there is a greater use of non-equity and co-operative relationships with other corporations.³⁶ This development has resulted in a

³³ WIR02 Overview, pp. 2-4; World Investment Report 1999. Foreign Direct Investment and the Challenge of Development (WIR99), pp. 149-156. Available at: <http://www.unctad.org>. (Accessed 2004-02-15).

³⁴ van Liemt, Gijsbert, “Towards ensuring minimum labour standards in export industries”. In: Blanpain, Roger (ed.), *Multinational Enterprises and the Social Challenges of the XXIst Century. The ILO Declaration on Fundamental Principles at Work, public and private corporate codes of conduct*, 2000, pp. 177-179; Shaw, Linda and Hale, Angela, “The emperor’s new clothes: what codes mean for workers in the garment industry”. In: Jenkins, Rhys, Pearson, Ruth and Seyfang, Gill (ed.), *Corporate Responsibility and Labour Rights. Codes of Conduct in the Global Economy*, 2002, pp. 107-109.

³⁵ van Liemt, Gijsbert, not. 22, p. 177.

³⁶ WIR99, pp. 153-154.

complex web of licensees, importers-exporters, suppliers and subcontractors on top of subcontractors; a corporate restructuring that tends to blur the boundaries of the corporation. Waddock describes the modern company as a *virtual company*, where “*the network of relationships actually becomes the company in a very real way.*”³⁷

The buyer-supplier/subcontractor relationship can take various forms depending on the corporation’s outsourcing strategy. The traditional relationship between buyer and supplier takes the form of a contract stipulating the particular products to be delivered, agreed prices and delivery conditions.³⁸ It has been suggested that avoidance of responsibility and liability for accidents or bad working conditions on the factory floor could be one reason for corporations to get engaged in international subcontracting.³⁹ This way of reasoning may have some substance if the contractual relationship is considered to be at arm’s length, meaning that the two businesses interact only to the extent necessary for completion of the agreement but nothing more.⁴⁰ In addition, a legal reasoning gives that the two businesses are independent legal entities, which can not be held accountable for each other’s actions. However, as will be shown later on in this thesis, the relationship between buyer and supplier is much more complex. Often various requirements, such as quality standards and working conditions, are incorporated into the contract in the form of a code of conduct. Increasingly MNCs in different ways exercise extensive control over the suppliers and the arm length’s relationship can be put into question. Moreover society increasingly tend to hold MNCs socially accountable for the actions of their suppliers, and outsourcing might consequently be a risk for business reputation if not managed with care. Thus outsourcing is a two-edged sword.

In contrast to the traditional supplier relationship, many Asian companies create interlocking networks of long-term family like relationships.⁴¹ These networks build on a foundation of trust and mutual interests among the companies involved.⁴² It is important however that this kind of network is open for innovation or the organization will be stifled and unable to adjust to external changes.

Relationships that are based predominantly on a contractual mind-set, rather than trust and mutual interests, are naturally more volatile, short-term and fast-changing. External factors such as fluctuations in demand and prices make companies contract with multiple suppliers so that they are dependent on no single one. The number of links in the supply chain can vary depending on the size of the buyer. For small buyers the supply chain can

³⁷ Waddock, Sandra, pp. 178-179.

³⁸ Waddock, Sandra, p. 179; Daniels, John D, Radebaugh, Lee H and Sullivan Daniel P, pp. 168-171.

³⁹ van Liemt, Gijsbert, p. 177.

⁴⁰ Waddock, Sandra, p. 179.

⁴¹ The network sourcing model (“*kereitsu*” in Japan and “*chaebol*” in Korea) derives from the Asian communitarian ideology.

⁴² Waddock, Sandra, p. 179.

become very long and complex involving many intermediaries. The economic and practical possibilities for these corporations to monitor and ensure working conditions deep down in the supply chain are often small. For larger buyers, with fewer links, exercising control is easier.⁴³ Consequently, the nature and flexibility of the traditional supply network leads to fast-changing relationships between buyer and supplier. In order to adapt to shifting circumstances global corporations need to keep their manufacturing chains mobile. Contracts can be shifted around between suppliers within and between countries. Licenses can move from one contractor to another within in very short periods of time. The rationale for the corporations is to be found in the search for lower production costs, new designs, and fluctuations in exchange rates or trade restrictions.⁴⁴

The short-term, fast-changing relationship between buyer and supplier is naturally reflected in the relationship between business partners and employment conditions further down the production chain. Features such as flexibility, intensity, short termism and insecurity are passed on to the workers. Thus, the employment on the supplier level is often informal, temporary, and flexible. Competition between suppliers is intense. Suppliers are pressured to lower labor costs or they risk losing orders to their competitors, or even to another country. The result of just-in-time manufacturing, exemplified above in the case of toy manufacturing, shows uneven periods of production. Slow periods of production when there are few orders to fill quickly turns into heavy periods of production in times of high demand from buyers. Consequently, orders from buyers are often given on short-time notice, which in turn encourages suppliers to hire workers on temporary contracts and have them work overtime to complete the order in time.⁴⁵ Thus, the “just-in-time manufacturing” in combination with intense competition between local manufacturers to gain contracts have a significant impact on wage levels and the implementation of labor laws and health and safety conditions on the supplier level.

Even if a short-term, fast-changing relationship with suppliers is still prevalent in most industries, globally dispersed MNCs start to realize the importance of moving closer to a more integrated network sourcing model. In the new business organization strategic alliances and closer relations with suppliers are emphasized. Such an approach leads a company to rely on fewer suppliers, which in turn means higher volume for the supplier and a more secure business environment.

⁴³ van Liemt, Gijsbert, p. 178.

⁴⁴ O'Rourke, Dara, “*Lessons in monitoring apparel production around the world*”, 2002 Available at: <http://www.ethicalcorp.com>. (Accessed 2004-01-25).

⁴⁵ Barrientos, Stephanie, “Mapping codes through the value chain: from researcher to detective”. In: Jenkins, Rhys, Pearson, Ruth and Seyfang, Gill (ed.), *Corporate Responsibility and Labour Rights. Codes of Conduct in the Global Economy*, 2002, p. 63; van Liemt, Gijsbert, p. 178; Shaw, Linda and Hale, Angela, pp. 107-109.

2.2.2 Small and medium size enterprises

So far the international discussion on involvement of business in sustainable development and CSR has mainly been focused on big brand MNCs. However, abundant MNCs are not giant entities but small and medium size enterprises. SMEs are qualified as MNCs if they have global value chains and are multiply connected with other companies. Their operations might be global although they operate under different conditions in terms of capital, resources and employees. In addition, most of the suppliers/subcontractors fall into the category of being SMEs.

The international debate on CSR often concerns MNCs in general neglecting the importance of taking the special features and challenges of the SMEs into consideration. It is essential to realize the problems and challenges of having limited resources and at the same time being expected to take on a social responsibility.

SMEs is a heterogeneous and very diverse group. SMEs have different goals and are of different sizes and levels of education. The EU has defined SMEs by size groups depending on the number of employees: micro-enterprises with less than 10 employees, small enterprises with less than 50 employees, and medium enterprises with less than 250 employees.⁴⁶

Smaller corporations often show little knowledge or interest in taking CSR seriously. Mainly this is due to a lack of resources and financing, educated staff, and technical expertise, which makes implementation of sustainable strategies harder.⁴⁷ Nevertheless it is important to encourage SMEs to work with these issues. SMEs are generally less mobile and therefore naturally take a long-term view in the local community. They are likely to have a stronger connection to the local civil, cultural and religious environment and play a significant social role as income generators for large parts of the population. Consequently, these companies play a key role in creating a sustainable environment and reduce poverty. Through the supply chain network large companies can influence the social performance of SMEs by building skills and standards. However, there is still the problem of convincing SMEs that there are business benefits to derive from implementing CSR into their business operations.⁴⁸

⁴⁶ Starcher, George, “*Some Notes on Responsible Entrepreneurship*”, EBBF 2003, pp. 7-8. Available at: <http://www.ebbf.org>. (Accessed 2004-01-25).

⁴⁷ “*The missing link: SMEs and sustainable development*”, World Business Council for Sustainable Development (WBCSD), 2003-11-17. Available at: <http://www.wbcd.org>. (Accessed 2004-01-25). See also

<http://www.ebbf.org/documentation/whitepapers/pdf/SMEs.pdf>, and http://europa.eu.int/comm/enterprise/csr/roundtable2/minutes_csr_300603_010703.pdf.

⁴⁸ “*The missing link: SMEs and sustainable development*”, WBCSD.

3 CSR and business benefits

“Social responsibility is not a question of charity, it is a question of enlightened self-interest. It is an issue of how we are going to keep our planet stable so that your businesses survive.”⁴⁹

The success of a voluntary approach to CSR is premised on two beliefs. Firstly, the belief that corporations must respond to new social demands. Secondly, the belief that good social performance makes sound business sense, not only social, ethical and legal sense. Research findings so far on CSR and the link to increased profits for the corporation, “the business case”, are limited and uncertain. Even if there is a lack of strong and casual quantitative evidence in terms of figures and graphs there are most likely qualitative benefits to derive from CSR policies. The way of thinking within the business community and among corporate leaders is changing. This is an important development.

3.1 Corporate social responsibility

3.1.1 The concept and elements of CSR

“Corporate social responsibility” is a concept of great importance on today’s business agenda. It is about a movement of integrating ethics into corporations’ business activities.

The idea of ethics in business is not new. Ethics comprises values and principles that influence how we behave, as individuals, a group or society. Business ethics is concerned with how such values and principles operate in business. Recently the idea of business ethics has come into new light. Hopkins defines “ethically and responsible behavior” as behavior that is deemed acceptable by civilized society.⁵⁰ However, what is deemed acceptable by civilized society changes. People today, especially the younger generation, begin to search for a more solid foundation of values and principles in business. Gradually, universal virtues such as trustworthiness, unity, justice and fairness are integrated into management practices and corporate language.⁵¹ In a time of a global economy, characterized by horizontal networking and where partnerships with

⁴⁹ Wolfensohn, James, World Bank President. Cited in: *“The Business of Business: Managing Corporate Social Responsibility: What Business Leaders are Saying and Doing 2002-2007”*. Executive Overview, Nima Hunter Inc. in co-operation with Ethical Corporation magazine 2002. Available at: <http://www.ethicalcorp.org>. (Accessed 2004-02-16).

⁵⁰ Hopkins, Michael, p. 1.

⁵¹ Starcher, George, *“Educating Tomorrow’s Managers”*, EBBF, pp. 5-7. Available at: <http://www.ebbf.org>. (Accessed 2003-12-19).

consumers, suppliers and contractors are crucial to conducting international business, perhaps trustworthiness is the most fundamental of virtues. For a complex and decentralized system of global networking to work it is important with trust among suppliers, consumers and clients. Social and ethical business behavior requires management to provide data, records and other information that show commitment and build trust among stakeholders. The costs for corporations of breaking this trust have proved to be high. In the other end it has become impossible for management to know everything that is going on in the value chain. Thus mutual trust and understanding is essential to effective partnership building and social and economic development.

The concept of CSR is more than just business ethics. Behind CSR lies an understanding that everything a corporation does have some flow-on effects either inside or outside the walls of the corporation. Shareholders, employees, customers, suppliers and communities all are stakeholders that have an interest, a “stake”, in a corporation’s business operations. Hopkins defines CSR as follows: “*CSR is concerned with treating the stakeholders of the firm ethically or in a responsible manner.*”⁵² As mentioned in section 1.6 there is no common definition of CSR. Rather each corporation responds in its own unique way depending upon its core business, stakeholder interests and country and cultural traditions. Consequently, the extent to which corporations can be said to be engaged in the CSR agenda is much dependent on how they relate to the concept of social responsibility.

So far most corporations have been operating at two extremes in their engagement in social issues. Increasingly corporations make high-level commitments to CSR policies. While making commitments is easy an actual change in the way business is performed stays away. At the other extreme corporations show social responsiveness by supporting local projects through for example donations of money. Such “charity” may bring benefits to the local community as well as enhance the company’s reputation. However, this type of local engagement is often completely distinct from the core business of the corporation. Consequently there is a strong perception among stakeholders that corporate CSR investments are more of a public relations act than an actual change in the way business is conducted.⁵³ In turn, this leads to mistrust among stakeholders.

The mission for CSR should be to become a part of corporate culture rather than an optional add-on activity to core business activities. The essence of CSR lies in how a corporation’s day-to-day operational behavior impacts on society. Whereas a corporation’s mission is traditionally defined in terms of making money to shareholders and investors, a business management model based on CSR in addition includes a commitment to social and

⁵² Hopkins, Michael, p. 1.

⁵³ Ward, Halina, Borregaard, Nicola and Kapelus, Paul, “*Corporate Citizenship - Revisiting the Relationship between Business, Good Governance and Sustainable Development*”, International Institute for Environment and Development (IIED) 2002, p. 2.; Keay, Malcolm, p. 2.

environmental concerns. A common view among businesses is that social responsibility means increased costs. Hence social responsibility is often viewed incompatible with good financial performance. Increasingly however corporations start to recognize that sustainable business and shareholder value can not be achieved only through maximizing short-term profits. Sustainable business is achieved through balancing various different interests. Interests of shareholders as well as those of customers, employees, suppliers and communities need to be integrated into corporate strategies.⁵⁴

What the concept of CSR really embraces and where the focus should be in the future is well described by Faisal Shaheen: “*corporate social responsibility is not an alternative to profitability - or even necessarily in conflict with it. It is a WAY of doing business by which business managers ‘internalize’ externalities. When done well, this process generates greater profits - in the short term through innovation, in the medium term through reputation and in the longer term by creating new markets and anticipating new regulations.*”⁵⁵

3.1.2 CSR on the agenda

CSR has in a couple of years become one of the most discussed topics on the agenda - internationally, regionally and nationally, and in the public as well as private sector. The relationship between business and CSR is principally based on corporate voluntarism and self-regulation. There is no binding regulation directly applying to corporations. One of the most debated issues today on the CSR agenda is whether there should be a voluntary or mandatory commitment to CSR.

Principally trade unions and NGOs represent the approach that favors legally binding, internationally enforceable rules of conduct for MNCs. One of their concerns is that international agreements on trade and investment often lack a human rights perspective. Supporters of a mandatory approach point out the risk that developing countries, in order to attract FDI, might continuously lower their labor and human rights standards. Since many MNCs have economical and political resources far extending those of governments in developing countries it is argued that MNCs should take responsibility alongside governments⁵⁶. The business community supports

⁵⁴ Palazzi, Marcello and Starcher, George, “*Corporate Social Responsibility and Business Success*”, EBBF, p. 2; “*Corporate social responsibility. A business contribution to sustainable development*”, Employment & social affairs, European Commission, July 2002, p. 4.

⁵⁵ Shaheen, Faisal (participant of a bulletin board discussion hosted on the website of the Regional and International Networking Group between 18 February and 5 March 2002). Cited in: Ward, Halina, Borregaard, Nicola and Kapelus, Paul, p. 2.

⁵⁶ “*Beyond Voluntarism. Human rights and the developing international legal obligations of companies*”, Summary, International Council of Human Rights Policy (ICHRP). Available at: www.ichrp.org. (Accessed 2003-12-04).

the voluntary approach and arguments are naturally based on the question of financial performance of the corporations.

The numerous voluntary initiatives stretch over a wide spectra from private individual corporate codes of conduct, work within private organizations (e.g. International Business Leaders Forum (IBLF) in London, World Economic Forum in Geneva, and the Global Reporting Initiative (GRI) in Amsterdam) and private multi-stakeholder initiatives (e.g. the Ethical Trading Initiative in Great Britain) to initiatives on an international organizational or governmental level (e.g. the UN Global Compact, the OECD Guidelines and the ILO Tripartite Declaration). The web of initiatives can seem confusing and complex, but is to be seen as different means towards the same goal.

The focus of the thesis is the corporate code of conduct. However, corporate codes of conduct have not developed from and are not applied in a vacuum. Other initiatives and international frameworks provide a historical basis and authoritative sources for corporate codes. Therefore, to better understand how the CSR issue is approached and what tools are available for corporations, some of the most prominent international frameworks on CSR, which are of relevance for my further discussion, will be presented.

3.1.2.1 The ILO's Tripartite Declaration of Principles 1977

In 1977 the ILO adopted a Tripartite Declaration of Principles concerning MNCs and Social Policy, which was updated in 2000 in the light of the 1998 ILO Declaration of Fundamental Principles and Rights at Work.⁵⁷ The Declaration calls for commitment to respect, promote and realize what have come to be referred to as the “core” labor practices of the ILO:

Freedom of association and the effective recognition of the right to collective bargaining.

The elimination of all forms of forced or compulsory labor.

The effective abolition of child labor.

*The elimination of discrimination in respect of employment and occupation.*⁵⁸

The value of the Declaration lies in its comprehensive content, covering most aspects of social policy, and the fact that it is addressed to a wide range of key economic actors and workers' organizations. Explicit mention

⁵⁷See <http://www.ilo.org/public/english/employment/multi/history.htm>. (Accessed 2004-02-17).

⁵⁸The core labor standards are derived from some of the most important ILO Conventions. See <http://www.ilo.org/public/english/employment/multi/decl.htm#annex>, and <http://www.ilo.org/public/english/standards/decl/declaration/index.htm>. (Accessed 2004-02-17). The ILO has succeeded in embedding its core conventions also in other international instruments e.g. the UN Global Compact and the OECD Guidelines. See sections 3.1.2.2 and 3.1.2.3.

is made to the contributions of MNCs as important elements in attaining these objectives.⁵⁹

3.1.2.2 The Global Compact, 2000

“This year, I want to challenge you to join me in taking our relationship to a still higher level. I propose that you, the business leaders gathered in Davos, and we, the United Nations, initiate a global compact of shared values and principles, which will give a human face to the global market.”⁶⁰

The UN Secretary-General Kofi Annan announced the Global Compact (GC) at the World Economic Forum in Davos in 1999. It was formally launched in 2000 and has engaged hundreds of corporations and organizations. The GC is not a traditional UN agency but a network that exists to bring companies together with UN organizations, international labor organizations, NGOs, governments and other parties. The GC works as a learning forum to encourage good practices and creative solutions among participants in order to promote sustainable development.⁶¹

The Global Compact is a voluntary initiative. It is not a regulatory instrument, a legally binding code of conduct, or a forum for policing or enforcing the behavior or actions of companies.⁶² Neither is it a “safe-harbor” allowing companies to sign up without demonstrating real involvement and results. The GC asks participating companies to undertake three commitments: to advocate the GC and its nine principles in mission statements and annual reports, to post on the GC website all the steps they have taken to act on the principles, and to join the UN in partnership projects of benefit to developing countries.⁶³ The nine principles in the areas of human rights, labor standards and environment, are derived from universal declarations. The principles, with respect to human rights and labor standards, are:

Human Rights

To support and respect the protection of internationally proclaimed human rights.

To avoid complicity in human rights abuses.

⁵⁹ The ILO’s Tripartite Declaration of Principles 1977. Available at: <http://www.ilo.org>. (Accessed 2003-10-25).

⁶⁰ Kofi Annan, UN Secretary-General, World Economic Forum, Davos, 1999. Available at: <http://utrikes.regeringen.se/ga/internationellt.htm>. (Accessed 2003-10-27).

⁶¹ “Guide to the Global Compact - A Practical Understanding of the Vision and Nine Principles”, pp. 4-6. Available at: <http://www.ud.se/ga/internationellt.htm>. (Accessed 2003-10-25).

⁶² “Guide to the Global Compact - A Practical Understanding of the Vision and Nine Principles”, p. 4.

⁶³ Ruggie, John Gerard, p. 31.

Labor Standards

To uphold freedom of association and the effective recognition of the right to collective bargaining.

To eliminate all forms of forced and compulsory labor.

To abolish effectively child labor.

*To eliminate discrimination with respect to employment and occupation.*⁶⁴

A problem is the credibility of submissions made by companies. A positive move is a recent agreement for collaboration between the GC and the Global Reporting Initiative (GRI).⁶⁵ The GRI complements the GC by providing the participant with an instrument to demonstrate accountability with respect to the GC principles.

3.1.2.3 The OECD Guidelines for MNCs, 2000

The OECD Guidelines are voluntary non-binding recommendations addressed by over 30 governments to MNCs operating in or from adhering countries. The Guidelines provide principles for responsible business conduct in fields such as employment, human rights, environment and competition to help MNCs operate in harmony with government policies and social expectations. The aim of the Guidelines is “*to encourage the positive contributions that multinational enterprises can make to economic, environmental and social progress and to minimize the difficulties to which their various operations may give rise.*”⁶⁶

Some of the general provisions stipulating various behavioral goals and objectives for MNCs, are:

Economic, social and environmental progress.

Respect for human rights.

Local capacity building, and domestic and foreign market development.

Human capital formation, including employment opportunities and training.

Self-regulatory practices and management systems.

*Business partners, suppliers and sub-contractors compliance with the Guidelines.*⁶⁷

⁶⁴ “*Guide to the Global Compact - A Practical Understanding of the Vision and Nine Principles*”, p. 13.

⁶⁵ See <http://www.globalreporting.org>. (Accessed 2003-10-25).

⁶⁶ “*The OECD Guidelines for Multinational Enterprises: Text, commentary and clarifications*”, 2001, p. 7. Available at: <http://www.ud.se/ga/internationalt.htm>. (Accessed 2004-01-26).

⁶⁷ “*The OECD Guidelines for Multinational Enterprises: Text, commentary and clarifications*”, p. 11.

3.1.2.4 The Global Reporting Initiative, 2000

The GRI was first established in 1997. The mission was to develop voluntary globally applicable guidelines that stipulate how corporations are to report on their economic, environmental and social performance. Some of the goals of the GRI are to design and promote standardized reporting practices and core measurements, and also to elevate sustainability reporting practices worldwide to the same level as financial reporting.⁶⁸

3.2 New legal challenges in business management

As indicated earlier the initiatives on CSR up till now are mainly based on corporate voluntarism and self-regulation. However, increasing attention is given to the potential role of national and international regulation. Much of today's CSR debate is focused on the issue "voluntary versus mandatory"; that is the need of binding rules versus the efficiency of voluntary actions by corporations. At the same time the very dividing line between "voluntary" and "mandatory" in itself is changing, a development resulting in new business incentives for improved social performance.

The reality is that law shapes and is a part of CSR. Some main reasons why it is important for a legal analysis to be factored into CSR are:

Corporations that adopt CSR policies have to take into account the importance of transparency and access to information. There is an increased interest in "*triple bottom line*" reporting, meaning that corporations are asked to address, in addition to financial performance, also social and environmental issues in their reports. The past years have shown a development of national governments imposing obligations on companies to report on social issues. For example disclosure of social and environmental performance in certain corporations' annual reports became mandatory due to legislation passed by the French parliament in 2001.⁶⁹ Voluntary approaches to reporting can also become mandatory by virtue of the authority of financial institutions. After new regulations in 2002 a company that wants to be publicly listed on the Johannesburg Stock Exchange (JSE) have to fulfil the reporting requirements set by the GRI.⁷⁰

Even when "triple bottom line" reporting is performed on a completely voluntary basis *laws on misrepresentation and false advertising* may put restrictions on what companies may legally say about themselves.⁷¹ In *Kasky v. Nike*, Nike was sued under Californian State Law for false

⁶⁸ See <http://www.globalreporting.org>. (Accessed 2003-10-25).

⁶⁹ Ward, Halina, pp. 3-4.

⁷⁰ Ward, Halina, p. 4.

⁷¹ Ward, Halina, p. 5.

advertising. In a response to complaints over working conditions in Asia, Nike initiated a public relations campaign where they stated that Nike products were manufactured throughout the world in accordance with a strict code of conduct, free from sweated labor. In 1998 Marc Kasky sued Nike claiming that the information on Nike's social performance was in breach of Californian statutes prohibiting false and misleading advertising. Nike defended itself based on the First amendment of the US Constitution on freedom of speech and claimed that communications with media was not "advertising", rather "policy statements". California's Supreme Court ruled, in first instance, against Nike to find that the company statements amounted to "commercial speech". Nike's statements would therefore be subject to the stricter standard of truth required by advertising law. Thus, public statements made by a company about its operations were treated in the same manner as every day commercial speech.⁷² However, on September 12th 2003, after five years of litigation, Marc Kasky and Nike Inc. settled their dispute. Nike was to pay \$1.5 million (about half of one day's advertising budget) to the Fair Labor Association (FLA) to be used for worker development programs.⁷³

Corporate codes of conduct can become legally binding as de facto minimum standards when they are incorporated into a contract with a supplier. In addition agreements reached through collective bargaining between employers and trade unions can become legally binding through incorporation into employment contracts.⁷⁴

States have a duty to protect human rights and in consequence they have to ensure that private actors, such as companies, do not abuse these rights. This duty upon states gives rise to *indirect obligations on companies*. A different question is if international human rights law can be applied directly on private actors. The question of legal accountability is complicated and a complete discussion on this subject falls outside the scope of this thesis. However it needs to be said that there is a trend, especially in the Anglo-Saxon world led by the USA, to hold parent companies legally accountable for their operations in developing countries, a development known as "*foreign direct liability*". National courts are using the standards of international conventions on companies although it can be questionable if these are directly binding upon companies. Usually these cases are based on either the proposition that companies should adopt minimum international standards wherever they operate, or that companies should exercise the same standard of care ("best practice") in their overseas operations that would be expected at home. Due to the sensitive question of jurisdiction and the sometimes vague chain of control between the parent company and its subsidiary, these kinds of cases are hard to bring and there are

⁷² See <http://www.cfac.org/CaseLaw/Cases/kasky.html>. (Accessed 2003-10-24).

⁷³ See <http://www.reclaimdemocracy.org/nike/>. (Accessed 2003-10-24).

⁷⁴ Ward, Halina, p. 6.

few conclusive results.⁷⁵ Nevertheless, these cases are increasing in number. *Wiwa v. Royal Dutch Petroleum (Shell)*⁷⁶ was a civil lawsuit charging multinational oil company Shell with complicity in human rights violation. The presence of an investor office in New York was sufficient to provide a New York district court with personal jurisdiction over the two Shell parent companies.⁷⁷ As a response to the development of “foreign direct liability” cases companies might seek to put distance between itself and legally risky business operations through outsourcing. There is one action in the USA taken against a retailer testing its liability in respect of abuses of labor rights further up the supply chain. Thus, the legal limits of subcontracting are starting to get tested.⁷⁸

3.3 CSR and the business case

Corporations point out that CSR needs to be a voluntary concept. Their main focus is naturally on “the business case”, that is, whether or not it means better financial performance for the corporation to be socially responsible. The research on “the business case” is yet unsatisfying and uncertain. Some claim that corporations, by putting on a CSR friendly approach, will face increased costs and less profit due to the fact that more interests have to be taken into consideration and that new necessary accounting and control methods have to be implemented.⁷⁹ On the other hand, a study done by Webley and Moore indicates that larger UK companies with codes of conduct financially outperform those companies that do not have a code.⁸⁰

The views regarding “the business case” are parting. In the absence of more conclusive quantitative research and case studies the arguments for and against a link between social responsiveness and increased financial performance for businesses are of a more speculative nature. However changes in business thinking and new demands from society indicate that there are qualitative benefits to derive from better social performance.

⁷⁵ Keay, Malcolm, p. 7.

⁷⁶ Hereinafter Royal Dutch Petroleum will be referred to as “Shell”.

⁷⁷ *Wiwa v. Royal Dutch Petroleum (Shell)*, 2000 U.S App. LEXIS 23274. Available at: <http://www.earthrights.org/shell/appeal.shtml>. (Accessed 2003-10-25).

⁷⁸ Ward, Halina, p. 17.

⁷⁹ Henderson, David, “*Misguided virtue. False Notions of Corporate Social Responsibility*”, 2001, pp. 59-61.

⁸⁰ Webley, S, and Moore, E, “*Does Business Ethics Pay? Ethics and financial performance*”, 2003, p. 10.

3.3.1 Changes in business thinking

First of all, as will be explored below, there has recently been a substantial change in business thinking concerning the adoption of policies dealing with CSR. This shows an important development that CSR is starting to be taken seriously within the business community itself.

The economist Milton Friedman once said: “*the one and only responsibility of business is to increase its profits.*”⁸¹ A growing number of business leaders and investors today see the more complex picture and increasingly state that making money for shareholders is necessary, but not sufficient. To push this one step further mounting evidence are starting to show that acting socially responsible means increasing business profits. Perhaps it will be more accurate in the future to say that *a company’s positive human rights behavior is good for business.*

Increasingly CEOs publicly declare the importance of CSR for business, showing an important development in business thinking.

In a report from the mid 1990’s the Tomorrow’s Company Inquiry made the following observation: “*The companies which will sustain competitive success in the future are those which focus less exclusively on financial measures of success – and instead include all their stakeholder relationships, and broader range of measurements, in the way they think and talk about their purpose and performance.*”⁸² Hence the interests of all key stakeholders has to be taken into consideration in order to assure the shareholders’ continuing value. Still, however, most companies see their stakeholders and shareholders as counterparts. Mark Goyder, director of the London-based Centre for Tomorrow’s Company, said in 1998: “*The old idea – which is still prevalent on Wall Street – is that companies which talk a lot about stakeholders and accountability are actually betraying their shareholders. I would say that is a 20th century view of the 21st century problem.*” In addition, Goyder says that to succeed in the next century companies need to build long-term trust with shareholders and stakeholders by reporting on their progress on human rights issues.⁸³

Shell recognizes in its statement of Business Principles five “inseparable” areas of responsibility: to shareholders, to customers, to employees, to those with whom they do business and to society.⁸⁴ Philip Watts, Chairman of the Committee of Managing Directors, says: “*Our commitment to contribute to*

⁸¹ Friedman, Milton, New York Times Magazine, 13 September 1970. Cited in: Avery, Christopher L, “*Business and Human Rights in a Time of Change*”, November 1999. Available at: <http://www.business-humanrights.org>. (Accessed 2004-01-27).

⁸² Cited in: McIntosh, Malcolm, Leipziger, Deborah, Jones, Keith and Coleman, Gill, “*Corporate Citizenship. Successful strategies for responsible companies*”, p. 47.

⁸³ Wah, Louisa, “*Treading the Sacred Ground*”, *Management Review*, July/August 1998. Available at: <http://www.wahansa.com/louisa/portfolio/mrclips.html>. (Accessed 2004-01-07).

⁸⁴ The Royal Dutch/Shell, The Shell Report 2002. “*Business Principles*”. Available at: <http://www.shell.com>. (Accessed 2004-01-07).

sustainable development is not a cosmetic public relations exercise. We believe that sustainable development is good for business and business is good for sustainable development."⁸⁵

CEOs at the World Economic Forum 2001 in Davos, said that MNCs had been given a wake-up call and that it was absolutely essential to take issues of corporate social responsibility seriously. One year later, at the World Economic Forum 2002 held in New York, CEOs argued that issues of CSR are not add-on but fundamental to core business operations.⁸⁶

It can be questioned whether public statements like those above show on a real change of thinking that affects corporations' day-to-day decision-making, or if it simply has a public relations' purpose. The answer is probably both. The effort of each corporation to implement these issues into day-to-day business operations depends on different factors such as the corporate size, culture and industry. In any event, CEOs are increasingly going on the record with commitments to take greater social responsibility and their company's social performance can now by society and by legal institutions, as in the case of Nike, be measured against those commitments as well as against other standards.⁸⁷

In addition, investment funds increasingly are declaring the importance of social responsibility and are thereby putting pressure on the corporations to implement policies on CSR.

In 2001 eight leading European pension funds with more than £400 billion under management together put pressure on MNCs doing business in Burma by requiring them to justify the risks to shareholders. Rob Lake, the head of strategy at Henderson Global Investors, observed concerning the warning: "*We can not be written off as lefty fund managers as we have £400 billion of investment under our control. It is our responsibility to assess risk and to look after those investments wisely.*"⁸⁸ The argument of the pension funds was that companies operating in unstable political climates could be exposed to loss of shareholder confidence, negative press and publicity campaigns, safety risks and corruption.⁸⁹ By their actions the investors wanted to be "*confident that company directors have considered the risks and, at the very least, have established policies for managing them.*"⁹⁰

⁸⁵ The Royal Dutch/Shell, The Shell Report 2002. "*Message from the Chairman*". Available at: <http://www.shell.com>. (Accessed 2004-01-07).

⁸⁶ See <http://www.weforum.org/pdf/AnnualMeeting/AMreport2001.pdf>, and http://www.weforum.org/pdf/AM_2002/Global_Agenda_Monitor_2002.pdf. (Accessed 2004-01-27). See also "*The Business of Business. Managing Corporate Social Responsibility: What Business Leaders are Saying and Doing 2002-2007*". Executive Overview.

⁸⁷ Avery, Christopher L.

⁸⁸ Lake, Rob, the head of strategy at Henderson Global Investors. Cited in: Macalister, Terry, "Oil Firms Called to Account", *Guardian Unlimited*. 3 December 2003. Available at: <http://www.guardian.co.uk>. (Accessed 2004-01-27).

⁸⁹ Macalister, Terry.

⁹⁰ Targett, Simon, "Investors link for Burma protest", *Financial Times*, 3 December 2001.

Barclays Global Investors, another leading fund manager with \$700 billion under management, has announced that it is looking into entering the market for socially responsible investment. The head of stock selection, Stuart Owen, has said: “*There is an enormous dam of desire for socially responsible investing.*”⁹¹

Noticeable is that serious fund managers today are pointing at the *risk of shareholders* if human rights are not taken seriously in the countries where they operate. The fact that these statements are coming from investors and CEOs, and not only from NGOs and other activists, is an important progress and shows that socially responsible investment is starting to be taken seriously within the business community itself.

3.3.2 Society’s new demands

One of the reasons why MNCs have been introducing policies on CSR is that civil society itself, e.g. consumers and NGOs, has been demanding it.

In December 1998 following was to read in *The Economist*: “*Today multinationals are under pressure as never before to justify their dealings with abusive regimes and their treatment of employees in developing countries. Firms used to brush off criticism, saying that they had no control over third-world suppliers, and that politics was none of their business anyway. This is no longer good enough.*”⁹²

Corporations have increasingly come to experience that silence and inaction no longer are tenable options. Shell is still paying the price of damaged worldwide business reputation for its operations in Nigeria.⁹³ Experience shows that corporations tend to “voluntarily” address human rights and labor issues first when they are faced with public exposure. Not surprisingly, mistrust and scepticism are shown towards the business community and corporations are seen as part of the human rights problem, rather than part of the solution. In order to gain public trust corporations have to actively demonstrate that the corporation is seriously committed to these issues.⁹⁴

Informed western consumers are getting more concerned about the products they buy and how these are generated. Mounting evidence show that

⁹¹ See http://www.csreurope.org/news/_page2281.aspx. (Accessed 2004-01-27).

⁹² “Survey: Human-Rights Law, The power of publicity”, *The Economist*, 5 December 1998. Cited in: Avery, Christopher L, 1999.

⁹³ Shell was attacked for its inaction in relation to the killing of Ken Saro-Wiwa and oppression of the Ogoni people in, at the time, non-democratic Nigeria. For further readings see for example “*The Price of Oil: Corporate Responsibility and Human Rights Violations in Nigeria’s Oil Producing Communities*”, Human Rights Watch. Available at: <http://www.hrw.org>. (Accessed 2004-01-27).

⁹⁴ Avery, Christopher L.

consumers more and more are letting factors such as a corporation's ethical and social behavior influence their buying decisions, even if there is a price difference.⁹⁵ Intensified competition makes changing consumer preferences crucial to business strategies. However, the fact that consumers *say* that they favour and are willing to pay more for ethically generated goods does not necessarily mean that they *do* actually *buy* these products. Probably it is so that most consumers in the end of the day do let the price tag be the determining factor in a situation where they have to choose between a declared "ethical" product and a "non-ethical" product. In any case, consumers are in focus.

The 9th of April 1996 the following was to read in the Wall Street Journal: *"What's changed is that for the first time human rights concerns could become a major marketing issue and a tool for manufacturers. In an era when companies must work harder than ever to sell their products, anything that turns the consumer off has to be avoided at all costs [...] I am not speaking as a do-gooder [...] I am a garment industry consultant who has spent thirty years in Asia [...]."* Some call the intense focus on consumers "the marketing concept"⁹⁶.

Jenkins elaborates the role of the consumer suggesting that the "threat" of consumer action in fact constitute political pressure from society. For example do NGOs use the threat of consumer action to make corporations take greater social responsibility. According to Jenkins the individual consumer decision in a market economy has little influence on producer decision, and he is sceptical about the thought of consumers as such bringing about greater corporate responsibility. Of course, there is a certain demand for ethically produced goods, but in Jenkins' view these are niche markets that supply foremost middle class consumers, and the problem of consumers acting collectively still stands. There are some exceptions of collective purchasing, for example US universities acting as bulk purchaser from a corporation, which can have direct effect on company behavior. Also in this scenario Jenkins claims that it is a result of political decision and mobilizations, rather than the development of consumer preferences.⁹⁷

In any event, the "threat" of changing consumer preferences is likely to have an increasing impact on the human rights and labor practices of companies wishing to sell their products. Whether this change is a result of pressure by consumers as such or has political reasons is a matter of how one choose to look at the problem. Fact still remains that consumers, whether it is direct or indirect, constitutes an important driver for CSR.

⁹⁵ Palazzi, Marcello and Starcher, George, pp. 2-3.

⁹⁶ Palazzi, Marcello and Starcher, George, p. 3.

⁹⁷ Jenkins, Rhys, "*Corporate Codes of Conduct. Self-Regulation in a Global Economy*", 2001, pp. 14-15.

3.3.3 The business benefits

MNCs will not adopt CSR policies simply for altruistic reasons. Adoption of CSR policies is likely to enhance benefits for the corporation. Several indicators, partly drawn from the discussion above, show that ethical and social consciousness is very likely good for business.⁹⁸

Competitiveness and market positioning

The value of the corporation's intangible assets, such as design and image as embodied in the company brand name, has become more important due to the extensive use of subcontracting. Increasingly, corporations see their reputation as one of their key and most carefully managed assets. Since branding has become a crucial element of competitiveness corporations spend enormous capital on creating and maintaining a favorable image. A corporation's reputation can easily and quickly be damaged by charges of irresponsible behavior, e.g. bad working conditions in the supply chain.⁹⁹ Creating a socially responsible reputation and a brand name that is associated with good social behavior is probably, from a company's point of view, one of the most important conditions in order to be successful.

Customer satisfaction and loyalty

To become a successful company it is essential to build long-lasting relationships with customers. A lot of money is spent on identifying what the customer preferences are. The customer perspective is often embracing the whole organization of the company; from research, production and finance to selling and marketing.¹⁰⁰

Building a company brand and a reputation of being committed to human rights and social issues is likely to improve customer loyalty. Studies indicate that the reputation of a corporation being dedicated in social issues increasingly influence consumer's choice of brands and producers.¹⁰¹

Investor relations and access to capital

Partly as a consequence of consumer and NGO behavior financial stakeholders start to ask for disclosure of information going beyond traditional financial reporting. This is necessary to better identify success and risk factors inherent in a company and the company's responsiveness to public opinion. As illustrated in section 3.3.1 world leading investment funds, with enormous capital under management, are

⁹⁸ Löhman, Ola and Steinholtz, Daniel, *"Det ansvarsfulla företaget. Corporate Social Responsibility i praktiken"*, 2003, pp. 45-102.

⁹⁹ van Liemt, Gijsbert, p. 173.

¹⁰⁰ Palazzi, Marcello and Starcher, George, pp. 2-3.

¹⁰¹ Palazzi, Marcello and Starcher, George, pp. 2-3.

starting to publicly declare risks, including shareholder risk, of not taking ethical issues seriously.

As investors increasingly factor ethical and moral considerations into their investment making process, there are also quantitative indicators showing that profits are not necessarily sacrificed. For example the Domini 400 Social Index¹⁰² shows that ethical investors do not sacrifice return on their investments.¹⁰³ It is often presumed that the shareholders' only interest is short-term profit. Many shareholders however are long-term investors who want to invest in responsible companies with the kind of reputation that helps to ensure business success in the long run. In a long-term perspective social and ethical consciousness are likely to create more productive and profitable partnerships with customers, employees, suppliers and investors for the corporation.

Employee recruitment and retention

Good reputation and a social record will increase the possibilities for corporations to attract and retain the best employees. One example is Shell who, in the aftermath of Nigeria, experienced unwillingness among graduates to work for the company. As a result efforts were made to understand and respond to public concerns on these issues.¹⁰⁴

Litigation risk

MNCs cannot disregard that they might be held legally accountable for any violations of international human rights norms that may arise from their corporate operations. More and more corporations choose to settle disputes instead of risking litigation. It is not the litigation costs as such that constitutes the real risk, rather the risk of losing market shares. One recent example is Coca-Cola who legally had a very strong case, but made the decision to settle the discrimination lawsuit. Coca-Cola's senior executives took the view that, whatever the strength of the case in their opinion, Coca-Cola as a company could not withstand the many months of bad publicity which fighting a class action would have caused.¹⁰⁵

In general when discussing the potential benefits of a CSR commitment to corporations no distinction is made between different sizes of corporations. Research and case studies involve predominantly larger MNCs. For reasons explored above it is important to develop a business case that is relevant to SMEs.¹⁰⁶ With regard to SMEs in particular some potential benefits of

¹⁰² The Domini 400 Social Index is an index of the share prices of 400 common stocks of American companies which were chosen based on their performance on environmental and social performance screens.

¹⁰³ Palazzi, Marcello and Starcher, George, p. 8.

¹⁰⁴ See section 3.2.

¹⁰⁵ See <http://www.findjustice.com/ms/cases/coke/summary1.htm>.

¹⁰⁶ See section 2.2.2.

interest may be operational cost savings (e.g. reduction in health-care costs) and increased new partnership opportunities (e.g. increased loyalty with existing customers and enhanced chances of gaining new contracts with larger corporations). Furthermore, increased learning and innovation introduce the SME to new ways to work, seize opportunities, management of risks and problem solving.¹⁰⁷

Of course every potential benefit carries also a cost. However, no in-depth cost-benefit analysis of CSR in a corporation has yet been undertaken.¹⁰⁸

3.4 Concluding discussion

Globalization has created new opportunities for corporations. However, the increasing extension of business activities abroad has also lead to new responsibilities on a global scale, particularly in developing countries. Consumers and NGOs start to ask for more information about the conditions in which products are generated. Considerations of image and reputation have come to play an increasingly important role in the business competitive environment. Even financial stakeholders start to ask for the disclosure of information going beyond traditional financial reporting.

Human rights conventions, together with guidelines, declarations, principles and codes form an extensive system of norms that have been developed by states, IGOs and the private sector in order to ensure respect for human rights and labor standards in economic relations. Much of the CSR debate is focused on the legal issue of “voluntary versus mandatory” approach to CSR. Perhaps a binding regulation on CSR will be reached in the future, although getting there will take time. Whatever position one takes about the need for a binding regulation on CSR the voluntary work will fill an important space for years to come. Therefore it is an important task to evaluate the voluntary approach to CSR and to work on how to improve its implementation.

It is important to realize that even “voluntary” approaches to CSR have a legal context. In my opinion it is not correct to make a strict distinction between “voluntary” and “mandatory” commitments to CSR. A strict theoretical discussion can easily put a blindfold on the debate missing out on important changes in reality. As I have showed in section 3.2 even voluntary CSR mechanisms can easily turn legally binding. Law and litigation is part of the CSR context. Legal risks can substantially affect the cost of doing business.

¹⁰⁷ Starcher, George, “*Some Notes on Responsible Entrepreneurship*”, pp. 31-33.

¹⁰⁸ A listing of items that are likely to be included in a cost-benefit analysis of CSR is presented by MHC International Ltd. in “*Corporate Social Responsibility: Is there a Business Case?*”, ACCA 2003, p. 21.

Voluntary initiatives on CSR are no substitute for effective action by governments. However, in many developing countries governments fail to live up to their own commitments either because of unwillingness or inability. In those situations corporations have the power to make a difference and society increasingly expects them to. Whether it is legally correct or not to put this responsibility on the corporations is a question that falls outside the scope of this thesis. The reality for the corporations is that they by society more and more are held *socially accountable* and consequently also *economically accountable*.

CSR is closely linked to business profit. Implementation of CSR into business operations will not be successful unless business leaders are convinced that being socially responsible in its operations make not only ethical, social and environmental sense, but also business sense.

Already in 1993 Peter Drucker, a leading authority on international business and management, wrote that the successful companies would be those organized for constant change and innovation, always ready to change products, procedures and policies. According to Drucker responsibility rather than power, and long-term success and reputation rather than short-term gain were going to be the roads to business success.¹⁰⁹ Today we very much experience what Drucker predicted in the beginning of the 1990's.

More and more evidence start to show that being socially responsible and implementing CSR policies will result in good business, meaning business that is long-lived and profitable. The implementation of CSR might increase costs today, but in a longer perspective the business benefits are likely to outweigh these costs and risks. Corporations start to recognize that sustainable business and shareholder value can not be achieved only through maximizing short-term profits. Drucker remarks that long-term results can not be achieved by piling short-term results. An exclusive focus on maximizing shareholder value will force the corporation to be managed for the shortest term, which leads to a decline in the long-term wealth producing capacity of the corporation.¹¹⁰

The controversy about the relationship between shareholder value versus social responsibility often has its source in the thought that something has to be maximized. That it has to be "either...or" rather than "both". In reality business leaders need to balance conflicting interests and concerns and increasingly this balancing process is colored by an awareness that satisfying other stakeholders can be a source of competitive advantage. A stakeholder approach to CSR implies that management needs to seek an optimum balance in responding to the diverse needs of various interest groups. In the words of Faisal Shaheen: "*It is a WAY of doing business by which business managers "internalize" externalities.*"

¹⁰⁹ Drucker, Peter F, "*Post-Capitalist Society*", 1993, pp. 51, 72, 88.

¹¹⁰ Drucker, Peter F, p. 72.

Several factors have been presented that are likely to enhance shareholder value in the long run through a stakeholder approach. In section 3.3.3 various potential business benefits for the corporation have been explored. Sharp Paine canalizes these drivers for CSR into four, partly overlapping, categories.¹¹¹

Firstly, *risk management*. Legal risks, reputational risks and financial risks are interrelated and need to be integrated with each other. A changing legal baseline for CSR, as described in section 3.2, generates new business incentives for improved social performance. The risk of litigation is today closely connected with a decline in reputation, risk of losing market shares, and competitive advantage. As Ward points out this constitutes a major challenge and is about building understanding between different mind-sets. Ward continues by arguing that legal and reputational risk management have to be integrated in a way so that management of legal risks does not damage reputation and, conversely, so that management of reputation does not give rise to litigation.¹¹² Bearing in mind that CSR and the law often take opposite starting points makes the task very complex. Legal risk management thinks in terms of liability whereas CSR focus on responsibility; legal risk management support confidentiality whereas transparency is important for CSR; and, legal risk management is typically characterized by caution and defensiveness whereas CSR needs bridge-building and partnerships.¹¹³ The legal profession increasingly has to take into account the business case. To guarantee the protection and integrity of the client's most valuable asset, its brand name and reputation, the business lawyer needs to provide practical commercial advice in addition to traditional legal advice.

Secondly, *market positioning*. The development of more extensive use of global subcontracting and the emergence of complex supply chains have made the company brand name increasingly important for competitiveness. The raise in customer power has made it essential to build long-lasting relationships with customers based on an understanding of what the customer preferences are. As consumers ask more and more for information about the conditions in which products are generated it has conclusively come to be important to create a reputation of being committed in these issues. One of the most valuable intangible assets is the reputation and trust that consumers have in the company and its brand. Hence, favorable brand image and reputation have become crucial to gain external trust and customer loyalty.

Thirdly, *the organization*. Closely linked to reputation and brand value is the identity of the corporation. Especially in times when stakeholder relationships are complicated and important to business success it has

¹¹¹ Sharp Paine, L., "*Corporate Performance in the Global Era*". Presentation at the SNS-Conference: Corporate Citizenship-Globally and Locally, Tylösand 2001. Referred in: Horn af Rantzen, Mia, 2003, p. 4.

¹¹² Ward, Halina, p. 27.

¹¹³ Ward, Halina, p. 27.

become necessary for a corporation to clarify its values and stand up for who they are, what they do and how they do it. The corporate identity provides value to all stakeholders, not least the employees.¹¹⁴ Much of the importance of identity lies in its function as an expression of shared values.

A “good organization” is likely to have “good employees”, and vice versa. A constructive behavior among employees has shown to create an efficient organization with increased work quality, group performance and co-operation. Hence if the employee can identify with the values of the corporation and be able to trust management they are consequently more likely to show obedience and loyalty towards management.¹¹⁵ Research indicates a lack of investor trust in corporations. According to Webley: “*Businesses should be surprised to find how low they score in the trustworthiness stakes. Increasingly, a commitment to ethical practice is a benchmark of reliability for stakeholders. Having a code of ethics is a powerful tool, but only if it is rooted in the core values of the business.*”¹¹⁶ Thereof the importance of mutual trusts and shared values within the business organization. Moreover, CSR practices are not only important for retaining existing employees, but have also positive impacts in attracting new talented staff.

Fourthly, *the position of the company in society*. Business has an impact on the local community and vice versa. For a corporation it is important to tailor its operations to local circumstances, build partnerships and understanding, give back to the community and earn a licence to operate.

The concept of “corporate social responsibility” is today often replaced by the more inclusive term “good corporate citizenship”, which is commonly defined as “*understanding and managing a company’s wider influences on society for the benefit of the company and society as a whole.*”¹¹⁷ As independent legal entities corporations become citizens of the communities where they operate, and they are consequently considered to have legal duties and rights. Most corporations develop a citizenship identity that complements their business identity.¹¹⁸ It is a question of creating a citizenship identity that appeals to stakeholders and legitimates the corporation’s operations. The perceptions that stakeholders have of a company’s corporate citizenship performance determine whether the company earns its licence to operate in that society. “*A licence to operate depends on both access and acceptance. Access is the formal licence or*

¹¹⁴ Andriof, Jörg and McIntosh, Malcolm, “*Perspectives on Corporate Citizenship*”, 2001, pp. 69-71.

¹¹⁵ Andriof, Jörg and McIntosh, Malcolm, pp. 109-111.

¹¹⁶ Simon Webley is research director of the Institute of Business Ethics (IBE) and author of the IBE guide “*Developing a Code of Business Ethics*”. Cited in: Walker, Octavia, “*New research indicates lack of investor trust in corporations*”, 10 October 2003. Available at: <http://www.ethicalcorp.com>. (Accessed 2004-01-24).

¹¹⁷ Andriof, Jörg and McIntosh, Malcolm, pp. 14-16.

¹¹⁸ Andriof, Jörg and McIntosh, Malcolm, p.70-71.

concession granted by governments. Acceptance is the informal licence granted by societies."¹¹⁹

A corporation's social consciousness is not only important to create acceptance as such by the local society. Mounting evidence shows that, in the long run, companies function best when the community where they operate is stable and prosperous. Especially for companies operating in developing countries the risks inherent in unstable local markets are evident. Therefore, it is in the interest of the companies to help create a healthy local community with adequate education, health care and reduced crime rates.¹²⁰

Starcher talks about how the company and its stakeholders create an *ecosystem*. If a company is to be long-lived and successful it needs to build a system of two-way relationships between the company and its stakeholders, which are mutually beneficial and reinforcing.¹²¹ Waddock states that corporations in the new business system have to realize that they co-evolve with their competitors, suppliers, customers and other stakeholders.¹²² Simplified it is about a tension where each stakeholder contributes a resource that is necessary for the company to be able to fulfil its mission (for example capital, labor or a licence to operate), and in return the company rewards each stakeholder by providing dividends, wages etc. If handled with care and understanding this tension can contribute to strong beneficial relationships. However, it can be destructive if one partner try to exploit the other. The corporation is the major actor in this deal.¹²³

The corporations will not change their behavior unless they are convinced that it makes good business sense. The business of business will always, with some exceptions, be to make money and increase profits. However, corporations have to realize that the basis and sources of making this money are changing. There are a lot of aspects to the discussion whether or not there is a business case in taking on social responsibility for the corporation. Research and case studies done on the subject are few, nevertheless growing in number. The discussion is speculative rather than conclusive, qualitative rather than quantitative. With that in mind the eyes have to be opened up for actual changes in the business environment. There is a movement of changes in attitudes and thinking within the business community itself, expressed by the means of CEO and investor statements. CEOs and investors play a crucial role for the corporation, internally and externally, in communicating the company's corporate purpose, principles and values. Official statements on CSR are even becoming more than simple arguments for the business case. Sir Mark Moody-Stuart (former Chairman of Shell) has observed: "*Without profits, no private company can sustain principles. Without principles, no company deserves profits.*" CEOs are not saying that

¹¹⁹ Hansen, Inge, President and CEO, Statoil. Cited in: "*VALUES AND VALUE: Communicating Strategic Importance of Corporate Citizenship to Investors.*", p. 27.

¹²⁰ Palazzi, Marcello and Starcher, George, pp. 6-7.

¹²¹ Starcher, George, "*Socially Responsible Enterprise Restructuring*", p. 3.

¹²² Waddock, Sandra, p. 54.

¹²³ Starcher, George, "*Socially Responsible Enterprise Restructuring*", p. 3.

a focus on profit is unimportant, but it needs to be supported by sound principles, values and a long-term perspective.¹²⁴ The greatest factor behind this development in corporations starting to change their behavior is probably the increased risk of social accountability - the “shame factor”. If a company violates important norms of social accountability it is likely to also suffer economically.

This leads me to the next part of this thesis, the implementation of individual corporate codes of conduct. Even if the companies want to take greater social responsibility and make a change, the change is not that easy to achieve in reality. There are a lot of standards and the next step is to work on the implementation of these standards set.

¹²⁴ Moody-Stuart, Mark. Cited in: “*VALUES AND VALUE. Communicating the Strategic Importance of Corporate Citizenship to Investors*”, p. 21.

4 Corporate codes of conduct

With globalization and the growth of FDI the nature of business relations has changed. The development of complex global supply chains has raised concerns and significant challenges for corporations with respect to social responsibility. Increasingly, companies have come to experience that for different reasons customers and other stakeholders do not always differentiate between a company and its suppliers. Increasingly, as discussed in Part I of this thesis, companies are held accountable legally, socially and economically for the labor and human rights conduct of their suppliers. Consequently, companies have responded by formulating their own company codes of conduct in order to address these issues.

Corporate codes of conduct are principally voluntary initiatives undertaken by the private sector to address various social issues. Compared to legislation the corporate code of conduct provides the corporations with a voluntary and flexible tool to address these concerns. The adoption of corporate codes is relatively wide spread. The challenge today lies in the development of how companies are to implement the codes. The implementation of codes requires an integrated approach touching on many areas, such as education, training, reporting and monitoring.

4.1 Historical development

The modern corporate code of conduct has not emerged out of nowhere. The relationship between employers and employees has since the early days of industrial production been shaped by some kind of moral, religious and political guidelines. The historical development of modern corporate codes takes its departure in the mid-twentieth century and the emergence of international frameworks.¹²⁵

As a result of a more critical attitude towards MNCs in developing countries, it was first in the late 1960's and the 1970's that more serious efforts to develop international standards for corporate conduct emerged. As a response to public pressure to eliminate unethical business practices international organizations and national governments adopted ethical codes addressing corporate behavior. Most significant were the OECD Declaration on International Investment and Multinational Enterprises, adopted in 1976, and the ILO Tripartite Declaration of Principles Concerning Multinational Enterprises, adopted in 1977¹²⁶. The international codes, adopted by governments in developed countries, were the response to a more restrictive climate in the developing countries. Developing countries started to pass

¹²⁵ Murray, Jill, "Corporate codes of conduct and labor standards", Working paper, ILO, p. 7. Available at: <http://www.ilo.org>. (Accessed 2004-01-31).

¹²⁶ For a brief description of these codes, as revised, see above in section 3.1.2.

legislation in order to control MNCs operating on their territory. Thus, the international codes were the consequence of a bargaining between developed and developing countries where the developing countries demanded greater share of the benefits from the activities of MNCs.¹²⁷

In the 1980's and early 1990's the attitude towards MNCs changed, resulting in a shift from state intervention towards market regulation. Governments in developing countries now shifted their focus from regulating to attracting MNCs and FDI. Existing measures, adopted to restrict MNCs, were removed and new investment regimes were developed to attract MNCs. Despite the change in attitudes the OECD Guidelines and the ILO Tripartite Declaration survived.¹²⁸

At the same time as the trend in national and international policies moved towards trade liberalization and deregulation, the activity of private regulation at the corporate level increased. The first trend within the private sector to develop corporate codes of conduct started in the late 1970's. The first codes were adopted mostly by US corporations and primarily concerned questions of bribery and corruption. The mid 1980's faced a decline in public pressures for adoption of codes, but again the interest increased in the 1990's, this time with a focus on environmental and labor issues. This second wave of corporate codes was dominated by leading apparel manufacturers such as Levi Strauss, Gap and Nike.¹²⁹

The modern corporate codes of conduct are different in several aspects from the international codes that were adopted in the 1970's. Firstly, as described above, the international codes are adopted by international organizations as a complement to national regulations of MNCs. The corporate codes of conduct, on the other hand, are voluntary codes adopted by the business sector itself. Secondly, whereas the driving force behind the international codes of the 1970's were the developing countries, the corporate codes of the 1990's were supported by actors from developed countries, e.g. international trade union organizations, NGOs and the corporate sector itself.¹³⁰ Thirdly, perhaps the most important difference is that the codes vary in scope. The new corporate codes of conduct are at the same time both narrower and broader in scope than the international codes. The international codes have a more comprehensive content and are directed towards the operations of the MNCs and their subsidiaries.¹³¹ The new corporate codes of conduct tend to be more focused on specific issues and are extended to include responsibility for the human rights and labor practices of suppliers and subcontractors. Indeed, the fact that the modern corporate codes of conduct are applicable to the workers of the suppliers,

¹²⁷ Jenkins, Rhys "Corporate Codes of Conduct. Self-Regulation in a Global Economy", 2001, pp.2-3; Murray, Jill, pp. 7-8.

¹²⁸ Jenkins, Rhys, 2001, pp. 3-4.

¹²⁹ Jenkins, Rhys, 2001, pp. 4-5.

¹³⁰ Jenkins, Rhys, 2001, pp. 5-6.

¹³¹ See section 3.1.2.

beyond the direct employment relationship between the MNC and the first level supplier, is what makes these codes especially interesting.¹³²

The new “supplier codes” represent an important shift in the function of corporate codes. Traditionally the corporate codes were regulating internal corporate behavior. The new codes include employees of suppliers and subcontractors who are not in a direct equity relationship with the MNCs authoring the code. This development may imply that the MNCs are recognizing a certain degree of responsibility for the consequences of their global business operations.

4.2 Types of corporate codes of conduct

Corporate codes of conduct can be separated into different types depending on to whom they are directed. Firstly, the traditional corporate code is directed to the corporation’s own employees. Secondly, there is the code that focuses on the labor conditions of the company’s suppliers and subcontractors (“supplier codes” or “sourcing guidelines”).¹³³

MNCs can either develop codes of conduct individually or in collaboration with other companies within the same industry. Often companies seem to prefer the industry code when faced with public pressure to regulate their ethical conduct for the first time. An industry code includes a common set of guidelines and implementations standards that all members of the group must adhere to.¹³⁴

Arguments to support the industry approach are often expressed in terms of cost-efficiency. A co-ordinated approach would reduce costs since companies in an industry are likely to face similar problems, competitive conditions and external pressure. Other reasons for taking a group approach could be to avoid confusion when contractors supply numerous different buyers, each with their own codes.¹³⁵ Furthermore, SMEs are often in a less favored position due to their size and limited capital when it comes to adopt and implement codes.¹³⁶ Sharing of logistics and costs of the monitoring process are therefore potential advantages of co-operating in these issues. However, Sethi means that there are flaws in this way of reasoning and

¹³² Justice, Dwight W, pp. 91-94.

¹³³ Jenkins, Rhys, “The political economy of codes of conduct”. In: Jenkins, Rhys, Pearson, Ruth and Seyfang, Gill, *Corporate Responsibility and Labour Rights. Codes of Conduct in the Global Economy*, 2002, p. 18; Urminsky, Michael (ed.), “Self-regulation in the workplace: Codes of conduct, social labeling and socially responsible investment”, 2002, p. 13.

¹³⁴ Sethi, Prakash S, “Setting global standards. Guidelines for creating codes of conduct in multinational corporations”, 2003, p. 85; Goldoner, Linda F, “The Apparel Industry Code of Conduct. A Consumer Perspective on Social Responsibility”. In: Williams, Oliver F (ed.), “Global codes of conduct. An idea whose time has come”, 2000, pp. 245-248.

¹³⁵ Sethi, Prakash S, pp. 85-86.

¹³⁶ See section 2.2.2.

emphasizes the positive aspects of individual codes of conduct. Sethi's arguments rest on the view of codes of conduct as a competitive weapon; a code is to be seen as a product just like any other product. All over the world companies compete with each other in providing products to customers. A company is not likely to delay an introduction of a superior product into the market, waiting for other companies to reach its level. The question could then be asked why there should be any different in the case of codes. As showed in section 3.3 and subsections, taking on a CSR friendly approach and, most important, finding a good way of implementing the standards and gaining public trust, is perhaps the most important way to gain a competitive advantage. Once the superiority of a particular code has been established in terms of its content and implementation system, Sethi argues that other companies would easily be willing to accept this code in meeting their own requirements.¹³⁷ According to Sethi industry codes are likely to hold companies back in taking risks and seeking more innovative solutions. There is also the risk that performance standards are set at the lowest common level since numerous companies need to find a consensus. However, the free-rider problem that industry codes are likely to cause is probably the hardest and most important problem to deal with. Being part of a group reduces the incentives for individual companies to improve their performance. Critics tend to focus on companies with poorer record and thereby deprive companies that do well of public goodwill.¹³⁸

Perhaps the strongest driver for a company to adopt its own corporate code is the case of first-mover-advantage, which is partly a consequence of asymmetric information. By formulating an individual corporate code, which is unique to the specific needs of the company and its stakeholders and differ (in content and implementation) from the ones of other companies, the company may gain market shares and earn higher profits. The problem with most codes is the lack of trust and credibility among stakeholders. Customers and other stakeholders are willing to credit and buy products only if they have reason to believe what the corporations claim, meaning that consumers need to be provided with enough credible information. Consequently, companies need to create a code that is different in quality and provide reliable information, which can be evaluated objectively.¹³⁹ From this perspective individually created codes of conduct give the companies the flexibility that is needed to take due regard to the interests of different stakeholders and to be able to create the necessary trust. However, there is an important point in the argument of the need of some consensus in code language. The very complex supplier network gives suppliers and subcontractors a hard task in adhering to numerous different code standards. Text consensus, if not a common code, might be worth striving for.

¹³⁷ Sethi, Prakash S, p. 86.

¹³⁸ Sethi, Prakash S, pp. 86-87.

¹³⁹ Sethi, Prakash S, pp. 86-87.

4.3 Code content

The scope of various labor and human rights issues covered in a code varies widely between different companies and between different industries. Often the labor issues covered tend to mirror the publicized labor problems within the particular sector. For example corporate codes in the apparel and footwear sectors tend to focus on child and forced labor since these areas have been recognized as problems by media.¹⁴⁰ Principally codes should include core labor standards such as those embraced in the ILO Conventions (e.g. freedom of association/collective bargaining, non-discrimination, absence of forced and child labor, wage levels and occupational health and safety). However, neither the business case for corporations nor the standards in the OECD Guidelines or the ILO's Tripartite Declaration are limited to legal minimum standards. Economic benefits for the corporations are derived from employee training, improved health and safety, industrial democracy etc. in a long-term perspective. The voluntary nature of the code makes it possible for the corporation to move beyond core minima and also include provisions that address training, hours and overtime, benefits and health and safety issues.¹⁴¹

For corporate codes to be successful it is important that the standards are clear, specific and precise. The standards may be set internally by the corporation itself or drawn from various sources including national legislation, international labor standards and industry benchmarks. Research shows that particularly among individual corporate codes it is common practice to set self-defined standards. It is also common to refer to national laws in the country of operation. Relatively few codes make explicit references to internationally recognized standards such as the ILO Declaration and the ILO Conventions, the OECD Guidelines or the UN Global Compact.¹⁴² Nevertheless, some companies are starting to recognize that there are reasons for making explicit references to internationally accepted standards rather than merely create internal standards that are "consistent" with international standards. An explicit reference might give the code legitimacy in the eyes of stakeholders. Adopting internationally recognized labor standards makes it easier for corporations to counter arguments from union activists claiming that there is a danger that corporate codes become replacements of governmental legislation. Some argue that a reference to national law is meaningless, as it is already a minimum obligation of the company. However, such provisions might be useful as a tool to reinforce existing legislation since the enforcement of labor laws in many developing countries is inferior, leaving local manufacturers with the possibility to operate largely without regulation.¹⁴³

¹⁴⁰ Urminsky, Michael (ed.), p. 21.

¹⁴¹ Murray, Jill, pp. 33-34; Mamic, Ivanka, "Business and code implementation. How firms use management systems for social performance", ILO 2003, p. 27.

¹⁴² Urminsky, Michael, pp. 22-24.

¹⁴³ Mamic, Ivanka, p. 28.

The inconsistency and random selection of code provisions from a variety of sources create obstacles to the implementation of these standards. Multiple sources make interpretation of standards more laborious for suppliers and increase the possibility of gaps and conflicts between code requirements.

Not only the choice of code provisions may lead to implementation problems. Equally important is the language used in a code. The fact that a company adopts a code does not necessarily mean that the attitudes and motivations underlying it are genuine and true. The specific code language used in the code determines its strength and reveals the underlying corporate commitment. By expressing a standard in specific terms and requiring absolute commitment, a company can set a mandatory obligation for itself and its suppliers. At the other end, a company can leave the definition and implementation measures up to the discretion of suppliers by using vague phrases. It is also of great importance that the language used is understandable to the local workforce. For communication to be effective it is imperative that the company understands and takes into account local conditions, such as dialects and the actual education and reading ability in the workforce, when formulating a code of conduct.¹⁴⁴

4.4 Implementation of corporate codes of conduct in the global supply chain

A code is merely a piece of paper if there are no clear methods of implementation and means to ensure that the code is being complied with. The implementation process is just as important as the code content itself if there is to be a change in actual practice on the ground. To date, the implementation of labor and human rights practices in the global supply chain through corporate codes of conduct has relied on a system of code formulation, monitoring and remedial processes.

The first step towards effective implementation is that the text of the code, as implied above, leaves little room for ambiguity in its interpretation. Moreover, stakeholders demand companies to show greater transparency regarding information of their business conduct. They want information that they feel they can trust; data that is reliable and valid. The system of corporate codes of conduct relies heavily on internal as well as external monitoring of code compliance.

In sum, the implementation system is very much focused on monitoring and auditing as the principal means of ensuring compliance with code provisions. However, the principles, strategies and procedures related to code implementation have evolved. As indicated above many codes start to become more consistent with internationally agreed principles. In addition,

¹⁴⁴ Mamic, Ivanka, pp. 23-24.

implementation guidelines for broad principles have been established in codes, and the importance of remedial processes is being recognized.

4.4.1 Contractual, internal and external monitoring

In the selection of supplier and supplying countries a company may use labor and human rights criteria to guide them in their decision. In a sense, this is a first step of monitoring.¹⁴⁵

Effective monitoring of existing suppliers/subcontractors is a complex and difficult task. Depending on factors such as the size and capital of the MNC, the number of suppliers used and the type of industry, effective monitoring is more or less difficult. For MNCs that use numerous suppliers and operate within a fast-changing supply chain monitoring can be almost impossible. Especially SMEs may find implementation and sustainable strategies hard due to a lack of resources, financing and educated staff. Therefore, many companies rely on guarantees made by the suppliers stipulating that they respect the provisions of the code - *contractual monitoring*.¹⁴⁶

Larger MNCs have an easier task to monitor the conduct of their suppliers. They generally have better financial and logistical resources and usually source from a fewer number of suppliers. Instead of relying on the suppliers on a contractual basis these companies tend to prefer to do the monitoring themselves - *internal monitoring*. Internal monitoring means that the MNC itself or its immediate agents conduct an on-site inspection.¹⁴⁷

Increasingly companies feel pressure, especially from activists and consumers, to use *external* and *independent monitoring procedures*. The nature of internal monitoring puts the company in a position of conflicting interests. The objectivity of the information is often questioned since the MNC may have an interest in being less honest and transparent with information in order to keep profitable supplier relationships. External monitoring is on-site inspections performed by actors hired by the MNC. These actors report back to the MNCs. Independent monitors are in contrast financially independent and report back not only to the MNC, but also to other interested parties such as consumers and NGOs.¹⁴⁸

¹⁴⁵ van Liemt, Gijsbert, p. 184.

¹⁴⁶ van Liemt, Gijsbert, pp. 185-186. See also section 2.2.2.

¹⁴⁷ Rosenbaum, Ruth, "In Whose Interest? A Global Code of Conduct for Corporations". In: Williams, Oliver F (ed.), *Global codes of conduct. An idea whose time has come*, 2000, p. 215.

¹⁴⁸ Rosenbaum, Ruth, p. 215; van Liemt, Gijsbert, p. 186.

4.4.2 Implementing guidelines

There is a need to standardize the various procedures that are required to fulfil the objectives of codes of conduct. The inconsistency in the application of codes is one important obstacle in achieving an actual change in social responsiveness among suppliers. “Implementing guidelines” is one attempt to create some consistency in this area.

Implementing guidelines, issued by the MNCs, are supplemental code material such as instruction manuals, audit checklists and other documentation that map out procedures for code implementation and follow up.¹⁴⁹ For example terms like “peak period” used in a code can be defined and explained in the guidelines and thereby provide guidance to the supplier, and to auditors.

The extent to which guidelines are offered by the MNCs varies. However, due to the fact that MNCs increasingly are held accountable for the actions of overseas suppliers the interest among MNCs to develop guidelines and work more effectively with implementation on supplier level has increased. Implementing guidelines are largely internally developed documents and procedures. Companies often claim these guidelines to be confidential business information or trade secrets providing a competitive advantage.¹⁵⁰ Thus, there is a lack of transparency also regarding implementing guidelines.

4.4.3 Remedial processes

Monitoring helps to identify a problem but does not solve it. One of the ultimate goals of a code should be to continuously improve working conditions on the factory level.

Relatively few codes have provisions stating that reporting of violations is a duty required of employees as part of their loyalty to the company. However, often, when channels for reporting exist, the penalties in case of non-compliance have counterproductive effects. Since the penalty often is potential termination of employment, in case of employee violation, or termination of the contract, in the case of violation by a supplier, the worker/supplier is placed in a dilemma of fighting for better working conditions or risk losing jobs/businesses.¹⁵¹ It is relatively easy for monitoring personnel to find code violations and report them. Furthermore, it is relatively easy to have these inadequacies corrected in time for the next audit. The goal should be to give factory-level stakeholders the motivation

¹⁴⁹ “Codes of Corporate Conduct- An Expanded Review of their Contents”, OECD, June 2000, p. 26. Available at: <http://appli1.oecd.org>. (Accessed 2004-02-02).

¹⁵⁰ Mamic, Ivanka, pp. 35-36. Compare to Sethi’s view of individual corporate codes of conduct in section 4.2.

¹⁵¹ Urminsky, Michael, pp. 35-36.

and capacity to remedy violations of labor and human rights apart from the periodic interventions of monitoring personnel. Some later codes make a distinction between wilful violations and unintentional violations due to ignorance and lack of control.¹⁵²

The strategy should be to improve an unsatisfactory situation rather than punish violations. It is important to emphasize alternative methods to instant termination of contract. The MNCs should first consider corrective actions, especially since code violations by suppliers and their workers often are results of lack of knowledge, resources and control. There is a need to move from policing to consultation.

¹⁵² van Liemt, Gijsbert, pp. 187-188.

5 Analysis

5.1 Industry structure and stakeholder attitudes towards CSR and codes of conduct

Globalization of markets, increasing intensity of competition, changing consumer preferences, rapid technological progress and new social expectations from employees, customers and communities - businesses today are managed in a time of change. With the new global economy the premises for international business operations have been altered and the requirements for competitiveness and business success have changed.

The new business environment has made it possible, and necessary, for the corporation to find new ways of running its operations and manage its relations with business partners. Without losing control corporations have decentralized their decision-making and introduced more flexible and less hierarchical business structures. Today competitiveness requires efficient production systems. In order to keep down production costs, be able to quickly develop new designs and respond to fluctuations in exchange rates and trade restrictions, corporations have to be flexible and mobile in their operations. As a result corporations tend to concentrate on their core areas of expertise and contract out other areas. Hence global outsourcing has become standard practice within many industries, especially low-skilled labor intensive production such as the apparel, footwear and toy industries. The development gives rise to a new network type of business organization, or a *virtual company* as Waddock describes it, consisting in a complex web of suppliers, subcontractors and licensees. Significant parts of the MNC's business actually are performed through alliances among companies (subcontractors, suppliers, licensees etc.). Hence, one might say that the network of relationships *becomes* the company in a way.¹⁵³

To be able to adapt to shifting external circumstances the MNC keeps its relationships with its suppliers on a short-term and fast-changing basis. This creates an insecure and unstable business environment that naturally is reflected in the relationships further down the production chain. Not surprisingly, employment on supplier level is often informal and temporary. Thus, the entire industry structure is built upon features such as flexibility, intensity, short termism and insecurity.

The globalization process, the development of supply networks and an increased public awareness of poor labor and human rights practices in the global supply chain have resulted in a growing perception that MNCs need to take greater social responsibility. For different reasons consumers, activists and other stakeholders do not always differentiate between a

¹⁵³ Waddock, Sandra, pp. 178-179.

company and its suppliers. Corporations are increasingly held responsible not only for profits, costs, quality and delivery dates, but also for living conditions, health and safety issues and labor practices of suppliers and their workers. As discussed in Part I, chapter 3, companies are increasingly held accountable - legally, socially and economically - for the labor and human rights practice of their suppliers. The corporation's reputation and brand name image in these issues have consequently become perhaps the most crucial factors towards competitiveness and business success.

Corporations respond to increased social expectations by formulating their own corporate codes of conduct. By the means of codes MNCs try to channel voluntarily adopted standards from their home countries, to the operations of suppliers, subcontractors and other business partners in countries where such standards may be non-existent, incomplete, not enforced or ignored. This task is not easy. As the new global economy has evolved, the concept of corporate social responsibility has gone through a parallel transformation. The corporate code of conduct applied in a global value chain has to define and apply performance standards to a complex web of suppliers, inexperienced workforces, differing local customs and cultural values, conflicting legislation and inconsistent enforcement. Being socially responsible in a global context is much more complicated than within a local framework where regulations and standards are consistent and cultural and ethical values are relatively homogeneous. Given the complex situation CSR has moved from being a concept to become an industry with new services such as social auditing and risk assessment services. It is important that these new services and tools are used to respond to society expectations and stakeholder needs, and not to redefine the same.¹⁵⁴

Throughout this thesis a stakeholder approach has been used in order to get a more comprehensive picture of the challenges and obstacles of effective implementation of CSR and corporate codes of conduct into the global supply chain. When they formulate and implement codes corporations have to balance between different interests. Who exactly is to be defined as a stakeholder in relation to MNCs' operations differs depending on factors such as the type of industry and how each corporation relates to the outside world. Moreover the kind of interests that stakeholders encompass varies widely. However some generalizations can be made as to common stakeholders, their interests in and attitudes towards CSR and corporate codes of conduct.

Most of the corporations, which have adopted supplier codes of conduct covering human rights and labor issues, are *large corporations* with well-known brand names that mostly rely on foreign suppliers and subcontractors in their manufacturing. In section 3.3 the importance of corporate image for competitiveness was discussed and consequently the major motive for larger corporations to adopt a code is to protect their reputation. In most cases codes are adopted as a means to pre-empt external criticism and pressure.

¹⁵⁴ Justice, Dwight W, p. 99.

Negative publicity may be devastating for a company with a high public profile. Other companies have done “bad” things in the past (see the examples of Nike and Shell). They have paid the price in public embarrassment and even diminishing sales or stock values and they choose to pursue a different path in the future.¹⁵⁵

Smaller corporations in the North are for several reasons less interested in taking CSR seriously than larger corporations of branded products. First of all they are less visible to the public and therefore less likely to attract attention and pressure from activists. Moreover it is harder to convince smaller companies that they will increase their financial performance by more seriously engaging in CSR. Since they have less capital under management they consider themselves less able to absorb any increased costs associated with the adoption and implementation of a code, for example the costs of monitoring suppliers.

Considering the fact that abundant MNCs operating in developing countries are smaller companies rather than large brand corporations makes it especially important to encourage the former to engage in social issues. Additionally, the free-rider problem might lessen the incentives for larger corporations to adopt codes or engage in industry wide solutions. The materials found regarding CSR merely to a lesser extent discuss smaller corporations in particular. Ordinarily the international debate discusses MNCs in general terms. It is important that the international debate more distinctly address the specific difficulties and challenges that smaller corporations are faced with.

Both *Northern NGOs* and *trade unions* often have a sceptical attitude towards unilateral codes of conduct adopted by companies. Their main concern is that the codes will become a substitute, not merely a complement, to governmental regulation of corporate behavior. Trade unions assert that corporate codes should support the standards in various ILO Conventions, however, they should never be a substitute for legislation nor an alternative to trade union representation or collective bargaining.¹⁵⁶

The deregulation in the 1980’s led to a perception in the 1990’s that governments were not effective enough in controlling large corporations. As a result NGO activism increased in the 1990’s with a focus on labor rights, human rights and the environment. Pressure from NGOs has played an important role in having corporations adopt codes. In numerous cases NGO pressure, by threatening a company’s reputation, has forced companies to respond either by adopting a code or revising an already existing code.

In the modern corporation ownership and management often are separated. Therefore, *shareholders* and *investors* must be seen as distinct stakeholders. The interest of shareholders is ultimately in the value of the shares of the companies in which they have invested. The management of the corporation

¹⁵⁵ Burns, Jennifer, “*Hitting the wall: Nike and International Labour Practices*”, 2000.

¹⁵⁶ Jenkins, Rhys, pp.10-12.

has as its primary responsibility to look after this interest. The question whether investments in ethical behavior by companies result in business benefits and better financial performance for the corporation (“the business case”) has been discussed in sections 3.3 and 3.4. Even if mounting data indicates that there are business benefits to derive from better ethical performance, the opinions are still divided. Research and case studies are yet not adequate enough for any certain and comprehensive conclusions to be drawn. Nonetheless, statements made by investors and CEOs show that ethical issues are starting to be taken seriously within the business community and that management increasingly believe that social responsiveness is necessary for the long-term profitability of the corporation.

One way through which shareholders can express their views regarding a company’s social behavior and push for code adoption is the stock market. Another important alternative is the development of “active shareholder engagement”, meaning that minority shareholders start to table resolutions and raise questions about CSR. The increase in shareholder pressure is important to alter the social behavior of companies, not least for smaller companies that do not rely heavily on brand image nor are vulnerable for public scrutiny.¹⁵⁷

Consumers are starting to become increasingly concerned about how products are generated. Since favorable brand image and reputation have become crucial to gain external trust and customer loyalty, the importance of mapping consumer preferences are often emphasized by companies. From this perspective, the adoption of codes of conduct might be viewed as a response by companies to consumer preferences expressed in the marketplace. Whether this impact on company behavior is a result of consumer pressure as such, or is, according to Jenkins, an expression for political pressure from society, fact still remains that consumers do matter.

Southern suppliers/subcontractors have a somewhat ambivalent view of CSR and codes of conduct. The demand for codes is mostly externally driven and often places the suppliers/subcontractors in a difficult position. As mentioned competition on supplier level is fierce and suppliers risk losing valuable contracts if they do not comply with certain labor and human rights standards imposed on them by their buyers. Complying with these standards, on the other hand, will likely mean increased direct or indirect costs that are often hard for the individual supplier to absorb. If the supplier is caught with not complying, corrective actions often have to be paid by the supplier himself, and in the worst scenario the supplier loses his contract. It is important to bear in mind that suppliers in developing countries often lack financial capacity as well as knowledge concerning code implementation. Suppliers need support and guidance in how to meet code requirements. In addition suppliers often have to face a wide variety of

¹⁵⁷ Jenkins, Rhys, pp.13-14.

demands, sometimes conflicting, from multiple codes from many different buyers, resulting in increased transaction costs on the part of the suppliers.

Often *workers* in supplier factories are uneducated, uninformed and unorganized. Relatively little is known about their attitudes towards codes of conduct. However, studies show that their priorities do not necessarily coincide with the standards set in the codes. For example codes have proved to have an adverse effect to marginal workers such as home-based workers. Implementing a code means conducting monitoring. Monitoring is easier and more efficiently performed if production is centralized. Hence, suppliers tend to centralize their production by bringing work into factories, resulting in displacements of workers whereby home-based workers tend to suffer.¹⁵⁸ Although the intention of a code of conduct is to improve the conditions of the workers this is often not achieved in practice. Since corporate codes of conduct often do not reflect the priorities of the workers themselves, the result may be that the codes actually worsens the situation of those who it is supposed to protect.

Knowledge of the code is essential for its implementation. Often codes are untranslated, unavailable or even unknown to the workers at the production facilities. If corporate codes are to help the workers then the workers need to be involved in the formulation, implementation and monitoring of these codes. Most important, however, is that the workers are aware of that the code exists and that they are able to read or understand it.

Conclusively, many different interests have to be balanced when to formulate and implement a corporate code of conduct.

5.2 Implementation of supplier codes of conduct in the global production chain

Corporate codes of conduct have the potential to serve important business as well as social purpose. In contrast to international governmental instruments such as the OECD Guidelines, or a future binding international legislation, the corporate code of conduct always requires a positive commitment by the company before it applies. The OECD Guidelines applies to all MNCs operating in or from adhering countries whether they have accepted the guidelines or not. The voluntary nature of the corporate code is often considered to be its greatest weakness. However, the very fact that the corporate code is in need of a positive commitment by the company itself is at the same time its strength. If only the company is convinced of the benefits of adopting a code of conduct and having it effectively implemented, then the voluntary code has great potentials in responding to

¹⁵⁸ Brill, Lucy, "Can codes of conduct help home-based workers?". In: Jenkins, Rhys, Perarson, Ruth and Seyfang, Jill, "*Corporate Responsibility and Labour Rights. Codes of Conduct in the Global Economy*", 2002, pp. 115-117.

the expectations of society and stakeholders in an effective and sustainable way.

The extension to the supply chain is an important innovation of the new generation of corporate codes. By including the behavior of the suppliers and their workers the corporate codes have moved from regulating internal behavior to external behavior. This implicates that MNCs are recognizing a certain degree of responsibility for the consequences of their global business operations.

From the MNC's point of view the company code of conduct provides the corporation with a flexible tool to address social concerns. The code is a means for the corporation to form solutions suitable to the special needs and public concerns of the individual corporation and its particular stakeholders. There is no "one-size-fits-all" for corporate codes of conduct applicable in a global context. Corporate codes of conduct can take various forms and can either be developed individually or in collaboration with other companies within the particular industry sector. I agree with Sethi and believe that a corporation has lots to benefit from developing its own individual code of conduct.¹⁵⁹ A company may enhance trust and credibility among stakeholders by being innovative and comprehensive in its formulation of code content and implementation processes. The company has the possibility to take due regard to the unique needs of the company and its stakeholders. However, the cost-efficiency and co-ordination aspects of creating an industry wide code are not insignificant. As will be discussed below there is a need to achieve harmonization in code language and application procedures since suppliers and subcontractors have a difficult task in adhering to numerous different code standards.

Nevertheless there are substantial flaws in corporate codes. The codes are predominantly formulated and applied unilaterally by the MNC authoring the code. Even if there is a renewed interest in the old international codes and other international frameworks, MNCs mostly create their own internal standards rather than directly refer to recognized international frameworks such as the OECD Guidelines, the ILO Declaration or the Global Compact. Notwithstanding the fact that existing international frameworks are non-binding and compliance is voluntary, their clear, precise and broadly applicable definitions and standards make them authoritative instruments in promoting responsible social behavior and in giving the corporate codes legitimacy and authority.

To implement a code of conduct and achieve its goals is not an easy task. As yet, the discussion has been focused on the importance of effective monitoring, especially external and independent monitoring. External and independent monitoring is very important, and will remain so even in the future. However, it is necessary to move "beyond monitoring" and see the complete picture in order to find the barriers and challenges of effective

¹⁵⁹ Sethi, Prakash S, pp. 85-86.

code implementation in the global supply chain. MNCs in general have poor records of implementing their codes.

Predominantly this thesis has touched upon three interrelated factors to be recognized as challenges or obstacles when to channel social responsiveness into the global supply chain. Firstly, there might be a need of harmonization of code content and application procedures. The inconsistent and random selection of code standards from a variety of sources creates obstacles to effectively implement these provisions. Secondly, the fact that codes are more or less imposed on suppliers might cause problems. Stakeholder participation needs to be increased. Thirdly, MNCs as well as suppliers need to better understand, and be convinced of, the link between CSR policies and increased financial performance for the corporation.

In the complex production chain competition among suppliers is intense. As a consequence of the insecure, short-term and fast-changing business environment suppliers often contract with numerous buyers at the same time. As a result suppliers are likely to have multiple codes of conduct imposed on them from different buyers. The increasing number of codes and the variety of standards they may contain are likely to lead to confusion and inefficiency on behalf of the suppliers. Hence, there might be a need for *harmonization of codes*. From the perspective of a supplier in a developing country it would presumably seem preferable with an industry wide code or a standardized code covering a limited number of key issues.

Even if the high number of codes causes inefficiency it might be suggested that this is not in itself the real problem. More and more codes tend to restate local laws and reflect a strong and growing convergence around core ILO Conventions or principles embraced by the OECD Guidelines.¹⁶⁰ An explicit reference to widely accepted international instruments is still not standard practice among MNCs issuing codes. Nonetheless, standards internally set by the companies tend to be “consistent” with international norms and cover core labor standards. Hence, codes are quite uniform regarding their content. For example studies have shown that in the end of 1990’s supplier codes within the apparel industry showed wide divergences in the commitments made. Thus the development since indicates a convergence in code content based on international standards and a gradual emergence of a de facto standard of commitment in sectors where labor conditions in supply chains are a concern.¹⁶¹

Rather the main problem seems to be found in the *application of codes*. The problem rests with multiple auditing and inconsistency in auditing procedures, management requirements and remedial processes, which is a result of duplication of codes. Codes differ in how suppliers are asked to demonstrate their management and implementation of code provisions.

¹⁶⁰ “*Managing Working Conditions in the Supply Chain: A fact-finding study of Corporate Practices*”, OECD 2002.

¹⁶¹ “*Managing Working Conditions in the Supply Chain: A fact-finding study of Corporate Practices*”, OECD 2002.

Suppliers are subjected to several audits per year and auditing procedures (e.g. the use of documentation, visual observation and interviews etc.) may differ resulting in inefficiency and high transaction costs. An already heavy burden on the suppliers is that they themselves often have to meet the costs of code compliance, monitoring and auditing. Duplicative requirements make this financial and managerial burden unnecessary heavy.¹⁶² Furthermore, MNCs often have very different approaches to what to do to address shortcomings in performance by suppliers.

Corporations have started to create *implementing guidelines* in order to make it easier for suppliers to adhere to code standards. The creation of implementing guidelines may have the potential to engage local stakeholders that work within a common local framework. Furthermore it might reduce the time and effort needed to establish consensus concerning core standards and create a level playing field for suppliers. However, so far these guidelines are, like the codes themselves, mostly internally developed documents. There is a risk that guidelines from different buyers are inconsistent. The external pressure that buyers face often leads them to develop and interpret implementing guidelines individually and there might be competitive advantages in doing so.

Conclusively, there is a growing demand to standardize the various procedures that are required to fulfil the objectives of corporate codes of conduct. The inconsistency in the application of corporate codes of conduct is one important obstacle in achieving an actual change in social responsiveness among suppliers.

Suppliers often feel that corporate codes of conduct are imposed upon them. Since the *top-down approach* does not involve suppliers, their workers or workers representatives sufficiently in the development and implementation of the codes there is need for a change. Alice Kwan and Stephen Frost claim that we need to look beyond the code as such: “*To move beyond codes of conduct is to move into an arena where those concerned do more than interview workers and promote training based on the answers. It may require us to actively engage workers in more creative and long-term relationships than we have envisaged, and to listen to workers so that we may act with them, and not on their behalf.*”¹⁶³ As yet corporate codes of conduct have been formulated, implemented and monitored by others than those who the codes are supposed to protect. It is often being assumed that the adoption of code standards and the priorities made therein are in the interest of the workers. As mentioned above this is not always the case. Adopted codes may actually worsen the situation of the very workers they are supposed to protect. Hence, to achieve sustainable solutions it is

¹⁶² Barrientos, Stephanie, pp.67-68.

¹⁶³ Kwan, Alice and Frost, Stephen, “ “Made in China”: rules and regulations versus corporate codes of conduct in the toy sector”. In: Jenkins, Rhys, Pearson, Ruth and Seyfang, Gill, *Coorporate Responsibility and Labor Rights. Codes of Conduct in the Global Economy*, 2002, p.133.

imperative that corporations, in the words of Kwan and Frost, *act with suppliers and their workers, and not on their behalf*.

The lack of involvement consequently results in a lack of trust between buyer and supplier. For different reasons suppliers question the motives of MNCs implementing social standards in the supply chain. For example adhering to social standards is only one additional requirement that the supplier is faced with. A code of conduct imposed in the supplier is likely to result in increased initial costs for the supplier. At the same time the supplier is pressured to lower prices and speed up delivery of goods or he risk loosing his contract with the buyer. Hence, the supplier is torn between the importance of CSR vis-a-vis other requirements such as price and delivery.¹⁶⁴ Moreover, the traditional supplier-buyer relationship often is fast-changing and temporary, and for many buyers CSR is still unfamiliar territory. The structure of the industry and the nature of the relationships make it hard to expect buyers to commit to more supplier-inclusive approaches.¹⁶⁵

The business community increasingly recognizes that new approaches have to move in the direction of bottom-up, meaning implementation strategies that to a greater extent rely on the positive engagement of suppliers, workers and local stakeholders. Most likely a change in corporate social performance would not come about to begin with if it was not to start from the top of the value chain. Many suppliers in developing countries are operating in violation of applicable laws and lack the capacity or will to change their behavior. Furthermore, CSR issues are driven by buyers as a response to top-down pressure from society and other stakeholders. Most certain CSR issues need to be driven top-down even in the future. However, this is not enough as a stand-alone strategy for sustainable implementation of social standards in the long run. Further sustainable improvements need more consultation with stakeholders, especially the suppliers and their workers.

Finally, *the business rationale* is a crucial factor in determining the willingness and motivation of suppliers, and buyers, to undertake investments in CSR practices. The potential business benefits for MNCs to implement social behavior throughout their global business operations have been thoroughly examined in Part I of this thesis.

Regarding suppliers in particular they often do not see a direct link between good CSR performance and increased financial performance. The main factor underlying this assumption is, again, *the nature of the supply chain*. Buyers tend to shift orders between suppliers within short periods of time.

¹⁶⁴ “Strengthening implementation of corporate social responsibility in global supply chains”, The World Bank Group, October 2003, pp. 23-26.

¹⁶⁵ “Strengthening implementation of corporate social responsibility in global supply chains”, The World Bank Group, October 2003, p. 25.

Since suppliers often do not have a guarantee of continuing business from buyers they do not see the benefits from investments in social issues.¹⁶⁶

¹⁶⁶ “*Strengthening implementation of corporate social responsibility in global supply chains*”, The World Bank Group, October 2003, p. 27.

6 Conclusions and implications for the future

Somehow the gap between the behavior of MNCs and social expectations in developing countries needs to be reduced. Multinational corporations are powerful actors in the globalized marketplace. It is no secret that companies operate globally to increase its profits; it is often spoken that the very business of business is business. The process of globalization that today is reality makes it profitable to expand business operations into developing countries where labor costs are low and working conditions and human rights standards are not high on the agenda. I do not believe that there are business justifications for poor social behavior among corporations operating in developing countries. However I believe that we need to stop focus on the corporation as being the *problem* and instead start looking at the corporation as being the *solution*, the tool to bring market and society closer together.

Given the divers interests of stakeholders this thesis seeks to evaluate the development of corporate self-regulation through voluntary codes of conduct. Voluntary corporate codes of conduct have great bridging potentials. The concept of voluntary corporate codes of conduct is good. The problem rests with the way these codes currently are created and implemented. It is also about what is reasonable for society to expect of the corporations. We should not expect corporations to contribute to the overall health of the local community and well being of the local people if by doing so the survival of the corporation is endangered. We should, however, hold corporations accountable for the conduct in the corporation's own operations and those of its local suppliers and subcontractors. The MNCs have a bargaining leverage against their suppliers and workers in developing countries and we should expect them to demonstrate that they are not abusing this power.

The main reason for corporations to operate globally and to outsource their production is to reduce costs and increase profits. At the same time, the business environment is going through a transformation altering the sources and premises for making this surplus. Increasingly the business community acknowledges that there is a positive link between social and financial performance.

A number of elements have been derived from the discussions of this thesis as being of importance to make a corporate code of conduct operate effectively. In sum some of these factors are:

The content of the code has to address the needs that are, first of all, important to the suppliers and the local workers themselves. Also the interests of other key stakeholders must be taken into account. The code

should have a reference to international recognized standards and principles such as the ILO Conventions or other widely accepted CSR instruments like the OECD Guidelines or the Global Compact.

The language used in the code has to be specific and should refer to international accepted standards.

The application processes by which the code is implemented and defined have to involve and empower the suppliers and workers that are subject to the code. The MNC authoring the code needs to be genuinely committed to its implementation. The MNC may demonstrate this commitment by providing the resources, training, monitoring and reporting mechanisms necessary to make it work.

It is important with positive engagement from the MNC's upper level management and the CEO.

Given the industry structure and the competitive environment it has to be economically possible for the corporation to implement the code.

In order to engender trust the corporation has to be transparent in its actions. Adherence to the code should be subject to external monitoring by qualified independent auditors.

Like a main thread through my thesis I have found the *structure of the industry* as the source of many difficulties associated with the implementation of corporate codes in the global supply chain. The implementation of supplier codes of conduct is much dependent on the structure and operation of the particular supply chain where the codes are to be applied. The code constitutes part of a contractual arrangement between the buyer and the supplier. Whereas a close and more long-lasting relationship between buyer and supplier makes the application of the code easier, heavily shifting contracts and short-term relationships makes code implementation harder.¹⁶⁷ Hence, the present business model characterized by long and complex value chains with multiple layers of suppliers and fast-shifting relationships, works against a commitment to CSR beyond the existing implementation system (monitoring).

Suppliers do not see a direct link between investments in CSR and more sustainable business. Since the relationship between buyers and suppliers often is short-term, insecure and fast-changing, suppliers tend to focus on short-term profits rather than invest in improved working conditions. Ironically it is the corporations authoring the codes that also create the conditions that operate against implementation of the same.¹⁶⁸

¹⁶⁷ Urminsky, Michael, p. 16.

¹⁶⁸ Shaw, Linda, p. 105.

Conclusively, CSR investments are long-term whereas the present business model forces suppliers to think short-term. Some companies (major brands in the footwear industry that faced public scrutiny in the mid-90's and today have evolved the furthest in their implementation systems) have started to reduce the number of suppliers with which they do business and in addition increase their size of orders or production runs. A constant demand for lower prices and new designs pressure the buyers to keep production flexible. Thus companies need to integrate CSR with sourcing practices and business policies in order to overcome these tensions.

Public acceptance of self-regulation is directly related to the extent that people *trust* the corporation and its executives. A *genuine top-level commitment* to CSR by a company suggests a deeper integration of CSR into corporate culture. CEOs are more and more making public statements demonstrating their commitments for legal and voluntary labor, social and ethical obligations. Additionally sustainability reporting is important to create a more transparent dialogue with external stakeholders. It is necessary with a system of reporting and transparency that provides external stakeholders with data they feel they can trust.

A wider range of stakeholder participation tends to enhance the legitimacy and credibility in a code. It is important that external as well as internal stakeholders are involved in the development and implementation of a corporate code of conduct. By incorporating the views of different stakeholders into corporate vision and leadership the corporation is better positioned to carry out a long-term strategy. Potentially this dialogue may take the form of a *multi-stakeholder forum*, where MNCs, suppliers, trade unions etc. come together to discuss social issues. These fora are also important for businesses to exchange "best practices". Since workers play a key role in any successful implementation strategy it is important with capacity building among suppliers and their workers. More education and training is important in the future.

Finally, there is a need to establish a more coherent and consistent argument for the economic advantages and benefits (*the business case*), as well as the social benefits, from implementing labor, social and ethical performance standards. We need additional case studies, research and data.

Bibliography

International Official Documents

ILO Documents

Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy (The ILO's Tripartite Declaration of Principles 1977). Adopted by the Governing Body of the International Labour Office at its 204th Session (Geneva, November 1977) as amended at its 279th Session (Geneva, November 2000). Official Bulletin, Vol. LXXXIII, 2000, Series A, No.3. Available at: <http://www.ilo.org>.

OECD Documents

"The OECD Guidelines for Multinational Enterprises: Text, commentary and clarifications", OECD October 2001. DAF/IME/WPG(2000)15/FINAL. Available at: <http://www.ud.se/ga/internationalt.htm>.

UN Documents

Proposed Draft Human Rights Code of Conduct for Companies. UN Doc. E/CN.4/Sub.2/2000/WG.2/WP.1.

Literature

Andriof, Jörg and McIntosh, Malcolm, *"Perspectives on Corporate Citizenship"*, Sheffield, UK: Greenleaf Publishing Ltd. 2001.

Barrientos, Stephanie, "Mapping codes through the value chain: from researcher to detective". In: Jenkins, Rhys, Pearson, Ruth and Seyfang, Gill (ed.), *Corporate Responsibility and Labour Rights. Codes of Conduct in the Global Economy*, London: Earthscan Publications Ltd. 2002.

Bauman, Zygmunt, *"Globalization. The Human Consequences"*, New York: Columbia University Press 1998.

"Beyond Voluntarism. Human rights and the developing international legal obligations of companies", Summary, International Council on Human Rights Policy (ICHRP). Available at: www.ichrp.org.

Brill, Lucy, "Can codes of conduct help home-based workers?". In: Jenkins, Rhys, Pearson, Ruth and Seyfang, Gill (ed.), *Corporate Responsibility and Labour Rights. Codes of Conduct in the Global Economy*, London: Earthscan Publications Ltd. 2002.

Buchholtz, Ann K and Carroll, Archie B, "*Business & Society. Ethics and Stakeholder Management*", 5 ed., Mason, Ohio: South-Western 2003.

Daniels, John D, Radebaugh, Lee H and Sullivan Daniel P, "*Globalization and Business*", 1 ed., Upper Saddle River, NJ: Prentice Hall 2002.

Drucker, Peter F, "*Post-Capitalist Society*", Oxford: Butterworth Heinemann 1993.

Goldoner, Linda F, "The Apparel Industry Code of Conduct. A Consumer Perspective on Social Responsibility". In: Williams, Oliver F (ed.), *Global Codes of Conduct. An Idea Whose Time Has Come*, Notre Dame, Ind.: University of Notre Dame Press 2000.

Hansen, Inge, President and CEO, Statoil. Cited in: "*VALUES AND VALUE: Communicating Strategic Importance of Corporate Citizenship to Investors*"

Henderson, David, "*Misguided virtue. False Notions of Corporate Social Responsibility*", London: Institute of Economic Affairs (IEA) 2001.

Hopkins, Michael, "*The Planetary Bargain. Corporate Social Responsibility Matters*", London: Earthscan Publications Ltd. 2003.

Jenkins, Rhys, "The political economy of codes of conduct". In: Jenkins, Rhys, Pearson, Ruth and Seyfang, Gill, *Corporate Responsibility and Labour Rights. Codes of Conduct in the Global Economy*, London, UK: Earthscan Publications Ltd. 2002.

Justice, Dwight W, "The international trade union and the new codes of conduct". In: Jenkins, Rhys, Pearson, Ruth and Seyfang, Gill (ed.), *Corporate Responsibility and Labour Rights. Codes of Conduct in the Global Economy*, London, UK: Earthscan Publications Ltd. 2002.

Kwan, Alice and Frost, Stephen, " "Made in China": rules and regulations versus corporate codes of conduct in the toy sector". In: Jenkins, Rhys, Pearson, Ruth and Seyfang, Gill (ed.), *Coorporate Responsibility and Labor Rights. Codes of Conduct in the Global Economy*, London: Earthscan Publications Ltd. 2002.

Löhman, Ola and Steinholz, Daniel, "*Det ansvarsfulla företaget. Corporate Social Responsibility i praktiken*", Falun 2003.

- McIntosh, Malcolm, Leipziger, Deborah, Jones, Keith and Coleman, Gill, “*Corporate Citizenship. Successful strategies for responsible companies*”, London: Financial Times 1998.
- Rosenbaum, Ruth, “In Whose Interest? A Global Code of Conduct for Corporations”. In: Williams, Oliver F (ed.), *Global Codes of Conduct. An Idea Whose Time Has Come*, Notre Dame, Ind.: University of Notre Dame Press 2000.
- Sethi, Prakash S, “*Setting global standards. Guidelines for creating codes of conduct in multinational corporations*”, Hoboken, New Jersey, USA: John Wiley & Sons 2003.
- Shaw, Linda and Hale, Angela, “The emperor’s new clothes: what codes mean for workers in the garment industry.” In: Jenkins, Rhys, Pearson, Ruth and Seyfang, Gill, *Corporate Responsibility and Labour Rights. Codes of Conduct in the Global Economy*, London: Earthscan Publications Ltd. 2002.
- Sims, Ronald R, “*Ethics and Corporate Social Responsibility. Why Giants Fall*”, Westport, Conn.: Praeger 2003.
- Tavis Lee A, “The Globalization Phenomenon and Multinational Corporate Developmental Responsibility.” In: Williams, Oliver F (ed.), *Global Codes of Conduct. An Idea Whose Time Has Come*, Notre Dame, Ind.: University of Notre Dame Press 2000.
- “Tomorrow’s Company: The role of business in a changing world”, Royal Society for the encouragement of Arts, Manufacturers and Commerce (RSA). In: McIntosh, Malcolm, Leipziger, Deborah, Jones, Keith and Coleman, Gill, *Corporate Citizenship: Successful Strategies for Responsible Companies*, London: Financial Times/Pitman Publishing 1998.
- van Liemt, Gijsbert, “Towards ensuring minimum labour standards in export industries”. In: Blanpain, Roger (ed.), *Multinational Enterprises and the Social Challenges of the XXIst Century. The ILO Declaration on Fundamental Principles at Work, public and private corporate codes of conduct*. The Hague: Kluwer 2000.
- Waddock, Sandra, “*Leading Corporate Citizens. Vision, values, and value added*”, Boston, Mass.: McGraw-Hill/Irwin 2002.
- Webley, S and Moore, E, “*Does Business Ethics Pay? Ethics and financial performance*”, London: Institute of Business Ethics 2003.
- Zadek, Simon and Forstater, Maya, “Making Civil Regulation Work”. In: Addo, Michael K (ed.), *Human Rights Standards and the Responsibility of Transnational Corporations*, The Hague/London/Boston: Kluwer Law International 1999.

Zadek, Simon, *"The Civil Corporation. The New Economy of Corporate Citizenship"*, London: Earthscan Publications Ltd. 2001.

Articles and Reports

Avery, Christopher L, *"Business and Human Rights in a Time of Change"*, November 1999. Available at: <http://www.business-humanrights.org>.

Batterson, Robert and Weidenbaum, Murray, *"The Pros and Cons of Globalization"*, St.Louis: Center for the study of American Business, Washington University, Januari 2001. Available at: <http://www.globalchicago.org>.

Burns, Jennifer, *"Hitting the wall: Nike and International Labor Practices"*, Harvard business School Cases, January 2000.

"CEO Survey: Leadership, Responsibility and Growth in Uncertain Times", 6th Annual Global CEO Survey, PricewaterhouseCoopers, 2003.

"Corporate Codes of Conduct", Bureau for Workers' Activities, ILO. Available at: <http://www.itcilo.it>.

"Codes of Conduct for Multinationals", Bureau for Workers' Activities, ILO. Available at: <http://www.itcilo.it>.

"Codes of Corporate Conduct- An Expanded Review of their Contents", OECD, June 2000. Available at: <http://applied.oecd.org>.

"Corporate social responsibility. A business contribution to sustainable development", Employment & social affairs, European Commission, July 2002.

"Corporate Social Responsibility: Is there a Business Case?", the Association of Chartered Certified Accountants (ACCA) 2003. Available at: <http://www.accaglobal.com>.

Donaldson, Thomas and Preston Lee E, "The Stakeholder Theory of the Corporation: Concepts, Evidence and Implications". In: *The Academy of Management Review*, Vol. 20, No. 1, (January 1995), pp. 65-91.

"Guide to the Global Compact- A Practical Understanding of the Vision and Nine Principles." Available at: <http://www.ud.se/ga/internationalt.htm>.

Horn af Rantzien, Mia, *"Företagens sociala ansvar- den internationella utvecklingen i ett svenskt perspektiv"*, 2003. Available at: <http://utrikes.regeringen.se/ga/index.htm>.

Jenkins, Rhys, “*Corporate Codes of Conduct. Self-Regulation in a Global Economy*”, 2001.

Keay, Malcolm, “*Towards Global Corporate Social Responsibility*”, The Royal Institute of International Affairs (RIIA), Briefing Paper No. 3, April 2002.

Macalister, Terry, “Oil Firms Called to Account”, *Guardian Unlimited*. 3 December 2003. Available at: <http://www.guardian.co.uk>.

Mamic, Ivanka (Research Officer, Management and Corporate Citizenship Programme, ILO), “*Business and code implementation. How firms use management systems for social performance*”, ILO 2003.

“*Managing Working Conditions in the Supply Chain: A fact-finding study of Corporate Practices*”, Working papers in international investment, Number 2002/2, OECD, June 2002.

Murray, Jill, “*Corporate codes of conduct and labour standards*”, Working paper, ILO. Available at: <http://www.ilo.org>.

O’Rourke, Dara, “*Lessons in monitoring apparel production around the world*”, 31 January 2002, EC Newsdesk. Available at: <http://www.ethicalcorp.com>.

Palazzi, Marcello and Starcher, George, “*Corporate Social Responsibility and Business Success*”, European Baha’I Business Forum (EBBF). Available at: <http://www.ebbf.org>.

Ruggie, John Gerard, “The Theory and Practice of Learning Networks. Corporate Social Responsibility and the Global Compact”, In: *the Journal of Corporate Citizenship*, Issue 5, Spring 2002, pp. 27-36.

Starcher, George, “*Educating Tomorrow’s Managers*”, European Baha’I Business Forum (EBBF). Available at: <http://www.ebbf.org>.

Starcher, George, “*Socially Responsible Enterprise Restructuring*”, European Baha’I Business Forum (EBBF). Available at: <http://www.ebbf.org>.

Starcher, George, “*Some Notes on Responsible Entrepreneurship*”, European Baha’I Business Forum (EBBF) 2003. Available at: <http://www.ebbf.org>.

“Strengthening implementation of corporate social responsibility in global supply chains”, The World Bank Group, October 2003.

“*The Business of Business. Managing Corporate Social Responsibility: What Business Leaders are Saying and Doing 2002-2007*”. Executive

Overview, Nima Hunter Inc. in co-operation with Ethical Corporation magazine 2002. Available at: <http://www.ethicalcorp.org>.

“The missing link: SMEs and sustainable development”, World Business Council for Sustainable Development (WBCSD), 2003-11-17. Available at: <http://www.wbcd.org>.

“The Price of Oil: Corporate Responsibility and Human Rights Violations in Nigeria’s Oil Producing Communities”, Human Rights Watch. Available at: <http://www.hrw.org>.

The Royal Dutch/Shell, The Shell Report 2002, *“Business Principles”* and *“Message from the chairman”*. Available at: <http://www.shell.com>.

Urminsky, Michael (ed.), *“Self-regulation in the workplace: Codes of conduct, social labelling and socially responsible investment”*, Draft, ILO, Geneva April 2002.

“VALUES AND VALUE: Communicating the Strategic Importance of Corporate Citizenship to Investors”. Findings of a 2003 CEO Survey of the World Economic Forum Global Corporate Citizenship Initiative. Available at: <http://www.weforum.org>.

Wah, Louisa, *“Treading the Sacred Ground”*, *Management Review*, July/August 1998. Available at: <http://www.wahansa.com>.

Walker, Octavia, *“New research indicates lack of investor trust in corporations”*, 10 October 2003. Available at: <http://www.ethicalcorp.com>.

Ward, Halina, Borregaard, Nicola, and Kapelus, Paul, *“Corporate Citizenship - Revisiting the Relationship between business, Good Governance and Sustainable Development”*, International Institute for Environment and Development (IIED) 2002.

Ward, Halina, *“Legal issues in Corporate Citizenship”*, International Institute for Environment and Development (IIED) February 2003.

Webley, Simon (research director of the Institute of Business Ethics (IBE) and author of the IBE guide *“Developing a Code of Business Ethics”*). Cited in: Walker, Octavia, *“New research indicates lack of investor trust in corporations”*, 10 October 2003. Available at: <http://www.ethicalcorp.com>.

“Whose Business? A Handbook on Corporate Responsibility for Human Rights and the Environment”, Prepared by The Californian Global Corporate Accountability Project, March 2002. Available at: <http://www.nautilus.org>.

World Investment Report 1999. Foreign Direct Investment and the Challenge of Development (WIR99), New York and Geneva: United

Nations (UNCTAD). Available at:
http://www.unctad.org/en/docs/wir99_en.pdf.

World Investment Report 2002. Transnational Corporations and Export Competitiveness (WIR02) Overview, New York and Geneva: United Nations (UNCTAD). Available at:
http://www.unctad.org/en/docs/wir2002overview_en.pdf.

World Investment Report 2003. FDI Policies for Development: National and International Perspectives (WIR03) Overview, New York and Geneva: United Nations (UNCTAD). Available at:
http://www.unctad.org/en/docs/wir2003overview_en.pdf

Electronic sources

<http://www.globalreporting.org>

<http://www.cfac.org/CaseLaw/Cases/kasky.html>

<http://www.reclaimdemocracy.org/nike/>

http://www.csreurope.org/news/_page2281.aspx

<http://www.findjustice.com/ms/cases/coke/summary1.htm>

<http://www.weforum.org/pdf/AnnualMeeting/AMreport2001.pdf>

http://www.weforum.org/pdf/AM_2002/Global_Agenda_Monitor_2002.pdf

<http://www.ilo.org/public/english/employment/multi/history.htm>

<http://www.ilo.org/public/english/employment/multi/decl.htm#annex>

<http://www.ilo.org/public/english/standards/decl/declaration/index.htm>

Newsarticles

Friedman, Milton, *New York Times Magazine*, 13 September 1970. Cited in: Avery, Christopher L, “*Business and Human Rights in a Time of Change*”, November 1999. Available at: <http://www.business-humanrights.org>.

“Survey: Human-Rights Law, The power of publicity”, *The Economist*, 5 December 1998. Cited in: Avery, Christopher L.

Targett, Simon, “Investors link for Burma protest”, *Financial Times*, 3 December 2001.

Other

Sharp Paine, L, “*Corporate Performance in the Global Era*”. Presentation at the SNS-Conference: Corporate Citizenship-Globally and Locally, Tylösand 2001. Cited in: Horn af Rantzien, Mia.

Speech by Kofi Annan, UN Secretary-General, World Economic Forum, Davos 1999. Available at: <http://utrikes.regeringen.se/ga/internationellt.htm>.

Table of Cases

Kasky v. Nike, (2002)27 Cal.4th 939. Available at:
<http://www.courtinfo.ca.gov/opinions/archive/S087859.PDF>.

Wiwa vs. Royal Dutch Petroleum (Shell), 2000 U.S. App. LEXIS 23274.
Available at: <http://www.earthrights.org/shell/appeal.shtml>.