Discussion Paper

"Corporate Social Responsibility and Public Policy: The role of Governments in facilitating the uptake of CSR among SMEs in developing countries"

Expert Group Meeting

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INTRODUCTION

"The CSR agenda as a whole may now have reached a turning point in which the public sector is repositioned as a centrally important actor. The mainstream CSR agenda as currently constituted leads directly to the need for greater engagement by the public sector in middle- and low-income countries. There is also a range of justifications for public sector actors to develop greater familiarity with the mainstream CSR agenda as a basis for strengthening CSR in developing countries." (Ward, 2004)

Small and Medium Enterprises (SMEs) constitute more than 90% of all businesses that exist around the globe and are found at the core of an economy. Hence, it is crucial that these enterprises integrate socially and environmentally responsible concepts into their business strategies if the CSR movement is to become sustainable.

However, we cannot ask SMEs to 'drive CSR', regardless of their cumulative strength. Large multinational companies (MNCs) that count with enormous press coverage and depend on brand reputation (market pressures) are certainly drivers of CSR and, more importantly, these businesses have the capacity to do so.

In recent years, there has been a growing trend for MNCs at the top of the value chain to require that their suppliers meet environmental and social standards, or at the very least they give preference to the ones that do. Given the trends in the geographic distribution of value chains, these pressures often translate into companies in the developed countries putting these demands onto export-oriented companies in the developing countries. The latter are therefore now being challenged to reconsider their environmental and social commitments. On the one hand, entrepreneurs fear that if they respond to social and environmental requirements the costs they incur doing this will lead to them losing their competitive edge in international markets. On the other hand, they are aware that if they do not meet these requirements, they will not be in a position to maintain their access to foreign markets or to gain new clients.

In general there is little ability in developing countries to face these growing pressures for CSR and to respond to them in an adequate fashion. On the one hand, there is a lack of technical and managerial expertise in this field, and on the other hand there is a dearth of practical experience in companies with implementing the changes necessary to meet emerging environmental and social standards being requested by customers in global value chains. As a reflection of this lack of capabilities, industrial support institutions in these countries usually have only limited capacities to advise local entrepreneurs.

In this context, the role of public policy is crucial, not only with a view to turn SMEs' position from passive 'standard-takers' to active CSR players, but also to ensure that supply chain requirements to not become an impediment to the competitiveness of these firms and, consequently, a factor of marginalization. At the same time, companies that do not form part of global supply chains and hence do not feel the 'international pressure', need to be encouraged to operate in an environmentally and socially sustainable manner through public policy.

This background paper was developed to facilitate and stimulate discussion at the upcoming Expert Group Meeting on the potential role of governments in promoting a wider uptake of corporate social responsibility initiatives in the SME community. It elaborates on some important aspects to be taken into consideration when discussing public policy for CSR uptake in the sphere of small and medium businesses, but refrains from repeating common public sector CSR activities due to the backgrounds and experiences of the participating experts in that field. Neither does the content represent the opinion of UNIDO staff members, nor is it to be seen as a comprehensive overview of initiatives and research undertaken in that field.

Objectives of this Expert Group Meeting

As an organization that has long supported SMEs and intermediary institutions in the context of CSR implementation, there is a need to provide assistance to governments in creating a conducive environment for the uptake of socially responsible and environmentally friendly business practices. The objective of this meeting is to elaborate on how governments in developing countries can use the incentives that can be made available through public policy to foster the uptake of CSR, particularly in small and medium enterprises. For that purpose UNIDO will gather a group of approximately 25 experts from the public sector, academia, civil society, international organizations and business associations, who will take part in a critical roundtable discussion that is expected to form a foundation upon which UNIDO will build its future role in this process.

UNIDO does not represent the view that there should be a single entity "owning" CSR, be it state or business. The rationale behind the concept of this Meeting focusing entirely on public sector activities is to explore an angle where UNIDO needs to further develop its expertise.

Apart from CSR and the role public policy in developing countries, one additional denominator is supposed to form an integral part of the discussions in the upcoming meeting: Small and medium scale enterprises (SMEs).

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

- SMEs that act as *subcontractors in international value chains*, usually as suppliers to multinational companies. This category of enterprise is increasingly under customer pressure to conform to minimum standards for employee remuneration, work conditions, and environmental performance. This pressure reflects the degree to which their client company adopts CSR as operating policy, and the degree to which it passes CSR requirements along their value chains.
- SMEs that *independently service international markets*. Such enterprises would adopt CSR measures to the extent required by regulation, or the extent to which consumer pressure exerts an influence, or the extent to which enlightened entrepreneurship is exercised by management to make CSR a voluntary tenet of company policy.
- SMEs that *service domestic markets or national value chains*. Such enterprises adopt CSR to the extent that domestic regulation, customer pressure or community concerns dominate the course of action. Domestically oriented enterprises are the most preponderant among SMEs in developing countries where external pressures to adopt CSR are relatively weak due to poor regulatory capacities and nascent consumer and community organization.

In order to be able to explore the role of public policy in promoting CSR in small and medium enterprises, it is also important to recall some of the communalities these businesses share:

- Financial, technical and human capacity constraints
- Occupied with tasks oriented towards solving day-to-day problems and survival
- Employment of more labour-intensive production processes than large enterprises

- Often over-represented in industrial sectors with high environmental impacts
- Not always subject to the same regulatory requirements and enforcement processes that aim at mitigating the negative impacts of larger comapnies
- Lower market pressure in terms of brand awareness and media attention
- Exposed to dynamics of markets dominated by large enterprises at the top of supply chains
- Thin line of separation between management and ownership
- Importance of inter-personal relations with suppliers, clients or the local community
- Reliance on informal lines of communication

DEFINITION OF CSR IN THE CONTEXT OF SMES

The interpretation of CSR ranges from a pure philanthropic understanding that is associated with companies "giving back" to society, to a concept where a company embraces a wider concept as an integral part of its business plan.

In recent years, we have been witnessing the emergence of a new approach to CSR, with companies recognizing that reducing their impacts and addressing wider social and environmental problems will be crucial in securing their long-term success. Increasingly, high profile companies are implementing CSR concepts and processes. However, there is still a huge gap comparing the uptake of CSR in large multinational companies with smaller local businesses. This is an alarming fact, recalling that about 90% out of all companies that exist around the globe are classified as small and medium enterprises (SMEs). But why are so many managers of smaller companies sceptic about CSR?

The reason why CSR has so far been embraced primarily by larger companies has to do on the one hand with their stronger media presence and their high reliance on brand awareness and reputation protection, and on the other hand with the way CSR was promoted and introduced to the business world. Many companies still relate the concept of CSR to large-scale philanthropic investments, donations or sponsorships. Pictures of company owners talking at an opening ceremony of a newly constructed sports yard or firms donating medical equipment to hospitals still come to one's mind when thinking of CSR.

CSR as a management concept – internal dimension

Environmental domain: e.g. environmental management, cleaner production, energy efficiency, water and waste management, green purchasing, use of chemicals

Social issues: e.g. employee satisfaction, working hours, wages, disciplinary measures, health and safety, child labour, forced and bonded labour, freedom of association, discrimination, harassment and abuse

Anti-Corruption & business ethics

CSR VS. PHILANTHROPY

If we compare two of the frequently used definitions of CSR and philanthropy the difference between the two concepts becomes obvious. The European Commission defines Corporate Social Responsibility as a concept whereby companies integrate social and environmental concerns in their business operations and in their interactions with their stakeholders. Philanthropy, in contrast, is seen as a practice of charitable giving by private companies and corporations to charitable causes. While the latter is about engaging in an activity that is out of the scope of a company's core business, with the purpose of enhancing its reputation or mitigating negative impacts caused by the operation, CSR encourages enterprises to do what they have always been doing, but in a different way - a way that benefits the business, and its stakeholders alike.

It is undisputed that philanthropic activities of the private sector, such as donations or socially motivated sponsorships, make a valuable contribution to poverty reduction and the Millennium Development Goals. A good example to mention in this context is the Bill and Melinda Gates Foundation to which Warren Buffet is donating more than 80% of his wealth. Without such initiatives the fight against Malaria, for example, would have never reached that stage. However, it is out of question that those activities are far beyond reach for smaller companies that are frequently faced with financial or human resource constraints. As a consequence SMEs often take up a rather sceptical position when it comes to CSR and one might here arguments like “this is something for large corporations, not for us who don’t have money. We are businessmen and we need to do business to survive. We cannot afford to give anything away.” This shows clearly that there is a need to demonstrate to the SME community that in fact the CSR concept equally works for smaller firms and that it can constitute an excellent business case as well.

The discussions taking place in this Expert Group Meeting should explore public policy option within that context, focusing on company’s operation methods rather than on stimulating corporate philanthropy.

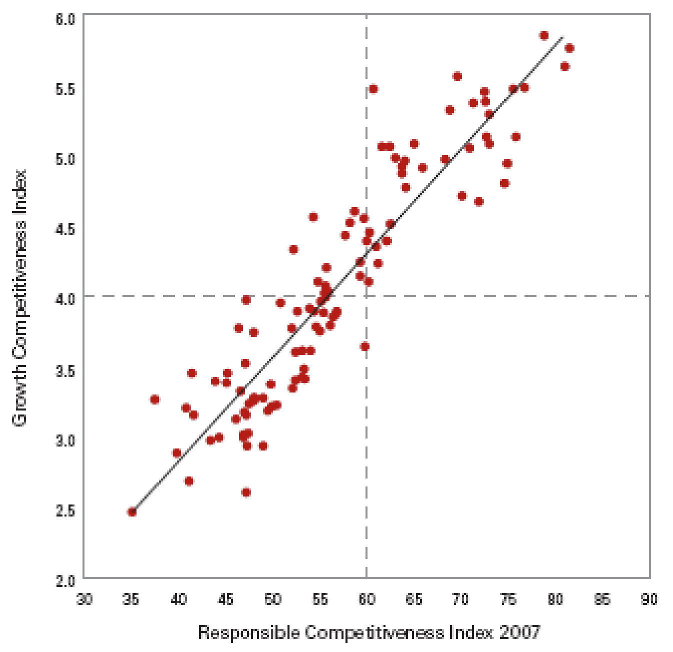
RESPONSIBLE COMPETITIVENESS

"Responsible competitiveness is about making sustainable development count in global markets. It means markets that reward business practices that deliver improved social, environmental and economic outcomes; and it means economic success for nations that encourage such business practices through public policies, societal norms and citizen actions". (Zadek & MacGillivray, 2007)

Why promote CSR through public policy?

More and more developing country governments are seeing CSR as a tool to enhance sustainable development strategies, as a component of their national competitiveness strategies to compete for FDI and to position their exports globally, and to improve poverty-focused delivery of public policy goals.

Figure 2: The 2007 Responsible Competitiveness Index and Growth Competitiveness



Source: Growth Competitiveness Index, World Economic Forum 06/07

At a national level, it has been proposed that corporate responsibility can contribute to competitiveness. Responsible competitiveness occurs when an economy's productivity and overall competitiveness is enhanced by businesses taking explicit account of their social, economic and environmental performance. It means markets that reward business practices that deliver improved social, environmental and economic outcomes; and it means economic success for nations that encourage such business practices through public policies, societal norms and citizen actions. *The State of Responsible Competitiveness 2007* Report assesses responsible business practices in 108 countries, highlighting which states have social conditions and are advancing public policies that encourage responsible competitiveness. The main message of this report is that is that responsibility can and does reinforce competitiveness, for countries at all levels of development.

Responsible competitiveness strategies require strong policy drivers. There are a number of reasons why government need to develop an effective CSR agenda.

- CSR can inform the development of *national competitiveness* approaches. Three possible public sector strategies have emerged: (1) aligning national investment promotion strategies with the CSR interest of foreign investors, (2) turning the market access impacts of CSR to positive competitive advantages, and (3) aligning businesses' CSR practices with the broader public goods that are a fundamental underpinning of national competitiveness.

- With appropriate public sector engagement and support, CSR expressed through international supply chains and foreign direct investment can act as a positive catalyst for *domestic enterprise development*.
- Public sector understanding of CSR in international supply chains and foreign direct investment can help *build and ensure the long-term sustainability of local CSR agendas*.
- CSR can help inspire new strategies to *address gaps in public sector capacity*.
- CSR can offer valuable insights for *partnerships that create synergies* between complementary skills of public, private, and civil society actors to achieve public policy goals related to sustainable development.

The above arguments highlight the importance of international competitiveness as an important driver of public sector engagement in CSR. Investigating the link between national competitiveness and CSR leads to the question whether development policies that include CSR promotion can contribute to a country's competitiveness and, if so, in what ways and what are the lessons to be drawn from experiences in this field to date?

Questions:

Q What role does CSR play in strengthening national economic competitiveness?

Q Could CSR help developing countries in that respect, given that the competitive advantage of many is primarily based on low costs?

Q How might CSR be included in the design of competitiveness strategies and policies of national and local governments?

Q Can we expect from businesses located in developing countries to adhere to social and environmental standards that western economies did not follow at earlier stages of their development?

Literature:

- "The State of Responsible Competitiveness 2007 - Making sustainable development count in global markets", AccountAility and Fundacao dom Cabral
- "Corporate Responsibility and the Competitive Advantage of Nations", AccountAility and the Copenhagen Centre (2002)
- "Towards a Croatian Business Agenda for CSR", Maya Forstater, Alex MacGillivray, and Peter Raynard for UNIDO (2004)

GOVERNMENT INTERVENTIONS TO FOSTER THE UPTAKE OF CSR IN THE SPHERE OF SMALL AND MEDIUM BUSINESSES

"Public policy has a key role in encouraging a greater sense of corporate social responsibility and in establishing a framework to ensure that business integrate environmental and social considerations into their activities […] Business should be encouraged to take a pro-active approach to sustainable development in its operations both within the EU and elsewhere." European Commission's Communication on Sustainable Development, from EU Green Paper on CSR.

Effective CSR depends on changing the relationship of government and the private sector from one of clienteeism and lobbying for protection, to one in which each sector is able to pursue its business, while legitimately inputting to the other's development. There has been much debate about the role of legislation and public policy in developing corporate social responsibility. While the 'voluntary vs. mandatory' debate rages on, in practise there are dynamic linkages between voluntary approaches and regulation already affecting the ongoing development of CSR.

Government involvement in CSR can be seen occupying three distinct levels:

1.) Firstly, there is its fundamental role in providing the *basic enabling environment* for good stakeholder relationships and governance that underpin both economic development and the development of CSR. These include the rule of law, effective justice system, independent media, good corporate governance and open and timely consultation about laws, as well as the quality of the business environment including infrastructure and human and social capital.
2.) Secondly, there are specific *interventions by government aimed at promoting the spread of CSR best practice*. Government action can encourage more companies to undertake CSR commitments by increasing the incentives or decreasing the costs of making these changes. This does not always mean tax-breaks or regulation but may mean promoting the uptake of CSR standards and tools, or funding or endorsing support organisations, which reduce the need for each individual company to 'redesign the wheel' in developing their approach to CSR.
3.) Finally, there are *strategic partnerships*, where governments recognise the need to work with business and civil society organisations to solve social and environmental problems and reach public policy goals at a regional or national level.

Within these three levels of involvement, the World Bank developed a framework that categorizes the different aspects and incentive tools, which was revised in 2004 with the support of members of the International Institute for Environment and Development. It ranges from 'hard' measures such as laws, via collaborative tools, to soft incentives such as recognition or acting as a role model. The categories are recognized as Mandating, Facilitating, Partnering, Endorsing and Demonstrating.

- **Mandating**: In their mandating role, different public policy bodies define minimum standards for business performance within a legal framework for corporate agents. Examples of such standards are regulation of working conditions, including maximum working hours, health and safety requirements and environmental protection laws. At the same time, governments also sign and enforce international agreements, particularly in the field of labour standards, the environment, corporate governance and human rights, to which companies must adhere. One frequently faced challenge is the limited capacity of governments in developing countries to implement laws and standards, particularly in the sphere of small and medium enterprises.

- **Facilitating:** The facilitating role of government seeks to improve company performance in social and environmental domains, by creating incentives and a platform for CSR development. This includes measures to stimulate the uptake of CSR by providing funding for research, leading campaigns, collating and disseminating information, training and awareness raising. Support under this category also extends to developing product labels and guidelines for company management systems or reporting. To ensure a coordinated approach, it is considered as crucial that a leading governmental body is assigned this responsibility. Public policy bodies can also stimulate pro-CSR markets by creating fiscal incentives and by applying its public procurement and investment leverage. Stimulating dialogue between all stakeholders at the national level is equally important to map out the different interests.

> Belgium has developed a **Social Label** for products from developing countries. Companies can adopt the label voluntarily. An independent body tests companies applying for the label on their social rights' performance. Businesses who are then awarded the label are be able to apply for subsidies from the Department for Overseas Development, while the government will promote the label among consumers.

- **Endorsing:** By endorsing the public sector offers political support to the CSR concept. This can take various forms ranging from ad-hoc public speeches to policy documents, awards schemes to backing innovative CSR-initiatives.
- **Partnering**: The government can be a direct partner in a multi-sector partnerships to engage the private sector in addressing a specific social issue. In general, public sector sectors are well placed to map different stakeholders' roles and set a policy framework that reflects and supports the different complementary core competencies at the national level. However, without capacity and interest from stakeholder groups, partnerships cannot succeed. Various actors enter this process with differing prerequisites, which raises questions of power and accountability.
- **Demonstrating**: To emphasise the importance of 'leading by example' a fifth category to conceive of the role of government has been singled out. This includes, for instance, safeguarding integrity by fighting corruption and enhancing transparency about public sector activities in relation to external stakeholders. Furthermore, governments need to apply CSR standards to their own operations, e.g. in relation to public procurement and tender policies.

ESADE Business School developed a different framework for classification, based on the different actors that are affected by public policy and the interrelations. It distinguishes public policies related to CSR that can be adopted by governments in their relationships with the administration itself, companies, society and in partnership with all actors.

Administration-administration
Public administrations should integrate the CSR principles into their own management systems and their relationships with interlocutors. This involves linking-up the contracting of goods and services with socially responsible companies, adopting CSR internal policies or environmental policies, as well as applying CSR in foreign policies, commercial policies and development co-operation.

Administration-company

Governments can adopt different policies that have a direct or indirect influence on company activity and development. Different departments can adopt policies that affect CSR: for example labour and social policies, company and economic policies, fiscal and funding policies, educational and training policies as well as policies related to agriculture, fishing and rural development. We would like to highlight the following CSR public policies adopted by the administration: the promotion of the convergence and transparency of the CSR practices and instruments adopted by companies (management norms, codes of conduct, accountability, audits, reports, fair trade labels, social labels and socially responsible investment, etc.), in addition to fostering the exchanges of CSR experiences and good practices between companies.

Administration-society

In the activities they carry out to promote CSR, governments can also adopt measures aimed at society, including carrying out campaigns and actions that reveal CSR's positive impact on society, supporting civil society's initiatives aimed at promoting responsible business practices, informing and educating the different social actors and establishing programmes to interrelate stakeholders.

Administration-company and society or 'relational CSR'

The public policies applied in this framework are CSR programmes in which there is co-responsibility in their design and implementation between administration-company and society. These public policies can include the creation of fora and areas in which to exchange experiences and good practices, the creation of independent institutions for analyzing, developing and applying CSR, and the promotion of the convergence and transparency of CSR practices and instruments.

In the context of SMEs, it is crucial to localize the CSR agenda so that it is rooted in local sustainable development concerns and to build into national CSR strategies an understanding and sensitivity to local, regional and national contexts. This raises again concerns bout capacity that need to be addressed. Many CSR frameworks analysed show evident lack in the field of public-private partnership especially at local and regional levels. Central governments usually represent the main coordinating institution, while regional and local bodies are hardly involved. Localizing CSR starts with the implementation of the national legal framework and involves defining the agenda in a transparent dialogue with the stakeholders. In order to build local ownership of CSR issues, initiatives need to be tailored to the local circumstances of particular sectors.

CSR in Italian regions - Tuscany:

The Tuscan region was the first of all of the EU administrations to promote collaboration between institutions and businesses to promote the sustainability of productive activities. The Region grants financial supports to local SMEs that want to be SA8000-certified, covering up to 50 % of their consulting and certification costs. In order to help enterprises reconcile economic competitiveness and sustainable development, the Internet portal *Fabrica Ethica* was launched in 2002, which explains to local SMEs how to adopt socially and environmentally responsible approaches. It is co-ordinated by Ministry of Economic Actvities and the General Direction of Economic Development. In 2003 a 25-member Regional Ethical Committee was set up, comprising trade unions, employers' associations, the Tuscan branch of the Association of Italian Municipalities and NGOs. In order to spread knowledge on CSR, the Region also created a CSR office within the Department of Economic Development.

Questions:

Q Few government initiatives have been undertaken explicitly as “pro-CSR initiatives”. Nevertheless, many have contributed effectively to its promotion and uptake. Does it matter? Is there a need for an all-encompassing and comprehensive approach if we want to pass the message to SMEs? Why/why not?

Q To what extend is CSR relevant to SMEs as individual competitors in the marketplace (not as part of global supply chains)? If yes, what is the role of governments in supporting the uptake of CSR in this sphere, where pressure groups and market requirements are generally weak?

Literature:

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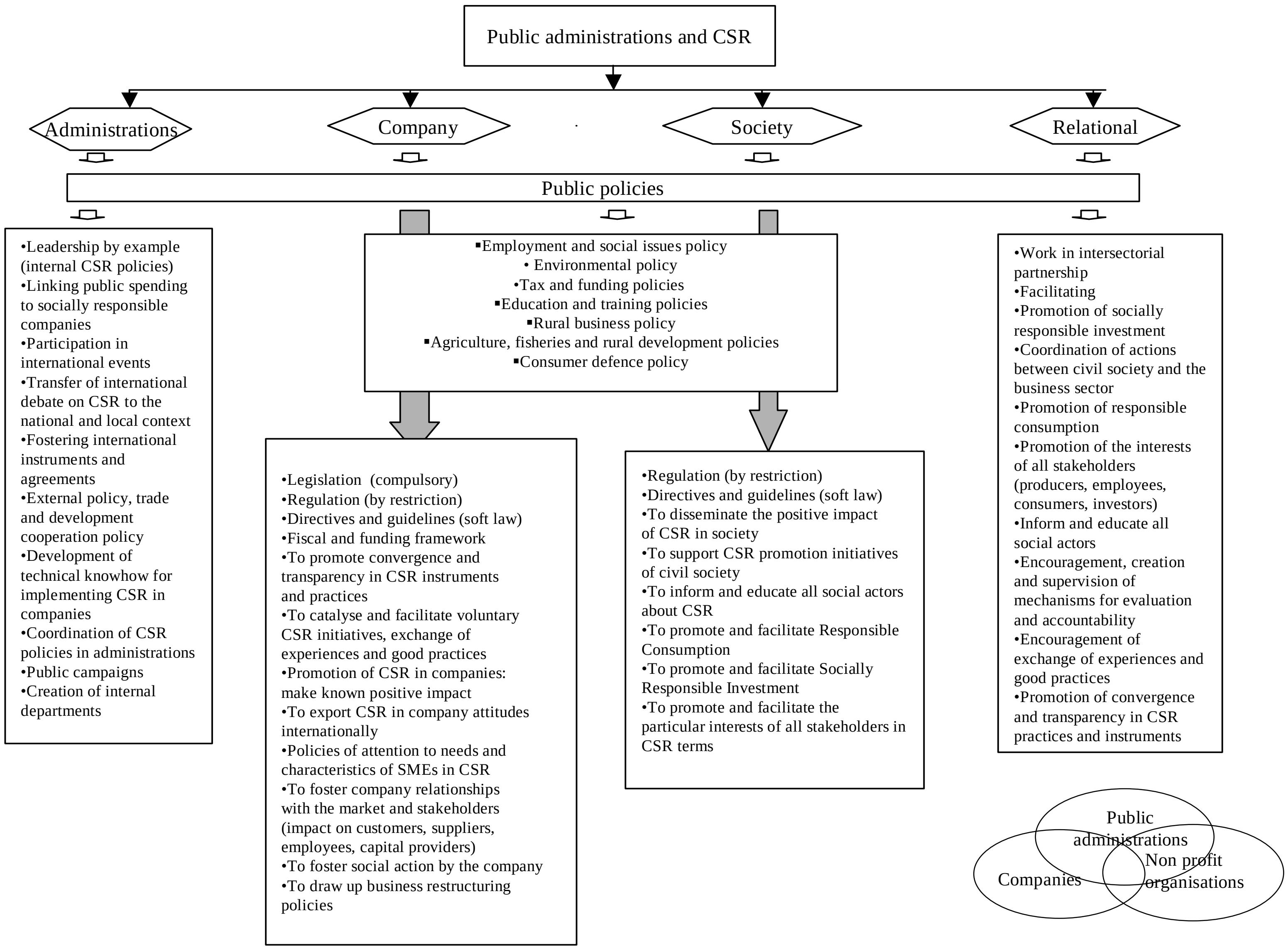
Public administrations and CSR
Administrations
Company
Society
Relational
Public policies
•Leadership by example (internal CSR policies)
•Linking public spending to socially responsible companies
•Participation in international events
•Transfer of international debate on CSR to the national and local context
•Fostering international instruments and agreements
•External policy, trade and development cooperation policy
•Development of technical knowhow for implementing CSR in companies
•Coordination of CSR policies in administrations
•Public campaigns
•Creation of internal departments
▪Employment and social issues policy
• Environmental policy
•Tax and funding policies
▪Education and training policies
▪Rural business policy
▪Agriculture, fisheries and rural development policies
▪Consumer defence policy
•Legislation (compulsory)
•Regulation (by restriction)
•Directives and guidelines (soft law)
•Fiscal and funding framework
•To promote convergence and transparency in CSR instruments and practices
•To catalyse and facilitate voluntary CSR initiatives, exchange of experiences and good practices
•Promotion of CSR in companies: make known positive impact
•To export CSR in company attitudes internationally
•Policies of attention to needs and characteristics of SMEs in CSR
•To foster company relationships with the market and stakeholders (impact on customers, suppliers, employees, capital providers)
•To foster social action by the company
•To draw up business restructuring policies
•Regulation (by restriction)
•Directives and guidelines (soft law)
•To disseminate the positive impact of CSR in society
•To support CSR promotion initiatives of civil society
•To inform and educate all social actors about CSR
•To promote and facilitate Responsible Consumption
•To promote and facilitate Socially Responsible Investment
•To promote and facilitate the particular interests of all stakeholders in CSR terms
•Work in intersectorial partnership
•Facilitating
•Promotion of socially responsible investment
•Coordination of actions between civil society and the business sector
•Promotion of responsible consumption
•Promotion of the interests of all stakeholders (producers, employees, consumers, investors)
•Inform and educate all social actors
•Encouragement, creation and supervision of mechanisms for evaluation and accountability
•Encouragement of exchange of experiences and good practices
•Promotion of convergence and transparency in CSR practices and instruments
Public administrations
Companies
Non profit organisations

CSR VS. PHILANTHROPY –
THE LIMITS OF VOLUNTARY ACTION

Rather than setting the focus on strengthening national or international regulatory actors to address social and environmental problems, voluntary corporate social responsibility initiatives have emerged as a favoured response within the international community. The underlying theory claims that companies respond to CSR related concerns as a result of self-interested with a view to enhancing their reputation in the eyes of consumers, business partners and investors. Yet, the voluntary nature of this concept, it is unlikely that companies will be driven to achieve more than a minimum of social responsibility. Most businesses, in particular SMEs, are unknown to most consumers or other pressure groups, and demands of investors to promote CSR are mainly targeting listed firms and come along with low powered incentives to which the business community responds by trying to avoid major scandals.

Some argue that for market-driven CSR issues, governments may chose to adopt a laissez faire approach or promote voluntary initiatives. In contrast, CSR domains for which the market drivers are weak and no clear business case is present require a stronger role of the public sector, including regulation.

Since in the context of SMEs we target an internal management concept rather than a philanthropic approach, as mentioned above, there is a clear need for regulation. When it comes to voluntary donations or engagements with local communities, a company is free to decide whether to give or not to give. In the sphere of operation practices the situation is different: fair labour conditions, pollution prevention or zero tolerance towards corruption are essential requirements a business needs to fulfill. Most of the internal CSR issues mentioned above are already regulated in one or the other way. Due to the fact the smaller businesses in particular find it difficult to maintain an overview of all the laws and regulation in place around that topic, implementation remains an issue in many developing countries.

Indonesia: First law on CSR
Indonesia has become the first nation on earth to legislate Corporate Social Responsibility. The lawmakers argued that the country needed such legislation because of the lack of understanding of CSR among Indonesian business people - evident by their non-observance of existing laws in that field. Initially, CSR was to be mandatory for all limited liability companies, but due to heavy resistance from the business community it was amended and now applies to companies in the natural resources sectors only.

The above law has received a lot of criticism from the business community stating that if it is obligatory, CSR is no longer CSR. But seen in the above context, could the law not be regarded as an attempt for a unified approach, appealing to companies' responsibility towards society and environment? Taking into considerations that most of the laws that fall in that context (e.g. child labour, human rights, fair labour conditions, pollution control, waste handling, use of toxic substances, etc.) are already in place – couldn't we argue that this new law on CSR is referring to all other pieces of legislation, unifying them under one umbrella called "CSR", rather adding new requirements for companies?

Questions:

Q Seen from that angle, are CSR laws, like the one of Indonesia, a good approach?

Q What are the implications on SMEs?

Q Do such laws contribute to a better understanding of what CSR entails and enhance uptake by local companies?

It has been questioned to what extent traditional intervention alone, referring to defining a minimum regulatory framework, can create effective controls on business that will fully promote public interest. Direct regulation might be both over and under-inclusive, affecting too many or too few commercial activities. The other option, a soft approach, is defined as an intervention without a primary resource to fiscal or legislative changes. The voluntary nature requires that the state perform an oversight role and ensures that appropriate standards are enforced in a legitimate and accountable way. The starting point, however, is a transparent enforcement of legislation.

Literature:

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– "Fostering regulation - Corporate social responsibility in countries with eak regulatory capacity", Tanja A Börzel and Adrienne Héritier (2007)

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INTRODUCING CSR BY TARGETING SME CLUSTERS AND VALUE CHAINS

THE CLUSTER APPROACH

With small and medium enterprises gaining ever more importance in the development agenda as effective sources of jobs and income, policies to promote clusters[1] became key for augmenting the positive impacts of smaller firms and optimizing resources to support them. Creating and strengtheing clusters helps SMEs to overcome all kinds of capacity and know-how related obstacles they generally face.

Since May 2005, the UNIDO cluster development programme has been involved in an action-research project on corporate social responsibility to ascertain if CSR compliance is more feasible and sustainable for small and medium enterprises that are located within clusters on account of the greater potential for coordinated private partnerships.

In recent years, more and more initiatives have been launched to support clusters of small and medium enterprises in developing countries in becoming competitive while at the same time successfully improving their innovation capacity, social, environmental and labor standards, and health-and-safety issues ("socially upgrading"). Corporate Social Responsibility and public policies have influenced the initiatives for social upgrading of clusters. But what are the factors may help SMEs overcome obstacles to collective action for social upgrading?

"Traditional upgrading" vs. "social upgrading"

Policy studies and literature on that topicemphasize on the need for clusters and their members to upgrade products, processes, functions and markets through continuous improvement and innovation. According to a study conducted by Prof. Puppim de Oliveira, Brazilian School of Public and Business Administration, there is one fundamental problem with the traditional idea of cluster social upgrading: "*Upgrading traditionally*" implies improvements in the economic sphere of the clustered businesses, allowing them to enhance products or processes, improve market access or reap more gains from their business activities. This kind of upgrading pays little attention to the labor, social and environmental spheres. It is solely based on the assumption that by upgrading companies, their workers and the communities would benefit automatically. Thismay not be true in all cases, as economically upgraded firms can also pollute more, dismiss workers or squeeze salaries. Thus, traditional upgrading generally overlooks the social and environmental dimensions of the process.

An alternative would be "*social upgrading*", aiming at a long-term development strategy based on formalized firms paying taxes, following environmental, labor, health and safety regulations, and improving social development.

The traditional cluster literature relies on the internal dynamics of the clusters for upgrading, referring to interaction among cluster members that enable companies to learn from each other. More recently, three other frameworks have been developed that explain the way businesses can upgrade: upgrading through markets, through CSR and through better enforcement of regulation.

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[1] The term cluster indicates a sectoral and geographical concentration of enterprises that produce and sell a range of related or complementary products and are, thus, faced with common challenges and opportunities

1.) *Upgrading through markets*: Some experts argue that linking-up with global value chains and markets would bring the motivations and resources to make companies chose to upgrade, even socially. However, the reality of most SME clusters located in developing countries gives little prospect entering global chains and often operate in the informal economy.
2.) *Upgrading through ethical and social principles*: This is seen as the basis of the framework of Corporate Social Responsibility, which involves business action to improve social and environmental standards. But despite of the fact that CSR has the potential to improve ethical behaviour of firms (in particluar of large firms and their supply chain partners), it has still limited impacts in the SME community because it is still a new, vague and often misunderstood concepts to smaller businesses located in the developing world.
3.) *Upgrading through regulation*: Social upgrading could be achieved by simply complying with the economic, labour or environmental laws, which are quite strict in many developing countries. However, regulatory compliance and enforcement are major problems and there are political obstacles to making local governments support upgrading. Many local SMEs prefer to make deals with local governments, arguing they cannot compete and may close down if certain laws are applied.

Questions:

Q Does it make sense to have a public policy for clusters to enhance CSR uptake?

Q What should be the role of public policy in socially upgrading clusters and their firms?

Q How can governments help clusters to socially upgrade without compromising competitiveness?

Q What have been the main obstacles to social upgrading and how have firms and clusters learned to overcome these obstacles?

Q What interventions did work and did not work? Why?

CSR IN VALUE CHAINS

Within the CSR agenda, the so-called business linkages theme is one entry point for addressing the objective to develop domestic enterprise capacity. It explores ways to develop best business practice through partnerships between large and small enterprises.

CSR concerns become market access concerns when they are integrated into value chains as market entry requirements through the mechanisms of direct investment or supply chain requirements. The standards, guidelines and principles that reflect these concerns are often referred to as codes of conduct, which can embrace corporate value statements, third-party labels and certification schemes, or informal guidelines addressing particular issues or sectors.

Concerns have begun to surface about the potential negative impacts of these requirements for local SMEs in developing countries. They have the potential to impose new costs on businesses that do not always have the financial, technical and human capacity to respond. Yet the market access impacts of the private tools of CSR cannot be controlled through the established mechanisms of the World Trade Organization, which are addressed to government action.

One way to upgrade SMEs and clusters in developing countries is by linking them with global value chains and markets, especially in more developed countries. However, there are some limitations to socially upgrading through supply chains:

- *Governance of the chain (relation between buyer and seller)*: It is sometimes the case that buyers in developed countries are putting enormous pressure on SMEs in the developing world to make them reduce prices, without taking into consideration the consequences in terms of lower salaries, deteriorated working conditions, etc.
- *Connection of firms in value chains*: Most SMEs located in developing countries see little chance to reach supply chains of more demanding international markets. When CSR pressure comes from global supply chain partners, the effects on SMEs may be limited, as many of these firms are not linked to those chains. Social or environmental certification generally pushes only the leaders to upgrade and does not move down the tiers.

Questions:

Q How can the government support SMEs in the uptake of CSR and help them comply with supply codes of their business partners, without compromising their competitiveness? How can governments mitigate certain pressures coming global chains that negatively impact SME development?

Q How can the government promote CSR in smaller businesses that do not form part of global value chains and do not have any incentive from that side to adhere to social and environmental standards?

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