POSSIBLE ROLE OF THE

MULTILATERAL INVESTMENT FUND (MIF)

IN THE AREA OF

CORPORATE SOCIAL RESPONSIBILITY (CSR)

PREPARED FOR

MULTILATERAL INVESTMENT FUND (MIF)

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Mr. Antonio K. Gaspar

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Mr. Antonio Gaspar of the School of Public Policy at Duke University wrote this report under the general supervision of Mr. Daniel Shepherd of the Multilateral Investment Fund (MIF) of the Inter-American Development Bank (IDB).

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Executive Summary

The main purpose of this document is to support the Multilateral Investment Fund (MIF) in its efforts to identify potential opportunities in the area of Corporate Social Responsibility (CSR), as a means of improving the overall competitiveness of the private sector in the region. The report addresses the most relevant issues related to CSR, while placing a special emphasis on small and medium enterprises (SMEs) located in the Latin America and the Caribbean region.

MIF efforts in the area of CSR should consider the existing market forces that influence SMEs toward the adoption of responsible CSR strategies. The report describes these forces as "drivers" for pro-CSR initiatives. Efficiency gains, access to markets and capital, and stakeholder pressure are examples of pro-CSR drivers. These drivers are pre-conditions for any reasonable CSR strategy, justifying from a business standpoint the adherence to CSR initiatives.

The scope of MIF projects in the area of CSR should target two different and overlapping areas: (1) SMEs involved in activities that are strongly influenced by the existing drivers of CSR, and (2) the enabling frameworks for CSR. Export-oriented companies, public service suppliers, labor-intensive companies, and extractive-based companies are examples of potential segments influenced by existing drivers of CSR. Alternatively, potential groups that might influence enabling frameworks for CSR include: large corporations, government agencies, the media, universities, and civil associations.

The report points out a number of recommendations for supporting effective interventions in the area of CSR. These recommendations are described as follows:

- *Approaching CSR Gradually*. CSR should be regarded as an evolving process. CSR strategies focusing on SMEs should consider the perspective of gradually implementing CSR, from its individual components to the entire group of CSR-related activities.

- *Approaching SMEs through Conventional Channels*. Use of existing channels, organizations and people that SMEs already trust and are already accustomed to dealing with on common business-related issues.

- *Developing Context-Specific Arguments and Models*. Efforts to engage SMEs into CSR initiatives should reflect and consider the specific contexts in which SMEs operate (i.e. geographic location, culture, type of business, and market conditions).

- *Demand Driven Initiatives*. CSR-related initiatives in the region should respond to the market demand for CSR-related services. Supply-side driven initiatives face the high risks associated with the creation of an artificial condition in which local suppliers could not be utilized and the project's outcomes would be useless.

- *Disaggregate the SMEs Sector*. SMEs cover an enormous range of enterprises. Banks and other commercial organizations that have to target and segment the SMEs market can provide useful insights into different ways of disaggregating the SME sector.

Other specific recommendations that are analyzed in the main document include: (1) Corporate governance issues and the Brazilian Novo Mercado; (2) Opportunities to build on the Bank-sponsored conferences and other Bank initiatives; (3) Partnering with national SME-representative entities; (4) Reaching SMEs through large corporations; (5) Partnering with local government agencies; (6) Educating business leaders; (7) Strengthening civil society; and (8) Specific opportunities in the fishery, forestry, and tourism industries.

Detailed research on the topic, interviews with a number of people involved in CSR initiatives in the region, and analysis of existing MIF initiatives in the area of CSR, all contributed to the proposed recommendations.

The starting point for this report is the general concept definition of CSR and the identification of the major areas related to CSR. The major CSR areas are represented by:

- <u>Corporate Governance</u>: the importance of sound business principles, transparency, accountability, values, and ethics in governing a company.

- <u>Environment</u>: the importance of an integrated and continuous environmental strategy to processes, products, and services in order to increase the overall business efficiency and reduce potential risks to workers, communities, and the environment.

- <u>Labor Issues</u>: the business commitment to provide high-quality working conditions, while improving employee's productivity and reducing potential liabilities and operational costs.

- <u>Stakeholder Engagement</u>: the company's strategy to work together with key stakeholders as an effective alternative to improve enabling frameworks, assess and manage business-related risks, and improve competitiveness (each relevant stakeholder is individually analyzed in the main document).

The report supports the "economic rationale" of CSR efforts and describes a number of business cases in which CSR strategies have significantly increased company's profit margins and improved business competitiveness. Competitiveness gains associated with sound CSR strategies are usually derived from both legitimacy effects (improved reputation and relationships with key stakeholders) and productivity effects (cost savings, quality improvements, staff morale, and risk management).

The issue of whether CSR initiatives make business sense depends heavily on the consideration of existing drivers for CSR. The major existing drivers for CSR are identified and described as follows:

- <u>Efficiency gains:</u> *Efficiency* is the internal driver for companies to engage in CSR initiatives. Efficiency gains are usually associated with reducing operating costs, improving product and service quality, and risk management control.

- <u>Access to markets:</u> Trends toward increasing market integration and free trade agreements pose unlimited business opportunities for export-oriented companies located in the region. In this context, compliance with CSR standards becomes a critical “license to trade” as these companies are increasingly facing higher production requirements and consumer expectations from developed countries. Simultaneously, domestic suppliers of large multinationals and state enterprises are gradually approaching market-share opportunities through CSR strategies.

- Access to capital: More than US$2.32 trillion of responsible-guided portfolios in the United States are managed by different financial institutions, including pension funds, mutual funds, and foundations. The growth of socially responsible investing (SRI) among professionally managed investment portfolios means that companies with sound CSR practices have improved access to capital.

- Stakeholder pressure: Stakeholders are increasingly pressuring corporations to incorporate responsible business practices into their core business activities. Pressures come from a number of different sources, including civil society, responsible investors, government, international organizations, large corporations, and financial markets.

- Increasing regulatory frameworks: International institutions and national governments tend to raise existing regulatory requirements for mitigating the growing impact of business externalities on societies at large. CSR offers opportunities for SMEs to respond to those changes and adjust their business models as a means to improve competitiveness.

These drivers have the potential to motivate SMEs to seek their own CSR strategies. The extent to which SMEs are influenced by these drivers determine the potential benefits of CSR initiatives. Ultimately, these drivers play an important role in shaping the effectiveness and outcomes of MIF projects in the area of CSR.

MIF recently approved a regional project *Promoting Corporate Social Responsibility*, which was the first one specifically addressing this area of CSR. Nevertheless, MIF has a number of existing projects that have components focused on CSR-related areas. These projects can be important to recognize potential synergies and to avoid potential overlaps between future CSR projects and current MIF initiatives. Beneficiaries of current MIF projects that address some component of CSR (i.e. cleaner production, accounting and auditing standards, etc.) are potential targets for the implementation of other components of CSR, since a gradual approach to CSR is usually desirable.

The report assesses two important themes in further details currently under discussion in the CSR business arena: (1) CSR & supply chain management and (2) CSR-related instruments, such as codes of conduct, management standards, and accounting / reporting standards. The capacity to engage SMEs in CSR activities through the supply chain of large corporations is analyzed in the main document, which describes possible alternatives of action as well as major limitations related to this approach. In addition, the capacity of existing voluntary initiatives (i.e. SA8000, ISO standards, GRI, and others) to support SMEs toward pro-CSR initiatives is also analyzed in the report.

The report summarizes the main findings of a number of interviews that were conducted among professionals involved in CSR activities. These findings are particularly important to provide insights about the current context of CSR in the region. Some of these insights are: (i) incipient demand of CSR initiatives in the region accompanied by the absence of local supply of CSR-related services; (ii) misunderstanding of the CSR concept and use of irresponsible marketing; (iii) consumers in the region have not demanded CSR measures from companies yet; (iv) the most recognized standards in the region are the ISO standards; (v) common view that it is easier for companies with management systems in place to incorporate new CSR measures; (vi) a general belief that a management systems approach is fundamental for achieving tangible outcomes from CSR initiatives; (vii) local CSR-reporting initiatives cited as potential initiatives for driving CSR adoption in the region; (viii) significant differences among country's "enabling environments for CSR"; (ix) the informal sector as a barrier for CSR; and finally (x) a number of CSR-related local initiatives were identified in different countries in the region.

CSR is still somewhat incipient due to the lack of understanding of potential benefits and the absence of enabling frameworks that reward corporate responsibility efforts. However, the issue of whether CSR is going to be incorporated into business practices seems to be a mere "question of time", at which point CSR will be regarded as a conditionality for business prosperity. While challenges to accelerate the adoption of CSR in the region still persist, these challenges should not undermine the potential benefits associated with successful initiatives in the area of CSR.

MIF can play a crucial role in promoting CSR practices in the region. For SMEs, successful efforts in the area of CSR depend on their recognition that CSR creates business value and improves competitiveness. Although it is not completely evident whether every business activity benefits from CSR, it is clear that CSR does create business value and improve the competitiveness of SMEs that are under the influence of existing CSR drivers. These drivers point to potential regions, industries, and SMEs to be targeted by MIF, as a means of designing projects that consider the business rationale and the enabling market frameworks of project beneficiaries. Alternatively, facilitator groups such as large corporations, government agencies, and business associations are crucial channels to be considered by MIF to achieve the best results from CSR projects. In the current and critical context of market integration, MIF efforts in the area of CSR have the fundamental role of leveraging the practices of companies, especially SMEs, for the attainment of the highest standards of excellence, thus assisting them with improving their competitiveness and access to markets.

1) Project Outline

The purpose of this study is to support the Multilateral Investment Fund (MIF) efforts in the area of Corporate Social Responsibility (CSR). The study addresses the most relevant topics related to CSR, ranging from the CSR concept definition to the main existing drivers of CSR in the Latin America and the Caribbean region. Considering the general MIF role in assisting small and medium enterprises (SMEs), the study places special emphasis on the perspective of SMEs located in the region. Finally, the study aims to provide support to the MIF for the identification and design potential projects in the area of CSR.

The document has the following specific objectives: (1) Develop a practical framework for the MIF that covers the most relevant issues of CSR; (2) Demonstrate the existing market conditions in regards to SMEs' CSR-related efforts in the region; and (3) Suggest possible alternatives of action for the MIF in the area of CSR.

In order to achieve the abovementioned objectives, the methodology utilized to develop the study encompasses three aspects: (1) Internet and publications research on the topic, (2) Interviews with a number of people involved in CSR initiatives in the region, and (3) Analysis of current MIF projects in order to identify possible synergies and lessons learned to assist future specific CSR-related activities.

2) Introduction

Corporate Social Responsibility is a theme that has increasingly emerged into the international business and policy agenda. Businesses in general are facing an ever-widening range of obligations, having not only to supply quality goods and services but also to respond to an increasing number of stakeholders with high expectations for responsible corporate behavior.

"Businesses must meet national rules and standards for commerce, and also international agreements, codes of conduct, and the standards of civil society at home and abroad.

The public and many governments will hold business accountable to be socially responsible – that they will promote development that meets basic human needs, support democracy, share information, and be open to the scrutiny and input of civil society." ***[Tomorrow's Markets, 2002]***

In this context, CSR initiatives should be regarded as a vital business strategy for responding to this emerging market demand, demonstrating how businesses can "do well by doing good". In fact, the increasing awareness around the issue of CSR is a desirable scenario that is reshaping the role businesses play as crucial actors for promoting the sustainable development of countries and societies worldwide.

In general terms, competitiveness gains are the prominent outcome derived from an effective corporate strategy on CSR. Ultimately, CSR-related competitiveness gains fall into two fundamental and overlapping categories: legitimacy and productivity.

- Legitimacy: The benefits of being seen as a responsible organization that meets social, environmental, and ethical standards. These benefits materialize into improved reputation and relationships with key stakeholders such as customers, investors, regulators, suppliers, and local communities.

- Productivity: The benefits of social and environmental initiatives in terms of cost savings, quality improvements, staff morale, product development, understanding of current and new markets and regulations, better risk management, and innovation.

Finally, it is relevant to mention that even considering the abovementioned market trends that clearly support the "economic rationale" for CSR, the adoption of CSR measures is still somewhat incipient due to the lack of understanding on CSR and the absence of enabling frameworks that reward a meaningful corporate behavior. However, the issue of whether CSR is going to be incorporated into business practices seems to be a mere "question of time", at which point CSR will be regarded as a conditionality for business prosperity. While challenges to accelerate the adoption of CSR still persist, especially in less developed countries, these challenges should not undermine the potential benefits associated with successful initiatives in the area of CSR.

"Extrapolation of current trends paints a picture of an unsustainable world: an increasing gap between the rich and the poor; billions of people who do not have access to clean water, proper sanitation, adequate food, shelter and health care; and the steady decline in key global ecosystems. As a company that is owned by thousands of investors, our challenge is to address these issues in a way that makes business sense. We define this direction as sustainable growth – the creation of shareholder and societal value while decreasing the environmental footprint along the value chains in which we operate." ***[Chad Holliday, DuPont, CEO]***

3) CSR Framework

3.1) Concept Definition

There are several existing CSR definitions publicized. However, it is relevant to mention that three important aspects should be considered in any CSR definition:

1) Triple Bottom Line Approach: Companies taking into account not only the financial outcomes of their activities, but also the social and environmental impacts of their operations.

"In today's world, the triple-bottom-line approach – economic, environmental, and social considerations – is critical to preserving shareholder value" ***[Brad Allenby, AT&T, V.P EH&S]***

2) Business Sense: CSR activities benefit not only the society at large, but also the companies that engage on CSR strategies. As described by OECD[1], "CSR involves the search for an effective "fit" between business and the societies in which they operate [and depend]", referring

[1] OECD, Corporate Responsibility: Private Initiatives and Public Goals, 2001.

to CSR as “the actions taken by businesses to nurture and enhance this symbiotic relationship”. It is particularly important to establish a distinction between CSR and philanthropy. In order to clarify both concepts, it is useful to treat CSR as an “investment” from which companies should expect tangible returns and positive impacts on their net profits. On the other hand, philanthropy should be regarded as “donations or charitable giving” from which companies do not necessarily expect any direct positive impacts on their business activities.

CSR	*vs.*	**Philanthropy**
Company (\$)⇔(\$) Society	**X**	**Company (\$)⇨ Society**

“Social responsibility is not a question of charity, it’s a question of enlightened self interest. It’s an issue of how we’re going to keep our planet stable so that your business survives.” ***[James Wolfensohn, World Bank President]***

3) Set of Policies and Procedures: CSR encompasses a range of actions that should be integrated into the company’s core operations. This factor is important for differentiating common initiatives that focus mainly on “public relations”, from sound CSR strategies that are successful in converting general principles and policies into an effective operational response.

“Companies without a capacity to manage social and environmental performance will be at a significant disadvantage compared to companies that aggressively develop a capacity to engage in stakeholder dialogue and effectively manage CSR.” ***[Ethical Corporation Magazine, 2002]***

Considering the relevance of these three factors for determining a comprehensive approach to CSR, this report identified among existing MIF documents the definition that best represents the concept of CSR. The selected definition is described as follows:

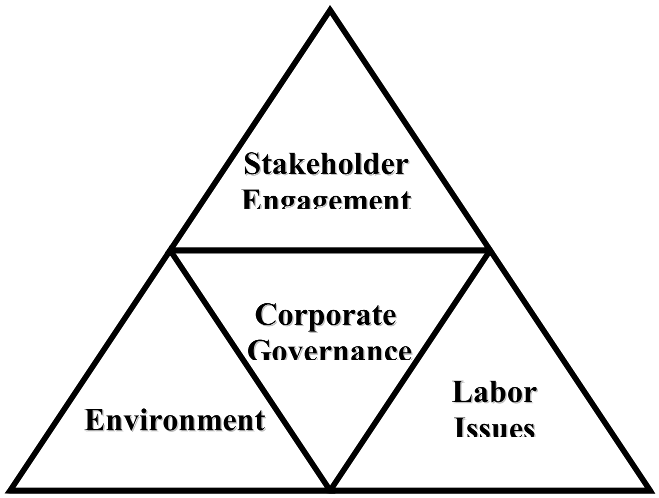
“CSR is a business approach that views respect for ethics, people, communities and the environment as an integral strategy that increases value added and thus improves the competitive advantage of a firm.

It is viewed as a comprehensive set of policies, practices and programs that are integrated throughout business operations and decision-making processes.” ***[MIF documents]***

3.2) CSR-Related Areas

There are several specific activities related to CSR that are grouped below in accordance with four fundamental areas: (1) Corporate Governance, (2) Environment, (3) Labor Issues, and (4) Stakeholder Engagement.

The figure below represents the four major areas of CSR, positioning Corporate Governance in the center of the pyramid as a strategic area for supporting any serious approach to CSR. These areas are further explained in accordance with a number of sub-categories.



(1) Corporate Governance

This area addresses the importance of sound business principles, transparency, accountability, values, and ethics in governing a company. Specific initiatives related to corporate governance are described below:

- Mission statement, business principles, and codes of conduct for responsible behavior (i.e. responsible marketing and customer-end-user care, responsible investment, responsible operations, and risk management policies).

- Accounting and auditing procedures in accordance with highest national and international standards.

- Governance structure that clearly establishes the responsibilities of the board and fairly represents the rights of shareholders and company's employees (i.e. open communication channels between top management and staff).

- Compliance with local regulations and mechanisms for avoiding bribery and corruption (i.e. internal and public information disclosure).

- Management systems, triple bottom-line reporting, and performance indicators.

(2) Environment

This area addresses the importance of an integrated and continuous environmental strategy to processes, products, and services in order to increase the overall business efficiency and reduce potential risks to workers, communities, and the environment. Specific initiatives related to the environment are listed below:

- Compliance with regulation.

- Pollution prevention initiatives (i.e. technologies / processes for reducing waste at source).

- Ecoefficiency practices (i.e. energy and waste management, material / energy / toxic dispersion reduction, recycling, sustainable use of renewable resources, product durability, eco-labeling, supply chain management and environmental life cycle, environmental design and product stewardship, and environmental management systems).

- Environmental reporting.

(3) Labor Issues

This area addresses the business commitment to provide high-quality working conditions, while improving employee's productivity and reducing potential liabilities and operational costs. Specific initiatives related to labor issues are described below:

- Respect for human rights in the workplace (i.e. fair employment and labor rights, reasonable working environment, no discrimination, equal opportunities, no forced labor and attention to child labor, working hours and overtime payment, and freedom of association).

- Payment of fair wages according to national averages and provision of basic benefits (i.e. health and pension plans).

- Provision of training and human resource development.

- Maintaining the workplace health and safety in accordance with government regulations. Provision of information and education to employees through developing and delivering health and safety guidance material such as brochures and guides.

(4) Stakeholder Engagement

This area addresses the company's strategy to work together with key stakeholders as an effective alternative to improve the enabling conditions for company's activities, assess and manage business-related risks, and improve competitiveness. The major business-related stakeholders are represented by employees, customers, shareholders and other suppliers of finance, suppliers and subcontractors, the local community and civil society in general, competitors, and the government. (Refer to the next section / "Main Actors" for specific initiatives related to Stakeholder Engagement)

"Stakeholder engagement is not simply something that businesses have to do. It is something that you want to do. Understanding stakeholder perspectives and needs is about gathering relevant business knowledge. It will lead to the identification of opportunities and risks, enabling greater product and process innovation" ***[Simon Zadek, UK Institute of Social and Ethical Accountability]***

3.3) Main Actors

Main actors or stakeholders are defined as all groups, individuals, or organizations that affect or are affected by a company's operation. Stakeholder inclusiveness and engagement arise as a fundamental area in the context of CSR. The idea is that through a meaningful stakeholder engagement, business managers are able to foresee the consequences and possible reactions among all relevant groups involved in the decision-making process, allowing them to build political support and crucial partnerships for sustaining business activities.

The main actors involved in the business decision-making process are described below. For each actor or stakeholder, a number of CSR-related initiatives are identified, demonstrating how stakeholder engagement might be an effective strategy for increasing the competitiveness of a company.

- Employees: Employees satisfaction is a crucial factor for improving the productivity of any company. Personal development (i.e. training and learning activities), fair wages, good and safe working environment, open and honest internal communication practices, respect for staff suggestions (communication channels between staff and top management), and non-working-integrative social activities (informal events including employees relatives and friends) are all important components that build trust among employees and help a company to prosper.

- Customers: Customer satisfaction is a fundamental factor for increasing businesses market-share and success of business. In general, companies need to provide customers with the highest quality products and services consistent with their requirement and expectations. Companies ensure integrity through responsible marketing and transparency in all business-related activities. Consultation with customers is an effective tool for getting insights about their priorities and to better design business strategies. Customer Relationship Management (CRM) practices represent a good example of available tools for improving business competitiveness through customer engagement.

- Shareholders and Other Suppliers of Finance: Investor's satisfaction and confidence are vital components for increasing business risk perception, terms of loans and insurance premiums, and access to capital. Transparency, auditing and accountability standards, public reporting, responsible operations, management systems, and risk management policies (triple-bottom-line assessments and reporting) are all components that build trust among shareholders and investors.

- Suppliers and Subcontractors: Good relations between contractors and suppliers are important for a variety of business-related reasons. Reliability among business relationships offers tangible financial gains for all parties involved, in terms of "customization" of operations (operational efficiencies, quality improvements, and better planning capacity). In addition, the issue of supply chain management arises in the business arena as large corporations are increasingly held responsible for their suppliers and sub-contractors practices. In this context, CSR-related efforts arise as an important strategy for increasing company's market-share.

- Communities and Civil Society: Good relations with local communities and civil society are important factors for sustaining business activities. These groups are important "external auditors" that not only provide the necessary legitimacy and "license to operate", but also represent potential channels of "business insights" for companies to better design products, services, and risk management strategies. The creation of formal channels of voice concern ("open door" policy, toll free number / on-line mechanisms for dialogue and feedback, and market surveys), public information and consultation on CSR issues, formal partnerships, volunteerism initiatives, and community involvement and investment are all initiatives that support building trust among these groups and contribute to business prosperity.

- Competitors: Healthy competition is a key component in the business environment. CSR assures to business players access to equal opportunities, by leveraging market conditions and the "rules of the game" through sound business practices. Moreover, the globalization phenomenon and the increasing competition for new markets impose an additional pressure to corporations. In this context, synergies on common CSR principles are opportunities for companies to interact with local competitors, establish partnerships, and co-operational activities that allow significant improvements on competitiveness (sharing of expertise and know-how, lobbying for improving enabling environments, customization of operations, and gains from economies in scale).

- Government: Good relations with public authorities are an important factor for business prosperity. Transparency and commitment to responsible business offer a number of opportunities for improving the relationship between businesses and governments. Cost reductions through regulatory oversight, potential gains in terms of access to public contracts (procurement practices), and anticipation to changes in legislation are examples of how good relations with the public sector positively impact business performance. Strategies to engage with the public sector as a means to improve business competitiveness include: identification of potential areas for partnering and cooperating with local government agencies (social and infrastructure improvements as well as technical assistance through capacity building programs), compliance with current legislation while looking for opportunities to suggest pro-CSR regulatory changes that reward good business practices (lobbying with other companies, business associations, and other stakeholders for demanding legislation adjustments), and consultation with government staff about key environmental and social issues.

3.4) Main Drivers

The assessment of existing drivers for CSR is fundamental for building understanding on why companies have engaged or should engage in CSR activities. These drivers reveal potential areas in which investments in CSR are supported by enabling conditions that reward responsible business practices. The main drivers for CSR are described below in accordance with two groups: internal and external drivers of CSR.

- ***Internal Driver for CSR***

The internal driver for companies to engage in CSR initiatives is represented by *Efficiency gains*. *Efficiency gains* are usually associated with productivity-related benefits, which result from an effective CSR strategy. Companies have experienced a range of bottom-line benefits derived from effective CSR initiatives:

- *Reducing operating costs through ecoefficiency activities* (cutting waste and inefficiencies, and improving productivity).

- *Reducing operating costs through human resources and organizational health and safety management, especially in labor-intensive industries*. A number of business benefits derive from improving the workplace conditions, such as: increased ability to attract and retain employee, meaning less turnover costs with recruiting and training; less absenteeism and labor suits exposure, meaning less operational losses and legal costs with injuries and non-compliance with safety norms; and increased productivity through employee satisfaction and motivation.

- *Increasing product / service quality and risk management control*. Efforts for improving working conditions, better governance practices, reducing environmental footprint, and greater employee involvement in decision-making often lead to opportunities for identifying and mitigating potential operational risks as well as for improving product quality and operational processes.

*(Business Case 1) "**The San Pedro Fishing Company** in Chile owns canning and fish-meal plants, as well as a fleet of seven vessels. Jack mackerel accounts for 85% of San Pedro's catch. Chile is one of the largest producers and exporters of fish-meal in the world. However, 60% of the production is concentrated in one region - discharging significant waste into the bay. The San Pedro canning and fish meal plants have successfully introduced the recovery of solids and pump water recycling and the recovery of soluble protein, as well as implementing a new system for unloading fish and installing a new steam dryer system. Preliminary results of the new system indicate a reduction in COD (chemical oxygen demand) loads of approximately 80% as the new technologies either recycle raw material or minimize loss.*

The San Pedro Fishing Company invested a total of US$3,720,000 - leading to an annual saving of US$5,240,000."

Source: Environmental Management Centre (Sustainability)

*(Business Case 2) "**Argus Group** is one of the Caribbean Basin's largest apparel manufacturing contractors. Under the leadership of Alfonso Hernandez, the founder, the company has developed one of the most progressive labor programs in its industry. While analyzing his company's leading cause of absenteeism, Hernandez realized that 85% of absences were caused by employees having to miss an entire day of work to reach state-provided medical facilities. So he decided to offer free, full-time state-sanctioned medical services on-site at the Argus Group, and to provide care for each employee's family.*

The investment in medical services definitely proved valuable. "While the average rate of absenteeism for our industry within the Caribbean Basin is 10%, we've reduced ours to 4%", said Mr. Hernandez. The Argus Group earned the Nicaraguan President Arnoldo Aleman's Best National Labor Programs award in 2000."

Source: Thunderbird Magazine (Sustainability)

*(Business Case 3) "**Grupo M** operates 26 factories in the Dominican Republic and, with 13,000 workers, is the country's largest private employer. It is growing 10-20% a year, selling US$200 million worth of clothing to such companies as Abercrombie & Fitch, Hugo Boss, Levi Strauss, Liz Claiborne, and Tommy Hilfiger. The company is also known for being a responsible employer, winning a corporate conscience award from the US-based Council on Economic Priorities. Vice President Joseph Blumberg admits they were originally motivated by "what an important customer [Levi Strauss] wanted", but says that over time they "began to realize that there were very real benefits - workers respond so well to this kind of approach." They have gone beyond Levi Strauss requirements, providing subsidized transport, day care centers, medical and dental services for employees and their families and training at various levels. The company pays wages of roughly 1,000 pesos a week - well above the country's weekly minimum wage of 555 pesos.*

"We have proven that you don't have to run a factory like a sweatshop in order to be profitable and to grow," Fernando Capellan, Grupo M's founder and president says. "In fact, we believe that we have been able to innovate, to expand, and to do what we have done because of the way that we treat our people. Everything that we give to our workers gets returned to us in terms of efficiency, quality, loyalty and innovation. It's just smart business." While apparel makers in countries like Honduras and China have lower labor costs, Grupo M can compete because its workers produce more goods of higher quality. "Grupo M's prices are absolutely competitive," says Bob Zane, senior vice president for manufacturing and sourcing for Liz Claiborne". Also, for 85% of Grupo M's employees, which includes workers and managers, turnover is less than 1% per year (the remaining 15% of the employees work on a seasonal basis, with nearly two-thirds of that group returning each year). The company also experiences low absenteeism and no strikes, allowing it to meet quality standards and win contracts from the major brands (Marks & Spencer, Liz Claiborne, Polo, etc.)"

Source: Amnesty International and Prince of Wales Business Leaders Forum (Sustainability)

- ***External Drivers for CSR***

External drivers of CSR are crucial aspects to be considered in the business decision-making process toward initiatives in the area of CSR. These drivers have the potential to justify and motivate from a business standpoint a company's adherence to sound CSR strategies. The external drivers of CSR are represented by: (1) Access to Markets; (2) Access to Capital; (3) Stakeholder Pressure; and (4) Increasing Regulatory Frameworks.

(1) Access to Markets

- International trade and foreign markets: CSR strategies are an opportunity and sometimes the conditionality for export-oriented companies to participate in the international trade arena. The global trends toward market integration and free trade agreements support the rationale for pro-CSR initiatives. CSR initiatives might potentially assist these companies to obtain the "license to operate" in accordance with the high market requirements of the developed world, leveraging domestic companies in the region to an international competitive position. As recently stated by the Office of the United States Trade Representative, in response to the Agreement on Textiles and Clothing (ATC)[2], initiatives for leveraging market-players conditions are currently being undertaken: "To foster trade and development in innovative new ways, the US-CAFTA negotiations will include a Trade Capacity Building group ... each Central American country identified its needs in a "National Trade Capacity Building Strategy". Other countries across the world are also taking "preventive" actions to respond to the current trends toward global market integration, as indicated by the Sri Lanka Apparel Exporters Association (SLAEA): "To achieve our Vision for Excellence by 2005, anticipating the need for corporate social responsibility, we launched the 'Certificate of Conformity' program in 1998, which examined members on compliance in relation to the laws and regulations of Sri Lanka applicable to Labor, Industrial Relations, Health, Safety and Welfare and Environmental Standards."

- Multinational Corporations and Large Domestic Companies: CSR practices are becoming strategic business initiatives for small and medium domestic companies that commercialize with Multinational Corporations (MNC) and Large Domestic Companies (LDC). Large companies are increasingly being held accountable for business practices undertaken across their entire supply chain, as general stakeholder pressure increases toward responsible corporate behavior. As a result, there is an escalating demand from large companies towards the adoption of CSR-related measures and standards among their suppliers and sub-contractors. (refer to section 4.1: "Supply Chain Management" for further details on this issue)

- Public Sector and State Enterprises: The public sector and state-owned enterprises tend to incorporate procurement-related conditions that support and benefit companies engaged in CSR activities. Therefore, companies adopting CSR initiatives have the potential to gain an important "competitive advantage" position while competing for public sector contracts. One

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[2] The Agreement on Textiles and Clothing (ATC) requires importing countries to increase base quota growth rates for major supplying countries with full elimination of restrictions on WTO Members scheduled to occur January 1, 2005.

example of pro-CSR procurement initiative has recently occurred in Taiwan. The government stipulated that products bearing "green labels", referring to the Green Mark eco-labeling scheme developed by the country's Environmental Protect Administration, should be given priority in government procurement bids.

*(Business Case 4) "**Faisán**, which began operations in 1994, produces aluminum sulphate and offers treatment services for domestic and residual water. They have only 20 employees, but control 20% of the Argentinian market and export to other South American countries, with sales worth $3,000,000 annually. In 1995, Faisán noted that the global trend was towards a market of massive industries interacting with SMEs as trusted suppliers. As a result, in 1998 Faisán began to develop and implement an environmental management system, and became the first SME in Argentina to certify an EMS to the ISO 14001 standard.*

As a result of their efforts, the quantity of waste being sent for disposal has decreased by 50% since 1997, accompanied by an important cost savings. Additionally, Faisán receives extra income from the material it sends for recycling. The numerous benefits to the company have not only been in waste reduction, but have also been reflected in the efforts of staff, which have adapted to the environmental policy of the company, and become more responsible in their daily activities. Since 1997, productivity has also increased by 120%. The risk of accidents has fallen and it has created a more pleasant work environment."

Source: Faisán, S.A. (Sustainability)

*(Business Case 5) "**Aserradero San Martín**, a Bolivian logging and wood products company, began its process of FSC certification in 1998, and has now three of the company's six forestry concessions under certification, totaling 300,000 hectares. They have also received chain-of-custody certification for their wood products, which will carry the FSC logo in stores. The certification of the first two concessions of the company cost US$20,000, a price that Roberto Saenz, the company's general manager, regards as an investment. The yearly monitoring costs by accredited certifiers of around US$4,000 are assumed as operating expenditures. Saenz notes that thanks to Bolivia passing strict forestry regulations in 1997, requiring companies to follow 'sustainable forest management', Aserradero San Martín was near to operating on FSC standards just by complying with Bolivian legislation. The key changes involved improving working conditions in the logging camps.*

"This year 80% of our sales (worth about US$5 million) were certified," said Saenz. "If we hadn't been certified, we wouldn't have had those sales." Many buyers now offer price premiums, paying 10-15% more if wood is certified. FSC certification helped the company open up new markets in alternative species. "If certification is calculated this way, the cost is very low compared to the benefits received," says Saenz. He also adds that the improvements in the logging camps, including providing written contracts, have bettered the company's relationship with workers."

Source: WWF International (Accountability)

*(Business Case 6) "**Tecon Salvador** owns and operates the recently privatized container and general cargo terminal in the Port of Salvador in the northeast of Brazil. As such, it provides cost effective and efficient access to coastal and ocean shipping services so as to support the industrial and commercial development of the State of Bahia. New industries – a herbicide plant and a Ford assembly plant – have moved into the area subsequent to the terminal becoming privatized. At IFC's request and using an independent consultant, Tecon Salvador prepared a Health, Safety and Environment (HSE) Action Plan to address the performance shortcomings uncovered during an investment review. A key action includes the development and implementation of an HSE management system to ensure the facility meets all of its legal and other requirements.*

Tecon Salvador's development and implementation of an environmental management system allowed them to secure a new major contract with a newly established Plant to handle 5,400 containers per year – equal to 10% of the Terminal's total volume. <u>This in turn allowed Tecon Salvador to achieve an increased market share of 75%</u>."

Source: IFC (Sustainability)

(2) Access to Capital

The growth of socially responsible investing (SRI)[3] among professionally managed investment portfolios means that companies with sound CSR practices have improved access to capital. More than US$2.32 trillion[4] of responsible-guided portfolios in the United States are managed by different financial institutions, including pension funds, mutual funds, and foundations. Trends toward the incorporation of CSR-based investment criteria for lending capital to the private sector are perceived across the world. For example, Britain launched an amendment to the 1995 Pensions Act that requires pension funds to disclose whether they take social, environmental, and ethical issues into consideration. This regulation has positively encouraged pension funds to engage with corporations in dialogue on social and environmental issues.

Multilateral Organizations and NGOs have demonstrated strong interest in the issue of CSR, meaning that companies already engaged or aiming to engage on CSR have opportunities to access funding through these organizations. In addition, special lines of credit and subsidies in general are being created to support CSR-related activities.

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[3] Socially responsible investing is an investment process that considers the social and environmental consequences of investments within the context of rigorous financial analysis. It is the process of identifying and investing in companies that meet certain baseline standards of CSR.

[4] According to the Social Investment Forum: 2001 Report on Socially Responsible Investing Trends in the United States.

*(Business Case 7) "**Banco Cuscatlán**, founded in 1972, is the second largest bank in El Salvador with a market share of more than 20%. It has nearly 2,700 shareholders, including nine prominent local and regional business groups. Banco Cuscatlán has developed a reputation as an environmental pioneer. To start with, the bank was able to meet IFC's environmental standards in order to obtain a credit line for SME on-lending. Subsequently, following the appointment of a full-time environmental compliance officer (Ing. José Francisco Rodriguez), it submitted an environmental plan that would move it beyond IFC's requirements for the specific credit line, expanding environmental reviews to all operations. In 2000, Banco Cuscatlán performed reviews for all projects (73) financed with external funds, in 2001 began a review of its entire portfolio, and since November 2001 has begun to perform environmental reviews for all new commercial projects. The bank is an example of a top-down, management-led dedication to improving environmental practices in the local financial industry and to changing the banking sector's approach to the environmental issues of project financing. Banco Cuscatlán represents the Salvadorean Bankers Association on the Business Commission for the Environment within the National Association of Private Businesses.*

Banco Cuscatlán's environmental commitment, its Environmental Management System (EMS) and practices strengthen its good-corporate-citizen image and reputation as an environmental pioneer in the Salvadorean banking industry. It has improved its ability to access long-term funding from multilateral or bilateral organizations with environmental requirements. The fact that Banco Cuscatlán has an EMS improved its access to funds in the form of a credit line from the Netherlands Development Finance Company ("FMO")."

Source: IFC (Sustainability)

(3) Stakeholder Pressure

Stakeholders are increasingly pressuring corporations for incorporating responsible business practices into their core business activities. These pressures come from a number of different sources, including: the civil society (media, NGOs, academics, and consumer / labor associations), responsible investors (screening investments and shareholder advocacy), the government (regulation, fines, and taxes), international organizations (trade rules, codes of conduct, and conditionality-oriented assistance), large corporations (supply chain management), and financial markets (public disclosure instruments).

It is relevant to mention that the increasing awareness around the issue of CSR has led to the development of innovative frameworks and instruments for supporting responsible business practices. These frameworks impose an additional "disclosure-related" pressure towards pro-CSR behavior, while offering the tools and mechanisms for companies to achieve the proposed and desirable changes. Multi-stakeholder or independent voluntary initiatives have developed a number of CSR-related codes of conduct and standards (labeling, management systems, and reporting frameworks), social accountability and performance indexes (Dow Jones Sustainability and FTSE4Good), and other market-based pro-CSR frameworks (general awards, competitions, and other mechanisms for press coverage / stakeholder recognition).

Other types of pressure come from activist groups. These groups have pressured corporations though actions such as public demonstrations and exposes, strikes, boycotts, and eco-radicalism.

"…Engaging with civil society is now a matter of risk assessment for business… In a world of multiple stakeholders, CSR strategies are a major advantage to building trust" ***[Richard Edelman, Edelman President & CEO]***

*(Business Case 8) "**Bitumenes Orinoco (BITOR)**, a wholly owned subsidiary of Petroleos de Venezuela (PDVSA), is responsible for the development, production and international marketing of its fuel Orimulsion, a new generation boiler fuel produced from natural bitumen and designed mainly for power generation and other industrial uses. However when BITOR started to exploit this new product it faced <u>huge criticism from Friends of the Earth (FoE)</u>, which led a <u>campaign against "the world's filthiest fuel"</u>. BITOR chose to engage in dialogue with WWF and Friends of the Earth, which led to the <u>company agreeing to a new policy: to sell only to plants with full emission controls in accordance with World Bank standards, to change its surfactant, and to ship Orimulsion only in double hulled tankers</u>.*

As a result, FoE publicly congratulated BITOR for its responsible attitude and the World Bank agreed to treat Orimulsion "like any other fossil fuel". Dialogue with FoE continues with a reduced list of issues. FoE refused to condemn a proposal that Orimulsion replace coal at a power station in Northern Ireland and has amended their website replacing reference to the "world's filthiest fuel" with "potentially polluting fuel."

Source: Sovereign Publications Limited (Sustainability)

*(Business Case 9) "**Companhia Vale do Rio Doce - CVRD** - is the largest diversified mining company of the Americas, with a market capitalization of approximately US$10.5 billion. CVRD has made an agreement to protect 1.2 million hectares of land and the indigenous populations on them, in exchange for the right to mine 412,000 hectares - of which it currently uses less than 2%. It was also the first mining company of its kind to achieve ISO 14001 certification.*

The company promotes its 'green' efforts as an economic necessity in a global market. "We at CVRD are not doing what we are doing because we love the monkeys, birds and butterflies - but in order to keep the company competitive," said Mauricio Reis, CVRD Environment Systems Manager. "<u>Our ecosystems are under the spotlight</u> . . . <u>Our clients, particularly from Europe, demand that our production uses clean methods.</u>" Reis says the company found that environmentally sound practices made good management sense by showing up operational defects and making systems - such as energy use or waste disposal - more efficient. The company has achieved (i) a price premium on iron ore sales to EU automotive customers (including Renault, Volvo, BMW, Mercedes-Benz and Peugeot) due to "environmental quality" and a reduced risk of land-use conflicts. The maintenance of local flora is also expected to significantly reduce later mine closure costs."

Source: Amazonia.net (Sustainability)

(4) Increasing Regulatory Framework

- Compliance with minimum standards: CSR offers opportunities for SMEs to operate in accordance with minimum standards established by local, national, and international regulatory frameworks. CSR strategies benefit companies by avoiding the risks of penalties for failing to comply with regulations and by reducing exposure to potential financial losses associated with public officials-related corruption activities, especially in less developed countries.

- Going beyond compliance: CSR also offers opportunities for SMEs to go beyond compliance with minimum standards. Regulatory-oversight is an immediate benefit resulting from "going beyond compliance". In addition, international institutions and national governments are indicating strategies for dealing with the increasing impact of business externalities on societies at large. This trend will likely result in not only more strict "rules of the game" (command and control-oriented policies) but also in market-based guided initiatives (pollution taxes, environmental permits, and labor-related incentives through procurement policies). In this context, companies involved in CSR activities tend to improve their ability to anticipate and adjust business models to likely changes in existing regulatory frameworks, benefiting from a better capacity to compete in the marketplace.

*(Business Case 10) "**Henkel Chile**, part of the German Henkel Group, is a manufacturer of adhesives and surface technology products. In 1995, it became the first company in Chile to stop using toluene in the production of adhesives. Adhesives that contain toluene can be misused as an intoxicant by glue-sniffers. This was a voluntary effort by the company to combat glue sniffing - a problem among street children. It was the first company in Chile to stop using toluene.*

In December 1998, prompted by Henkel's example, the Chilean president signed a law forbidding the production and marketing of toluene-based adhesives. "Through our social leadership we had a clear competitive advantage in the market, and we learned the benefits of behaving responsibly," notes the company. Although in the beginning raw material costs were slightly higher for the company, as other competitors changed to toluene-free adhesives as well, raw material prices settled at an equivalent level as before the change. Moreoever, the initial outlay was more than offset by securing market share and improved public image, which included being awarded the national health award by the Chilean Minister of Health in recognition of its pioneering role in banning toluene."

Source: World Business Council for Sustainable Development (Sustainability)

It is relevant to mention that the "legitimacy" effects derived from sound responsible business strategies justify the adoption of CSR initiatives as an important tool for SMEs that interact with those external drivers. The business rationale beyond the "legitimacy" component is usually explained by the positive bottom-line impacts that result from an improved reputation, company's image, and better relationships with key stakeholders such as customers, investors, staff regulators, suppliers and local communities.

These factors are translated into tangible financial benefits such as: increasing company's sales, revenues, and market share; increasing overall investors and shareholder value, which impacts company's ability to attract and negotiate better terms of financing and insurance premiums based on lower costs of capital due to improved risk profile; improving enabling networks to operate and company's ability to attract business partners as well as quality employees; and reducing company's liabilities due to regulatory oversight while improving company's competitive advantage by foreseeing opportunities and adjusting business models to changes in regulations.

4) Important CSR Themes

There are several specific CSR-related themes that are currently under discussion among well-known institutions directly involved in the CSR arena. These themes relate to issues such as: the role of the public sector in promoting CSR (i.e. Government Social Responsibility initiatives or "GSR"), corporate governance instruments and its relevance to business activities, the role of civil society in promoting CSR, the role of investors as crucial drivers for CSR, the role of multinational and large corporations in promoting CSR (i.e. supply chain management), and the importance of existing internationally recognized instruments of CSR. In this section, two relevant themes of CSR are analyzed as they were selected and prioritized in accordance with the MIF objectives in the area of CSR. The two themes selected are: CSR & Supply Chain Management (capacity to engage SMEs in CSR activities) and CSR-related instruments (capacity to support SMEs toward pro-CSR initiatives).

4.1) CSR & Supply Chain Management

4.1.1) Introduction

Large multinational corporations (MNCs) operating in less developed countries are increasingly becoming accountable to perform "public sector" roles that should be undertaken by country's national governments. Although the extent to which business adherence to responsible practices should be primarily an issue of national governance and law enforcement, large corporations are being gradually regarded as fundamental actors to promote CSR among smaller business players, especially in less developed countries. Companies in developed countries can rely on government oversight to ensure that their suppliers are at least complying with laws and minimal business standards. On the other hand, governments in less developed countries usually lack the capacity to enforce minimum standards of business practices, which are being progressively enforced and monitored by large corporations. Therefore, the issue of "responsible" supply chain management arises from the lack of national governance capacity to enforce legal compliance with minimum standards, especially in less developed countries.

4.1.2) Concept

As described by the OECD Guidelines for Multinational Enterprises (2002), supply chains are networks of facilities and distribution channels that encompass the procurement of materials, production, assembly, and delivery of products or services to customers. The management of inventories and returns of products / materials to suppliers are included in each of these functions. The complexities of the supply chains and the business relationships between the above components vary greatly among different industries and companies. Supply chains range from fully vertically integrated, in which a single company owns an entire process of production, to those where each stage of the chain operates independently.

Cooperation and strategic alliances among business partners have intensified on a worldwide basis. Although the global market is still characterized by local and regional differences that impose cultural and geographic challenges for managing suppliers, the benefits associated with supply chain management initiatives have been targeted by a number of companies. These initiatives seek to improve operational efficiencies, shorten product development cycles, increase product variety, and improve quality and forecasts. Information technologies play a critical role in the integration of the supply chain, by reducing costs while improving know-how and control along the company's chain.

4.1.3) "Responsible" Supply Chain Management

"Responsible" Supply Chain Management (RSCM) refers to company's efforts to manage CSR throughout the chain of suppliers. RSCM initiatives are usually driven by the potential business-related benefits derived from an improved public reputation and an accurate risk management policy.

Actions related to RSCM include:

- *Codes of Conduct and Pre-Qualification of Suppliers*. Before committing to a contract, a growing number of companies are asking suppliers to commit with codes of conduct and rules regarding legal, environmental, and employment standards.

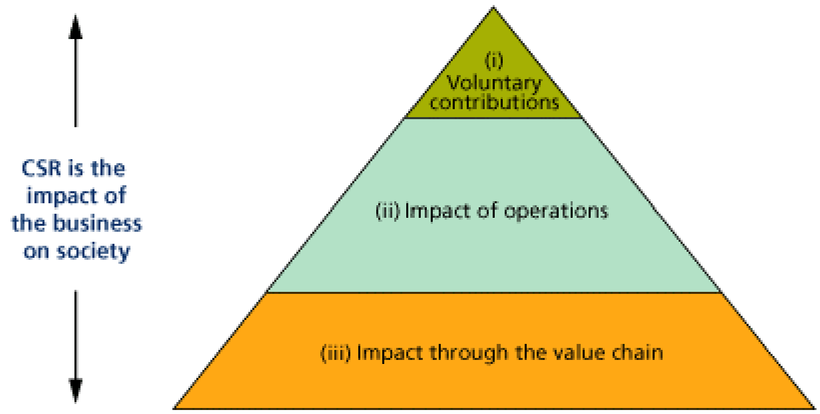
- *Auditing and Reporting*. Some companies have established monitoring and assessment mechanisms (external auditing and periodic reporting obligations) that may lead to cancelled contracts if a supplier is found to be in continuous violation of certain CSR objectives.

- *Collaboration and Joint Problem Solving*. Many enterprises have committed to assisting suppliers meet CSR objectives through training programs on labor and environmental standards, as well as education about the bottom line benefits of CSR.

- *Streamline Supply Base*. Many companies are streamlining their supply base, reducing the number of suppliers as well as developing cooperative long-term relationships with key commercial partners.

- *Communication*. Good communication is vital to a RSCM program. Suppliers must be informed and given sufficient time before the enforcement of any standard or requirement. Written policies, workshops, and meetings to inform suppliers about company's goals and expectations are critical aspects of RSCM programs.

*(Box 1) "We [**Unilever**] define social responsibility as the impact or interaction we have with society in three distinct areas:"*



Source: Unilever website

4.1.4) Practical Limitations of "Responsible" Supply Chain Management

The company's ability to promote CSR among suppliers and subcontractors will depend upon the type of industry, the quantity of suppliers, the structure and complexity of the supply chain, and the market position of the enterprise. Some examples of company's limitations to promote CSR through the SCM include:

- *Commodities Markets*. Companies that purchase commodities as raw materials for their products usually buy such goods from commodity markets, which have hundreds of thousands of small producers suppliers.

- *Non-Representative Purchasers*. Companies' purchasers that represent a small portion of supplier's output, leaving the customer with little influence over the supplier's operations.

- *Monopolistic Markets*. Markets with a monopolistic structure in which the supplier has a strong position to disregard the promotion of codes of conduct among its clients.

- *Supply Chain Complexities*. Companies in some sectors have thousands of suppliers and complex supply chains, making RSCM logistically unfeasible (i.e. footwear and apparel).

- *Short-Term Contracts*. Many businesses rely on short-term contracts with suppliers and change suppliers frequently.

- *Public Utilities*. It is usually extremely difficult for private companies to promote CSR in all sectors in which suppliers are owned by government (i.e. public utilities).

- *Costs*. High costs associated with monitoring, auditing, and corrective practices, making RSCM cost-ineffective.

- *Conflict of Interest*. Suppliers may be unwilling to cooperate or invest in activities that could conflict with demands for low prices. Suppliers can also resist disclosing possible liabilities and internal information.

- *Technological Barriers*. Technological constraints may occur when addressing some complex environmental-related aspects, such as the lack of local substitutes for toxic substances, or logistics issues in general.

- *Lack of Communication*. Customers and suppliers must be knowledgeable about each other's businesses. RSCM requires frequent, consistent, and two-way communication channels. Poor communication can result in conflicting requirements and unreasonable demands.

Finally, the most relevant limitation to apply CSR through RSCM relies on companies' inability to reach the vast majority of businesses that produce goods for local consumption or operate outside the formal economy. This means that the capacity of business to promote CSR in business is limited to certain types of industries and economic sectors.

*(Business Case 11) "**British Telecom (BT)** is a wholly owned subsidiary of BT Group Plc. BT has recognized through its Statement of Business Practice 'The Way We Work' that the company can have a global impact. As such the company has acknowledged the need to manage activities in a socially responsible manner. This commitment has resulted in an extensive human rights program that is managed by a number of departments and units throughout the business. One key project has been the establishment of 'Sourcing with Human Dignity', a supply chain initiative.*

Sourcing with Dignity promotes universal standards, in particular the United Nations Universal Declaration of Human Rights and the International Labor Organization Conventions on labor standards. By working collaboratively with suppliers, BT is seeking to identify areas of risk and work towards the improvement of practices and standards so that any identified human rights abuses are eradicated.

Existing suppliers and new tenders are required to sign an Agreement or Clause that commits them to work towards principles that include public reporting, awareness raising and training, monitoring and independent verification, and continuous improvement. As part of this program BT has also committed to report publicly the number and proportion of suppliers signing the agreement, as well as the number of suppliers who have contractually agreed to work towards the standard. The company also aims to hold forums with suppliers and other network members."

Source: Guide to the Global Compact

4.2) CSR-Related Instruments

4.2.1) Introduction

The growing demand for CSR from various sectors of society has fomented the proliferation of a number of CSR-related voluntary instruments. These pro-CSR instruments are classified into three categories:

(i) Codes of Conduct
(ii) Management Standards
(iii) Accounting / Reporting Standards

These initiatives have performed an important role in disseminating CSR worldwide by facilitating the business sector's adherence to CSR through "supportive" voluntary frameworks of sustainable practices (Refer to Annex A: CSR Instruments).

(i) <u>Codes of Conduct</u>

Codes of conduct are important instruments for the promotion of fundamental human, labor, environmental, and ethical values within companies' culture and business practices. Codes of conduct usually refer to internationally recognized principles based on universal documents such as the Universal Declaration of Human Rights, the International Labor Organization's Conventions, and the Rio Declaration on Environment and Development.

Codes of conduct offer a broad-spectrum approach to CSR that includes all relevant issues related to sound ethical business practices, and perform an important role as general guidelines and public references for CSR-initiatives. The biggest challenge related to codes of conduct is to ensure that they are effectively implemented, monitored, and verified.

There are a number of existing codes of conduct voluntarily developed by renowned international organizations as well as by large private enterprises (i.e. refer to Annex B: Unilever Code of Business Principles). Examples of global codes of conduct include: the United Nations Global Compact*, the OECD Guidelines for Multinational Enterprises*, The Global Sullivan Principles, The Keidanren Charter for Good Corporate Behavior, and The Caux Round Table.

(ii) <u>Management Standards</u>

Businesses are facing an increasing and widening range of complex issues in areas such as labor practices, environment, corporate governance, and supplier relations. In this context, management standards that offer the appropriate mechanisms and systems to deal with such complexities are extremely important tools for incorporating CSR into core business operations.

According to the International Organization for Standardization (ISO), *"<u>Management System refers to what the organization does to manage its processes, or activities</u>."* The ISO also makes an interesting distinction regarding the size of enterprises, stating that *"in a very small organization, there is probably no "system" as such, just "our way of doing things", and "our* *way" is probably not written down, but all in the manager's or owner's head. The larger the organization, and the more people involved, the more the likelihood that there are some written procedures, instructions, forms or records. These help ensure that everyone is not just "doing his or her thing", and that there is a minimum of order in the way the organization goes about its business, so that time, money and other resources are utilized efficiently. To be really efficient and effective, the organization can manage its way of doing things by systemizing it. This ensures that nothing important is left out and that everyone is clear about who is responsible for doing what, when, how, why and where."* Therefore *"Management system standards provide the organization with a model to follow in setting up and operating the management system. This model incorporates the features which experts in the field have agreed upon as representing the state of the art."*

Types of CSR-related management standards:

- *Focus on CSR-related areas*: These standards usually focus on specific areas of CSR such as the environment (i.e. ISO 14000 and Eco-Management Audit Scheme / EMAS) and labor issues (i.e. SA8000*, Fair Labor Association*, and OHSMS 18000). Some few existing standards focus on all CSR-related areas (i.e. GoodCorporation*).

- *Focus on specific sectors*: These standards focus on specific industries, such as the chemistry industry (i.e. Responsible Care*), the apparel industry (i.e. Worldwide Responsible Apparel Production "WRAP"), the tourism sector (i.e. Certification in Sustainable Tourism in Costa Rica), the forestry sector (i.e. Forest Stewardship Council "FSC"), and the fishery industry (i.e. Marine Stewardship Council "MSC").

Three important components among CSR-related management standards:

- *Process*: referring to procedures that a company should put in place, such as how to develop management systems and how to conduct dialogue and communicate with stakeholders.

- *Performance*: referring to what a company should do or not do, such as pay a living wage, prevent discrimination, and adopt specific ecoefficiency activities.

- *Certification*: referring to a system under which certificates of compliance are awarded to companies that comply and have passed an independent / third-party audit (accreditation process).

(iii)Accounting / Reporting Standards

Sustainability reporting refers to the process for publicly disclosing an organization's economic, environmental, and social performance. It is linked with the increasing consensus that financial reporting alone no longer satisfies the needs of shareholders, customers, communities, and other stakeholders for information about overall organizational performance. Benefits associated with triple bottom line reporting include enhanced management, governance, communications, stakeholder relations, and capacity to evaluate company's performance.

These standards are represented by initiatives such as: Global Reporting Initiative (GRI)*, AccountAbility1000 (AA1000)*, as well as the already recognized International Accounting Standards (IAS) and Generally Accepted Accounting Principles (US GAAP), both financially-oriented accounting standards.

(*) These instruments are analyzed in the "specific comments" section.

4.2.2) General Comments

- *Initial Emphasis on Management System Standards*. It is relevant to establish a distinction between standards and guidelines. Standards are more specific initiatives and usually refer to a complete framework for CSR engagement, including a set of policies, procedures, and mechanisms for incorporating sustainable practices into corporation's operational activities. Guidelines are generic statements that are usually utilized as references for indicating to stakeholders company's policies toward CSR. Therefore, the efforts required for SMEs to engage in sound CSR activities are directly related to SMEs capacity to effectively adopt CSR-related management systems. Following this process, reporting standards should be adopted for showing to the "market" and rewarding companies with additional recognition-related benefits.

- *Process Standards, Acceptability, and Competitiveness*. "We need to distinguish between process and substantive standards. We believe that process standards can significantly enhance competitiveness. Stakeholder engagement, particularly with the workforce but also external stakeholders, is key. So is verification and compliance to show people that you are doing what you say you are doing. Developing countries that may see substantive standards set by foreign companies or multilateral institutions as an infringement of their sovereignty are likely to see process standards more positively, as these imply a welcome transfer of management know-how [and avoid culturally biased unsuitable recommendations]." ***[Pascal Lamy, Commissioner for Trade, European Commission]***

- *Important factors for Standards Choice*. Choosing standards means taking into consideration the scale of the business and its operational complexities (large vs. SMEs), nature of business activities (labor intensive, extractive activities, and export oriented industries), and geographic location (enabling frameworks and market conditions).

- *International Aspirations vs. Local Realities*. The ineffective rule of law in developing countries, along with market competitive forces, tend to increase the gap between the reality of the situation on the ground and the principles embodied in the global codes of conduct.

- *Costs vs. Acceptable Risks*. Standards require expensive specialists and consultants during the implementation process, and auditors during the accreditation process. There is a need for identifying what is acceptable in terms of implementation and verification costs.

- *Stakeholder Support*. Government, trade unions, and other traditional forms to oversight compliance with minimum requirements have not been effective in developing countries. Voluntary initiatives to improve this scenario should be regarded as a means to reduce the gap between SMEs and standards requirements, and therefore facilitating standards' incorporation in the region.

- *Absence of Multi-Areas CSR Standards*. Most CSR-related management standards designed for multi-sector purposes only address individual areas of CSR, creating barriers for companies aiming to jointly address all the areas of CSR.

- *Pre-Requisite for Reporting.* Reporting standards are useless and non-sense for companies that do not have sound CSR practices in place, as they mainly function as "complementary" tools for CSR management system standards.

- *Trends.* "With several leading companies advancing the cause of labor standards and respecting basic worker's rights in a variety of host countries it is only a matter of time before labor becomes a competitive problem within and between nations ...It's difficult to imagine a world 50 years from now where there won't be government regulation at a global level" *[Jim Baker, Head Multinationals, International Confederation of Free Trade Unions]*. Besides labor issues, other initiatives highlight the latent trend towards standards for environmental protection, corporate governance, and stakeholder engagement issues. In addition, Nike have argued for "a [mandatory] global system that measures every multinational against a core set of universal standards using an independent process of social performance monitoring akin to financial auditing".

Finally, it is relevant to emphasize that the triple bottom line reporting standards represent a great complement for management systems standards, as these reporting frameworks allow companies to show what they are doing in terms of CSR.

As stated by Simon Zadek, from the UK Institute of Social and Ethical Accountability, *"*Reporting is not just about reporting, but becomes a driver of change and forces businesses to look at new alternatives*"*

4.2.3) Specific Comments on CSR-Related Instruments

Eight instruments of CSR were selected and analyzed in further details in this section. The criteria for selecting the CSR instruments included two general aspects: (1) the current worldwide recognition of those particular instruments, and (2) an interest in analyzing a spectrum of instrument types, including general codes of conduct, management systems, and reporting frameworks.

The selected instruments are: (1) the UN Global Compact (code of conduct); (2) OECD Guidelines for Multinational Enterprises (code of conduct); (3) Social Accountability 8000 (management standard focused on a specific area of CSR: labor issues); (4) Fair Labor Association (management standard focused on a specific area of CSR: labor issues); (5) Responsible Care (management standard focused on a specific industry: chemistry); (6) GoodCorporation (management standard addressing all areas of CSR); (7) Accountability 1000 (accounting / reporting standard); and (8) the Global Reporting Initiative (accounting / reporting standard).

It is relevant to mention that the analysis presented herein considers the situation of SMEs in the region and the MIF efforts in the area of CSR.

(1) The UN Global Compact

The Global Compact (GC) is a voluntary and general framework developed by the United Nations to support organizations around the world with a guideline for responsible business behavior. The GC framework establishes nine principles of corporate behavior in the general areas of Human Rights, Labor, and the Environment. The GC principles are derived from the Universal Declaration of Human Rights, the International Labor Organization's Declaration on Fundamental Principles and Rights at Work, and the Rio Declaration on Environment and Development.

Comments: In terms of general business frameworks for responsible behavior, the Global Compact guidelines have had a significant acceptance among corporations throughout the world, achieving a total of 1,213 participating companies as of July 2003. The Latin American countries account for almost 10% of these companies, and most of them are located in Brazil (75). The UN has produced this database through the letters of intent that are requested from companies interested in adopting the GC framework. As a general framework for CSR, the advantages for adopting the UN GC are related to the strong reputation of the United Nations, which provides an initial credibility and legitimacy for corporation's initiatives toward responsible practices. The framework also supports companies as guidelines for shaping their own codes of conduct while offering the opportunity to be listed in the UN GC website with no additional costs. The UN database specifies all the companies that are involved with the GC, which might be an interesting resource for identifying potential companies that are at least considering CSR as a strategic approach for business. The UN also highlights important international business associations that represent potential channels for achieving large and SMEs in the region. These associations are represented by organizations such as the International Chamber of Commerce (ICC), International Organization of Employers (IOE), International Federation of Consulting Engineers (FIDIC), International Fertilizer Industry Association (IFA), International Petroleum Industry Environmental Conservation Agency (IPIECA), International Road Transportation Union (IRU), International Council of Chemical Associations (ICCA), International Center for Alcohol Policies (ICAP), and the Global Mining Initiative (GMI).

(2) OECD Guidelines for Multinational Enterprises

The OECD Guidelines for Multinational Enterprises are recommendations on responsible business conduct addressed by governments to multinational enterprises. The Guidelines provide voluntary principles and standards for responsible business conduct. The guidelines covers the following areas: (1) General Policies; (2) Disclosure; (3) Employment and Industrial Relations; (4) Environment; (5) Combating Bribery; (6) Consumer Interests; (7) Science and Technology; (8) Competition; and (9) Taxation. It also establishes an implementation framework through the National Contact Points (NCPs), which are supervised by the Committee on International Investment and Multinational Enterprises (CIME).

Comments: The guidelines are specifically designed for large corporations and therefore are not appropriate for SMEs in the region. However, the NCPs as well as the CIME might be potential MIF partners for catalyzing CSR-related initiatives throughout the supply chain of the "affiliated" large multinational enterprises.

(3) Social Accountability 8000

Social Accountability 8000 (SA 8000) is a voluntary standard that covers the majority of the widely accepted international labor rights, according to the international workplace norms and specifications addressed by the International Labor Organization conventions, the UN's Universal Declaration of Human Rights, and the Convention on Rights of the Child. The standard addresses issues related to child and forced labor, health and safety workplace conditions, disciplinary practices, discrimination, compensation, working hours, freedom of association and right to collective bargaining.

SA 8000 requires facilities to adopt factory-level management systems and perform verification of compliance through independent SAI-accredited auditing bodies in order to become certified. SA 8000 certification lasts for three years and inspection audits are normally required every six months. After three years facilities must undertake a complete certification audit to maintain its certification. SAI also offers the Corporate Involvement Program (CIP), a program focused on disseminating good working conditions and the SA 8000 standard throughout the supply chain management. The CIP was launched in late 1999 and has attracted large entities that jointly sum more than US$100 billion in annual revenue. Besides the CIP, SAI also offers a series of training (i.e. auditor, supplier, supply chain management, worker, and custom training) and public education programs (i.e. conferences and workshops) for supporting the standard implementation and dissemination.

SA 8000 was developed by Social Accountability International (SAI), a non-profit US-based human rights organization founded in 1996 by the Council on Economic Priorities – a corporate social responsibility research institute that operated from 1969 through 2001.

Comments: Since SA 8000 system became fully operational in 1998, 242 facilities throughout 36 different countries were certified as of May 15, 2003 (32 facilities are located in Latin America - 1 in Costa Rica, 1 in Argentina and 30 in Brazil). Comparing to other standards, the SA8000 is relatively well known in some countries in the region, offering an alternative for addressing one important area of CSR (i.e. labor rights and working conditions). The standard offers a clear framework for all types of organizations, and considering its focus on labor issues it might be an option for the companies involved in labor-intensive activities. The SA 8000 database also represents a potential channel for the MIF to identify current institutions in the region that are involved in CSR-related initiatives. It is relevant to mention that the high costs associated with the SA 8000 and its third party certification process, reaching in some cases U$500 / day per auditor, are still a significant barrier especially for SMEs.

(4) The Fair Labor Association

The Fair Labor Association (FLA) was created to improve working conditions in factories around the world. The FLA developed a workplace code of conduct that includes provisions on forced labor, child labor, harassment or abuse, nondiscrimination, health and safety, freedom of association and collective bargaining, wages and benefits, working hours, and overtime compensation. The FLA also established a framework that covers six important areas: (1) code of conduct implementation, (2) internal monitoring, (3) independent external monitoring, (4) remediation, (5) verification, and (6) public reporting.

There are currently 12 leading companies participating in the FLA, and most of them are in the apparel and footwear industry. The companies are Adidas-Salomon, Eddie Bauer, GEAR for Sports, Joy Athletic, Liz Claiborne, Nordstrom, Nike, Patagonia, Reebok, Phillips-Van Heusen, Polo Ralph Lauren, and Zephyr Graf-X.

Comments: The FLA might be an interesting alternative / standard to be considered in the area of labor and working conditions. The FLA framework encompasses all important aspects required for converting general principles into tangible actions, including implementation support and monitoring system, auditing and accreditation process, public reporting, and supply chain management initiatives (not clear in the website). In addition, the FLA has some already certified accreditation bodies in the region, which might also be considered for other CSR-related standards (i.e. Intertek Testing Services (ITS), Grupo de Monitoreo Independiente de El Salvador, Cotecna, and A & L Group Inc.).

(5) Responsible Care

Responsible Care is an initiative of the global chemical industry in which companies, through their national associations, commit to work together to improve the health, safety, and environmental performance of their products and processes. The program includes a management system, an independent third party certification process, reporting on performance indicators based on economic, environmental, health and safety, and a security code that helps protect people and society throughout the chemical industry chain.

Responsible Care started in 1985 in Canada and is now in 46 countries where more than 85% of the world chemicals (in volume) are manufactured.

Comments: Responsible Care (RC) demonstrates an interesting and comprehensive approach to CSR practices. It is probably the most advanced and developed initiative in terms of corporate / private sector-guided actions to address global societal concerns and industry’s externalities. This might be associated with the RC learning process, which is significantly longer than most of the other CSR-related initiatives that have been initiated in the end of the 90’s. RC has an interesting and unique approach of utilizing national business associations as channels for engaging chemical-related corporations with the RC program. This framework not only allows the creation of a centralized database within the association (i.e. important for tracking information and establishing a network for sharing experiences) but also represents an opportunity for customizing the overall RC program according to the particular characteristics of each country. In this case, the main risks of RC programs are associated with the national chemical association's institutional capacity, which are minimized by the supervision of the International Council of Chemical Associations (ICCA). Considering the current stage of the RC model, the chemical industry arises as a strategic target for implementing CSR practices. CSR-related initiatives involving chemical-related corporations should therefore consider the adoption of the RC model.

(6) GoodCorporation

GoodCorporation is a standard of corporate responsibility that supports organizations of all types and sizes in developing, managing, and monitoring responsible actions. The standard sets out a framework of policies and practices that covers employees, customers, suppliers and subcontractors, shareholders or other providers of finance, the environment, and the community.

The GoodCorporation framework offers a voluntary accreditation process in which companies must pass through an annual assessment by an independent verifier that looks at the existence and effectiveness of management practices covered by the standard (i.e. Full Membership). Companies might also use the framework without being certified (i.e. Associate Members). During the accreditation process the verifier checks an organization against 65 practices of responsible management in order to make sure that: (1) a policy exists, (2) a system is in place to implement the policy, (3) records exist showing that the system works in practice, and (4) stakeholders agree that the system works and is fair.

GoodCorporation is a private company established in the UK in 2000 by the Institute of Business Ethics.

Comments: GoodCorporation is not a well known standard and probably few in the region have even heard about the initiative. However, among all existing standards of CSR, the GoodCorporation seems to be the only standard that combines together all the areas of CSR and that offers the most comprehensive and straightforward CSR approach. GoodCorporation adopts an interesting methodology for developing its CSR standard / framework, by focusing on the main business-related stakeholders, and through these stakeholders it indirectly covers all the areas of CSR. The accreditation costs are quite high, ranging from U$ 725 (i.e. no employees) to U$10,050 (i.e. 501 to 1,000 employees). Considering the apparent incipient stage of GoodCorporation with approximately 30 companies certified, the MIF might consider the possibility of partnering with the institution in order to allow SMEs having access to an affordable certification process. In case the accreditation process by GoodCorporation is not regarded as strategic for the MIF initiatives, the adoption of the standard / framework as parameters for CSR initiatives could still be considered in the overall MIF CSR strategy. The simplicity and comprehensiveness of the standard makes it extremely attractive for SMEs while positively impacting the MIF efforts in terms of training and overall capacity building initiatives.

(7) The Accountability 1000

The Accountability 1000 (AA 1000) is a voluntary accountability standard, focused on securing the quality of social and ethical accounting, auditing, and reporting. AA1000 comprises a set of process standards that cover different areas related to AA 1000 implementation stages, such as: planning (definition of values, ethical and social objectives), accounting (information gathering and scope definition), auditing and reporting (report preparation, external auditing, and stakeholder feedback), embedding (implementation of supportive structures and systems), and stakeholder engagement (participation in all process stages).

AA 1000 employs principles of accountability, inclusiveness, and operational meaning. The standard is supported by a set of guidelines and professional qualification programs that together form the AA 1000 framework. AA 1000 is designed for all types of organizations and currently it is not a certifiable standard.

The Institute of Social and Ethical Accountability (AccountAbility) is a UK based non-profit institution dedicated to the promotion of social, ethical and overall organizational accountability.

Comments: The standard is not clearly explained through the public sources available, demanding a reasonable amount of time for understanding its core functions. The number of companies that have reported the adoption of the standard is not significant, represented by only 10 organizations since it was launched in 1999. Currently, the AA 1000 seems to be a standard that <u>could evolve</u> significantly in order to be regarded as an alternative either for large or SMEs. The institute of social and ethic responsibility has indicated efforts to launch specific modules targeting areas such as Assurance (already launched), Risk Management, Stakeholder Engagement, and Small and Medium Enterprises. In particular, the initiative / <u>module focused on SMEs</u> might justify a special analysis in the future.

(8) The Global Reporting Initiative

The Global Reporting Initiative (GRI) offers a voluntary reporting framework for all types of organizations, addressing the economic, environmental, and social dimensions of their activities. The reporting framework includes: (1) Sustainability Reporting Guidelines (i.e. general reporting principles and report content / sections), (2) Technical Protocols on Indicators Measurement (i.e. guidelines for implementation based on performance indicators), and (3) Sector Supplements (i.e. capturing the unique set of sustainability issues faced by different industry sectors). The GRI does not have any accreditation process / structure in place for verifying compliance with the guidelines and framework, but it has recently established the verification and assurance-working group for addressing the issue of accreditation.

From 1997 until spring 2002, the GRI was a project of the Coalition for Environmentally Responsible Economies (CERES) and the UN Environment Programme. The GRI is now a permanent, independent organization, with headquarters in Amsterdam, Netherlands.

Comments: The GRI is <u>internationally recognized</u> as an important initiative in the sphere of CSR / sustainability reporting (i.e. triple bottom line reporting). The initiative is also supported by the <u>reputation and legitimacy</u> of the UN. More than 3,800 individuals from 77 countries are in the GRI network, allowing the development of the guidelines / framework through an intense process of consultation and stakeholder engagement. According to the GRI website, 309 companies in the auto, utility, consumer products, pharmaceuticals, financial, telecommunications, transport, energy, and chemicals sectors have voluntarily published reports that adopt all or part of the Guidelines. Although the framework was originally designed for both large companies and SMEs, most of these companies are large corporations. Considering that these large corporations have demonstrated at least some concerns about sustainable business practices and are also listed in the GRI website, the GRI database might be a channel for the MIF to identify these corporations and design strategies for SMEs supply chain engagement. The GRI is gradually evolving and currently represents an interesting "consultative" framework for corporations of all sizes throughout the world. It is relevant to mention that the GRI is still in an incipient stage, which is made evident by the few available / under development components of the proposed framework. These components are currently represented only by three technical protocols (child labor, energy and water indicators) and four sector supplements (financial services, tour operators, automotive, and telecommunications). However, the already available protocols and supplements as well as future publications should be regarded as interesting frameworks for SMEs and the overall MIF efforts in the area of CSR. These frameworks effectively address different sector's particularities and clearly identify tangible measurement's indicators, which might be used in order to track the performance of CSR-related initiatives.

4.2.4) Conclusion

Considering the significant number of standards and guidelines available, companies in general have demonstrated concerns about what standard / guideline would best support their CSR initiatives. In this context, it is important to emphasize that these standards / guidelines should be regarded as "flexible" frameworks that organizations should work with for shaping their own CSR model. There is no particular solution that responds for all diversities and complexities of business activities and cultural differences worldwide. Therefore, one important aspect to consider in selecting CSR standards is the local initiatives that have been undertaken in Latin America. Examples include CEMEFI in Mexico, Ibase in Brasil, and other initiatives in Chile. These standards are already locally-culturally-adapted, and therefore better representing particular demands from the potential "users".

It is also relevant to mention that although some standards might be more appropriate for some organizations than others, the choice for a specific standard is not a crucial factor for determining whether a CSR strategy will succeed or not. The determinant factor in this case relates to the willingness of organization's members and top management, the enabling conditions, and the existing "drivers" that are supporting the CSR initiative.

5) CSR in Latin America

5.1) General Aspects

CSR perspectives differ significantly between developed and developing countries. In order to approach the issue of CSR in Latin America, it is imperative to clearly understand and consider the peculiarities of the region. These differences are usually related to the driving forces of CSR, the role of government, and the overall country's institutional capacity, as described below:

In developed countries, an important driver for responsible corporate behavior comes from investor or consumer pressure. In developing countries, the ownership and structure of the industry as well as the tighter budget constraints that consumers face account for a relatively minor importance of local investors and consumer pressure. On the other hand, an important impetus for corporate responsible initiatives is competition for foreign investment.

Assumptions of typical "business cases" for CSR are not realistic in the context of developing countries. For instance, local consumers in developing countries are usually not even aware of about their basic rights as citizens, imposing serious limitations for pressuring corporations toward responsible behavior.

Governments in developing countries usually lack the capacity and at times the apparent willingness to impose minimum standards of corporate behavior. In this context of lax enforcement, companies usually can earn higher profits by avoiding compliance with existing local legislation through bribes to public officials.

Companies in the region have provided financial support to poor communities under the pressure of trade unions and civil society. As a result, there is a common tendency to misunderstand the real concept of CSR, associating it with philanthropy. There is also a general view that voluntary initiatives today will become mandatory actions tomorrow, and that the current pressure from local unions towards CSR might increase the overall CSR-related requirements from foreign investors, reducing the current comparative advantage of domestic industries, especially labor and resource intensive industries, against an increasing international competition. In some cases, developing countries producers perceive CSR-related schemes such as labeling or certification schemes as "non-tariff" barriers to trade.

5.2) Progress Towards CSR

As described by Adrian Hodges, director of The Prince of Wales International Business Leaders Forum, "There has been a tremendous surge in interest in CSR in the [Latin America] region." According to Hodges, several factors contribute to this positive trend, such as:

- The majority of International companies investing in the region are demonstrating clear statements of CSR.

- CSR-related initiatives are becoming incorporated into core business practices (adherence to CSR-instruments and standards, cause related marketing programs as well as management and employee development through volunteerism).

- Increasing number of national organizations promoting CSR, such as Instituto Ethos (Brazil), Fundemas (El Salvador), Accion Empresarial (Chile), and Peru 2021 (Peru). In addition, it is relevant to mention an increased adherence from the private sector to those initiatives, represented by the significant number of affiliated companies in CSR-related organizations.

- Media coverage has frequently addressed CSR issues in the region (corporate governance, environment, labor, and tri-party partnerships), as well as the increasing number of events, programs, and projects addressing the issue of CSR.

*(Business Case 12) "**The Asociación Chilena de Seguridad (ACHS)** was created in 1957 to provide insurance against workplace accidents, and to develop risk prevention programs. Since 1975, they have undertaken an internal social report, which measures the quality of life in the company based on 19 indicators, including job security, training, work environment, accident prevention, recognition of achievements and pay system. The report is based on a voluntary and confidential survey of employees. In 2000, 82.35% of the staff responded to the survey, reflecting strong support for the process. The results are used to develop a plan - in conjunction with the employees themselves - of how to improve the results for the following year.*

In ACHS they are convinced of the benefits of internal social reporting, which are reflected in the low staff turnover. Employees stay with the company an average of 8 years, compared with the national average of only 4 years. The level of absenteeism and sick leave is also low. Moreover, the company notes that the positive attitude of the employees is an important competitive advantage in a sector in which the prices are set by law - so that the quality of the workforce is the key difference between companies."

Source: Acción Empresarial (Sustainability)

*(Business Case 13) "**The Compañía General de Electricidad (CGE)** distributes and transmits electricity to over 1.5 million people in Chile and Argentina. They have a number of progressive human resources policies and benefits, which include: an employee profit share scheme since 1992 (50% of all increases in profits in one period, compared to the previous, are shared with the employees - with a guaranteed minimum of 1.5% of total profit); an internal social report since 1999; training and development (an average of four to six days per person per year); housing loans; health insurance; and an early retirement scheme.*

Says Guillermo Matta, the managing director, "We are aware that our employees are our corporate identity and image with our clients. They are our most valuable asset." CGE has seen its productivity increase from 474 to 837 clients per employee since 1990, while profits have increased 112%. The company has been able to lower its tariffs 22% in real terms since 1990, despite a level of investment of over 8% per year."

Source: Acción Empresarial (Sustainability)

5.3) SMEs Considerations

Small and Medium Enterprises approach to CSR differs in a number of ways from large corporations perspectives. Specific characteristics that appear to be inherent to SMEs are described below:

- Ownership and management control are usually concentrated in the same hands, placing the company's owners with a key and central position in the decision-making process. In that case, the personal choices and preferences of one or a few owners / top-managers are the most influential factor affecting the company's engagement in CSR.

- SMEs owners and businesses are usually strongly embedded within their local communities. Therefore, SMEs generally rely more than large enterprises on the healthy, stability, safety, and overall prosperity of the local communities in which they operate. SMEs' clients and employees frequently come from surrounding areas, making local community engagement / development a critical competitiveness factor for their businesses.

- SMEs managers / owners are frequently exposed to time and task pressures, which limit their capacity to act strategically and plan on implementing CSR activities. Besides the lack of top-management involvement and time to investigate and implement potential business improvements through CSR-related initiatives, personal and financial resources constraints represent major barriers for CSR adoption. These constraints are exacerbated by the absence of qualified and affordable consultants in the area of CSR.

- SMEs usually have limited access to capital due to higher risk perception and transaction / intermediation costs.

- Limitations in terms of capacity for bargaining (no economies in scale), along with the common lack of cohesiveness among SMEs (diverse interests), obstruct SMEs capabilities to defend their collective interests within the market place and regulatory framework.

- The "survival-oriented" environment in which SMEs operate does not allow respective owners / managers to understand what CSR means and the benefits associated with a CSR strategy. Several factors explain some of the barriers that SMEs have faced to implement a sound CSR strategy, such as: mismatch between beliefs and actions, where positive attitudes are not translated into effective actions; narrow interpretation or misunderstanding of the concept (perception that CSR is not cost-effective and has no relevance to business); lack of leadership and inertia of top-management; short-term-guided business strategies; resistance to change / skepticism to realize CSR-related potential benefits and opportunities.

- CSR activities in SMEs become more vulnerable to economic fluctuations (boom vs. recession) than in large corporations, making long-term investments in CSR activities usually difficult to sustain, especially in developing countries.

- Personal relationships and close individual contacts between the owner / manager and employees, investors, suppliers, customers, and sometimes competitors, help to build open business partnerships in a way impracticable with large firms.

- SMEs face the challenge of competing with the informal sector, which in some cases forces SMEs to not comply with minimum standards established by the regulatory frameworks. This situation increases the gap between CSR and SMEs practices.

- SMEs are more flexible and less bureaucratic than large companies, facilitating the adherence to new CSR strategies. On the other hand, the immaturity of SMEs organization structures (management and information systems), along with the limited accessibility of reliable technical information tailored to the SMEs needs and assimilative capacities, represent a challenge for implementing CSR activities.

- Unlike large companies, brand reputation is not usually regarded as a fundamental benefit associated with a CSR strategy.

5.4) Interviews Findings

In order to develop a better understanding of the current market conditions for CSR initiatives, a number of interviews were conducted with professionals directly involved in CSR activities in the region. Professionals from private companies, public agencies, local and international NGOs, universities, and accreditation bodies were interviewed based on a questionnaire that covers major issues related to CSR (Refer to Annex C: CSR Questionnaire). Some of the interview's insights are described below:

- There is still an incipient demand for CSR initiatives from both SMEs and large corporations in the region. Regarding SMEs, such demand is usually directly related with requirements from large corporations, reinforcing the idea of a "supportive" market for CSR initiatives within companies inserted in the supply chain business. In general, there is no supply of local CSR-related services.

- Misunderstanding of the CSR concept and use of irresponsible marketing (focus on public relations) are general barriers for CSR in the region. These initiatives often jeopardize the true meaning of the CSR concept among consumers, media, and civil society, weakening seriously oriented CSR efforts. The current market perception of CSR in Latin America is often related to philanthropy activities, and CSR is rarely regarded as an important component of companies' business strategy or integrated into business activities.

- Consumers in the region tend not to be drivers for CSR. But consumers in developed countries are drivers for export-oriented industries from the region. The media is still not informed about CSR activities but sometimes helps promote philanthropy activities. On the other hand, the media has been crucial in pressuring and demanding risk management practices in regards to business environmental impacts, especially from large corporations. NGO's and the organized civil society have pressured corporations for good behavior; however these groups need better organizational capacity to be more CSR-supportive.

- The most common and recognized existing standards in the region are the ISO standards (ISO 9000 and ISO 14000). Most of the certification initiatives in the region relate either to quality stewardship or the environment, and companies in general have experienced tangible bottom-line benefits from these initiatives. Some few other initiatives are emerging related to labor issues, such as the SA 8000 in Brazil.

- The "Prospective CSR" ISO standard, which will probably be launched within 2 years, is regarded as a potential solution for the current lack of common accepted CSR standards that jointly address all relevant areas of CSR.

- There is a common understanding that it is usually easier for companies with management systems in place (i.e. ISO 9000, ISO 14000, or SA 8000) to incorporate new standards and management systems.

- There is a general belief that management systems are fundamental for achieving tangible outcomes while implementing CSR initiatives in SMEs. General codes of conduct might be useful to complement management systems in SMEs, and existing internationally recognized triple-bottom-line reporting frameworks are more suited for large corporations. Nevertheless, local CSR-reporting initiatives were cited as potential initiatives for driving CSR adoption in the region.

- Significant differences among countries in the region in terms of "enabling environments for CSR" were identified, especially in regards to macroeconomic conditions (stable vs. unstable economies and financial markets structure), regulatory frameworks (law enforcement and incentives' structures), and international trade context (industry characteristics and trade agreements perspectives).

- Macroeconomic instability leads to a situation in which SMEs mainly seek to survive (cost reduction strategy), impeding long term strategies and their appreciation as to the benefits of CSR. The informal sector was mentioned as a barrier for CSR that imposes an unfair source of competition for legally established SMEs, making their situation even worst and distant from CSR practices.

- Some state-owned companies, such as telecommunication and construction industries, are taking pro-CSR initiatives along the supply chain of local SMEs by establishing procurement procedures that reward CSR efforts.

- Export-oriented companies, public service suppliers, labor-intensive companies, extractive-based companies, and "risk-related" companies were identified as potential sectors for implementing CSR. Several industries were cited, including: mining, oil & gas, chemicals, textile, paper & cellulose, cosmetics, telecommunications, electricity, construction, metallurgy, forestry, fishery, and agro-industry.

- The most relevant barriers for SMEs to obtain CSR-related standards certification are related to the lack of suitable instruments, high costs, and the absence of funding sources for implementing the standards requirements (only Chile indicated the possibility of a special credit line from CORFO to support the implementation of standards). In some cases, barriers result from the overall consultant's lack of know-how / experience with management systems. It has been noticed that consultants, although having the conceptual knowledge about the standards' principles, have faced difficulties in translating such concepts into effective management systems.

Some CSR-related local initiatives were mentioned in different countries in the region, including:

Mexico: CEMEFI with a number of pro-CSR initiatives, and COMPITE as a model of management system that aims to incorporate all aspects of CSR.

Brazil: Ibase with the development of a triple bottom line reporting scheme; Instituto Akatu and Idec as CSR promoters / educators among consumers and civil society; Fundo Etico de Investimentos ABN AMRO as pro-CSR investors; ADVB and IRES (Associação dos Dirigentes de Vendas e Marketing) with CSR training, research, and competitions; and FIESP with a market-research on CSR involving 17000 corporations through its Nucleo de Acao Social.

Chile: Avina and Accion Empresarial with a number of initiatives for supporting CSR, including the development of local CSR standards for SMEs; and Red Puente with a networking of NGOs that aim to disseminate CSR in Chile.

5.5) MIF Activities Related to CSR

In order to design future projects related to CSR, it is imperative to identify and assess what MIF has done in the area of CSR. At this time, it is worth mentioning that CSR consists of several individual components, including environmental considerations, labor issues, community development initiatives, capacity building programs, corporate governance practices, and so forth. Considering the MIF perspective, it is important to recognize that a number of MIF projects that are already completed, under implementation, or in the pipeline have important components of CSR.

As demonstrated in the Annex D: "MIF / CSR Related Projects", a number of MIF initiatives in the area of CSR were identified in accordance with the seven categories of MIF projects (i.e. Environment, Small Business Innovation, Microenterprise, Market Functioning, Financial & Capital Markets, Investments, and Building Worker Skills). According to general information available through the MIF intranet, these projects have important aspects of CSR, including cleaner production, sustainable community development, responsible trade, environmental and responsible investment funds, accounting and auditing, management systems and standards in general, "responsible" institutional strengthening of organizations and civil society at large, good governance and transparency, and working conditions improvements. Therefore, besides "explicit" projects in the area of CSR, such as the recently approved regional project: "Promoting Corporate Social Responsibility", other MIF projects have contributed to strengthen CSR in the region.

Analyzing existing MIF projects that have components of CSR is particular important for identifying potential synergies and overlaps between future CSR projects and current MIF initiatives. The beneficiaries of current MIF projects that address specific components of CSR are potential targets for implementing other aspects of CSR. These beneficiaries are probably more "receptive" for gradually incorporating a comprehensive CSR approach into business activities.

In this context, it is relevant to highlight the MIF initiatives in the area of cleaner production (i.e. Cluster: *Achieving Ecoefficiency through Cleaner Production and Environmental Management*) as the most concrete CSR-related component (environment) in which the MIF has undertaken projects. MIF efforts in the environmental area also include the creation of environmentally-oriented equity funds. These funds are focused on initiatives for promoting business models and technologies that benefit the environment. Examples of these initiatives include renewable energy, energy efficiency, pollution abatement, water treatment, sustainable forestry and agriculture, recycling, and ecotourism.

Other initiatives in the MIF, although in some cases still in incipient stages, clearly suggest potential areas and opportunities that directly match with CSR practices. MIF efforts aiming to disseminate International Accounting Standards (IAS) among regional accounting associations are an example of a CSR-related initiative in the area of corporate governance. MIF has worked directly with the IAS board, and currently has four projects approved within the cluster of *International Accounting and Auditing Standards*. MIF efforts in the area of Organizational Health and Safety (OHS) also illustrate the fund's initiatives in regards to "labor issues", which is another area of CSR. Currently there is a project in Argentina focusing on market dissemination of OHS practices, OHS training, and capacity building within the Ministry of Labor.

6) Recommendations

6.1) General Recommendations

Understanding the actual framework of CSR is fundamental to identify and better design potential projects in the area of CSR. The existing framework of CSR is essentially represented by: (1) the already mentioned market forces or "drivers of CSR", and (2) the organizations that are directly or indirectly connected to those drivers. The drivers of CSR (international trade, supply chain management, stakeholder pressure, and others) are the forces that shape the business rationale of CSR and lead organizations toward responsible business responses. These drivers are pre-conditions for any reasonable CSR strategy, justifying from a business standpoint the adherence to CSR initiatives as a means to improve company's overall performance and competitiveness.

As illustrated below, the existing framework of CSR operates in accordance with the following dynamics:

Drivers of CSR → ***Corporate Response*** → ***Performance*** →

The existing framework of CSR indicates two potential segments for the MIF initiatives:

- **SMEs involved in activities that are strongly influenced by existing drivers of CSR**: MIF can support SMEs "corporate response" to existing "drivers" for CSR initiatives. MIF can perform an important role not only by providing the necessary resources for implementing CSR-related initiatives, but also by helping SMEs inserted within this "enabling context" to realize the potential business-related opportunities of CSR. These companies / sectors are the ones with the highest likelihood of obtaining tangible and positive outcomes from a CSR strategy. Therefore, these companies are also the ones that might adhere to a long-term engagement on CSR, offering the highest "economic rate of return" for the MIF investments. Export-oriented companies, public service suppliers, labor-intensive companies, extractive-based companies, and "risk-exposure" companies are examples of potential segments for implementing CSR.

- **Enabling frameworks of CSR**: MIF can work directly with the common "drivers of CSR" as a means of strengthening the enabling conditions and the "business case" for supporting CSR efforts in the region. Examples of potential drivers include large corporations, government agencies, the media, and civil associations.

Other general recommendations include:

Approaching CSR Gradually. CSR should be regarded as an evolving process. CSR strategies focusing on SMEs should consider the perspective of gradually implementing CSR, from its individual components to the entire group of CSR-related activities. It is important to consider existing "stages of CSR" within the national, regional and sector contexts. If MIF is dealing with SMEs that do not even comply with local regulation and minimum requirements of corporate behavior, the first step should be to promote compliance with legal requirements. It is not reasonable to expect companies that do not comply with laws and minimum requirements of responsible behavior to suddenly undertake initiatives to go beyond compliance. In this context, it is relevant to consider what MIF has done in the area of CSR. For instance, considering the suggested "gradually-oriented" approach to CSR, the organizations already engaged in cleaner production activities might be potential targets for implementing sound labor practices / standards, proposing community / local business partnerships, and adopting corporate governance related activities. ISO 9000 certified organizations are also potential targets for implementing CSR-related initiatives as these companies already have management systems in place.

Approaching SMEs Through Conventional Channels. Use of existing channels, organizations and people that SMEs already trust and are already accustomed to dealing with on common business-related issues. These organizations must be targeted as a means to reach SMEs, but first it is important to convince them that CSR is relevant to SMEs' businesses and to train them on CSR major areas.

Developing Context-Specific Arguments and Models. Efforts to engage SMEs into CSR initiatives should reflect and consider the specific contexts in which SMEs operate. These efforts must take into account issues such as: the scale of the business and its operational complexities, the nature of business activities (labor intensive, extractive activities, and export oriented industries), and companies' geographic location (enabling frameworks and market conditions). CSR encompasses a number of issues that are not equally relevant to all business activities. Therefore, in order to persuade SMEs regarding the business rationale for incorporating CSR practices, it is fundamental to demonstrate the specific areas and respective benefits in which industries located in particular regions would mostly benefit. Apparel-related SMEs located in Central America that export to the US might have a strong interest in adopting the WRAP certification before 2005, when importing countries will eliminate the existing quotas on textile and clothes. The CSR approach to those companies should necessarily focus on labor issues and certification schemes. There might have no business sense to approach those companies with an environmental strategy for example, which could undermine the potential benefits associated with the abovementioned labor-related initiatives.

Demand Driven Initiatives. CSR-related initiatives in the region should respond to the market demand for CSR-related services. Supply-side driven initiatives face the high risks associated with the creation of an artificial condition in which local suppliers could not be utilized and the project's outcomes would be useless.

Disaggregate the SMEs Sector. SMEs cover an enormous range of enterprises. Banks and other commercial organizations that have to target and segment the SMEs market can provide useful insights into different ways of disaggregating the SME sector.

6.2) Specific Recommendations

Corporate Governance and the Brazilian Novo Mercado. Improving corporate governance practices among SMEs would sustain the further development of other complementary areas of CSR. Considering the current CSR-stage of SMEs in the region, corporate governance seems to be a crucial element for leveraging their practices toward compliance with minimum labor, environmental, and accounting standards. In regards to corporate governance, it is relevant to mention the *Novo Mercado* initiative from BOVESPA in Brazil. The *Novo Mercado* is a listing segment of the Brazilian stock exchange designed to improve corporate governance practices among Brazilian companies. Companies that voluntarily comply with *Novo Mercado* requirements of corporate governance practices and disclosure requisites (which go beyond those requirements already established by Brazilian legislation) are listed in the *Novo Mercado* stock exchange segment. These companies benefit from getting market exposure as responsible and solid companies. Moreover, the government is supporting the initiative by allowing pension funds to invest a higher percentage of assets in domestic equities, as long as they are listed in the Novo Mercado. It seems that there is a potential project for the MIF in this area. MIF could partner with BOVESPA and design a fund with counterparts from national pension funds (PETROS, PREVI, and others) for supporting companies to improve their corporate governance practices and achieve the Novo Mercado requirements. MIF could also establish funding conditionality requirements for companies to positively impact their smaller suppliers through responsible supply chain management initiatives.

Build on IDB Conferences and Other Bank Initiatives. MIF should better coordinate its efforts with other departments involved in CSR initiatives within the bank, such as the SDS (dissemination awareness, civil society, and corporate governance) and the Ethics and Development department (social capital and ethics initiative). For instance MIF could take advantage of the IDB conferences on CSR as well as on Ethics & Social Capital to build strategic alliances with the participants, envisioning the design of potential CSR-related projects. As Business for Social Responsibility (BSR) has established parallel meetings with the private sector during its annual conferences on CSR, MIF could organize meetings with specific companies aiming at sharing supply chain experiences and establishing partnerships for potential projects in the region.

Partnering with National SMEs Entities. Partnering with conventional organizations that have supported SMEs on common business-related issues as a means to reach SMEs in the region. These institutions should be identified and regarded as potential partners for MIF projects in the region. For instance, Sebrae should be considered a potential partner for MIF projects in the area of CSR in Brazil. Sebrae is currently involved in CSR initiatives with Instituto Ethos (awareness dissemination and development of “tool kits” for SMEs). MIF could partner with Sebrae in developing initiatives for specific industries in Brazil (development of tailor-made instruments and technical assistance to implement CSR-related management systems). This concept could be applied to all countries in the region through either national (Sebrae in Brazil, CORFO in Chile, and APYME in Argentina) or regional entities (Asociación Latinoamericana de Micro Pequeños y Medianos Empresarios / Alampyme).

Reaching SMEs Through Large Corporations. MIF should regard large corporations as the most feasible existing channel for reaching SMEs. In order to succeed in this strategy it is fundamental to focus on specific industries or sectors prior to deciding what large corporations should be involved. By selecting specific industries to implement CSR initiatives, MIF could target the correspondent business association (i.e. chemical, mining, oil & gas, paper, and other industries) as a means to scale-up the number of large corporations adhering to the project. Business associations also facilitate multi-stakeholder consultations among all business entities within the context of those specific industries. General industry associations might be useful strategic channels for reaching large corporations as a means to further develop an industry-specific initiative. For instance, these general national industry associations in Brazil would be represented by FIESP (Federação de Indústrias do Estado de São Paulo), FIEMG (Federação das Indústrias do Estado de Mingas Gerais), FIRJAN (Federação das Indústrias do Estado do Rio de Janeiro) and others. Recognized NGOs involved in CSR initiatives might also indicate potential “associate” corporations for partnering toward initiatives in the area of CSR.

Partnering with Local Government Agencies. The public sector has an important role in promoting and enforcing minimum standards of CSR. Considering the incipient stage of CSR practices in the region, along with the fact that CSR activities usually lead to some form of public good, governments in the region should not only be important actors but also receptive to support CSR initiatives. Regulatory agencies (i.e. telecommunications, mining, and energy sectors) could support the adherence of companies in pro-CSR initiatives. The MIF could consider partnering with those agencies as a means to support the SMEs compliance with minimum standards of CSR. MIF could also influence specific state-owned industries to establish procurement rules that foster CSR practices, and support SMEs to achieve the CSR requirements. The regional departments in the Bank might be important channels for reaching those public entities.

Educating Business Leaders. Education is an important factor to disseminate CSR practices in the region. MIF could partner with recognized universities in the region in order to create CSR-related academic disciplines and research centers for supporting local SMEs with affordable or free consulting services. This initiative would produce short-term impacts by supporting SMEs to respond to market requirements, and long term benefits in regards to overall dissemination of CSR among future business leaders. Academic centers should also be regarded as potential partners for developing tailored CSR instruments and innovative solutions for supporting CSR efforts in the region. For instance, Fundacao Getulio Vargas (FGV-SP) in Brazil recently created a Sustainability Center, which has an incipient project for creating a sustainability index in partnership with BOVESPA. This is an example of a potential partner (university / academic center) for MIF projects in the region.

Strengthening Civil Society. Civil society in the region often lacks the capacity to influence business leaders toward responsible behavior. As an important driver of CSR, civil society groups should be strengthen so as to improve the enabling conditions for CSR in the region. MIF could partner with specific pro-CSR NGOs, consumer associations, community initiatives, and labor organizations to empower those groups and raise pressure toward sound business practices. In this context, it is relevant to mention the important role of the media as potential "public disclosures" of business practices. The Media should be educated on what CSR is about and encouraged to utilize their investigative and reporting skills to help expose examples of good and bad business practices.

Fishery and Forestry Industries. Fishery and forestry industries depend on the sustainable harvesting of "renewable" resources to have long-term access to those resources. While sustainable harvesting is not widely practiced in the region, there is an increasing trend towards international requirements for sustainable practices in those industries. MIF could support labeling initiatives in those areas as a means to assure access to markets to SMEs. MIF could partner with multinational corporations for disseminating sustainable management practices in those industries. For instance, Mc-Donald's and Conservation International are developing purchasing guidelines standards for well-managed fisheries throughout McDonald's suppliers. In addition, there are a number of large corporations in the region, such as the paper industry, currently involved in sustainable forestry activities.

Tourism Industry. The tourism industry has an enormous potential for incorporating CSR into core business activities. Large hotel groups usually depend upon the maintenance of an enabling surrounding environment, especially the ones located in potential eco-tourism areas. The community must be safe, clean, and receptive to tourists. Environmental considerations and community involvement initiatives are fundamental for promoting the adequate maintenance and sustainable development of enabling environments in which the business operates. The hotels, as mainly service providers, rely on the satisfaction of their employees for better attending their clients. Therefore, MIF investments in promoting CSR practices within the tourism industry might play an important role for the tourism business prosperity in the region.

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