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Corporate Social Responsibility: The Lex Mercatoria of Corporate Governance in the 21st century

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Dear reader,

When I first attended the law programme at Stockholm University in 2005, I could easily distinguish two different groups of students. They were either money-grubbing students primarily motivated by becoming successful corporate lawyers, or idealists that wanted to use the law to make a change in the world. Perhaps, this observation enhances the preconception about jurists as either greedy lawyers or heroic human rights defenders.

I have a huge personal interest in entrepreneurship and business development, which may involve legal skills, but I also recognize the importance of working with human rights. Therefore, I am very pleased to write my master thesis in the field of Corporate Social Responsibility and argue that lawyers that genuinely recognize issues such as human rights, climate change and social inequities may contribute to making the world a better place while helping clients to gain a competitive advantage on the market and consequently increase profit.

Another preconception of the legal profession is that it is only connected to a career within the national jurisdictions of one's LL.M. degree. In the light of globalization, this thesis proves that so is not the case. The global market has enforced standards that apply regardless of jurisdiction. In the case of this thesis, I have examined the development of these international standards in the context of multi-national corporations operating in China.

Although it is a very interesting topic, I have experienced that it is also a very complex one, especially since the market, legal system and corporate behaviour in China is incredibly different from what to expect in Europe.

I am very grateful for the help and inspiration I have received from my supervisor Thomas Lagerqvist, Special Counsel at Mannheimer Swartling Law Firm in Hong Kong, and his colleague Max Granström. Their genuine interest in these issues have kept my highly motivated and their guidance within the field of CSR, sustainability, human rights and corporate law has been exceptional in many ways.

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1. Introduction

“With great power comes great responsibility”

In the age of globalization, developments in technology, communications and transportation have facilitated a rapid increase in transnational political, economic and social exchanges.¹ The world has become increasingly interconnected and interdependent, which has also changed the scene for international business. Moreover, economical globalization is promoting greater competition, which has forced corporations to seek decreased production costs by outsourcing production to areas where the cost of labour is still low. Consequently, we are experiencing a revolution in supply chain networks where the multi-national corporations (MNCs) are only focusing on core competencies and outsource complementary operations to save costs.

Globalization undeniably has some obvious beneficial effects, not only for the MNCs, but also for the host countries. Besides reducing the sense of isolation felt in much of the developing world, globalization can increase tax revenues to the government, provide employment opportunities, offer goods and services that were previously unavailable, introduce technology, knowledge and management techniques. But above all, the presence of MNCs brings capital, which means that governments in the developing world are competing to win their investments, often through lowering social policies, labour standards and accounting practices. It has been suggested that the problem of poverty in these countries presents the opportunity of labour exploitation and the opportunity to profit from the misery of others.² This development, and the instability of local governments, often puts corporations operating in the third world into questionable positions and it has raised the question of what role and responsibilities corporations have in the globalization process.

As the MNCs expand their operations beyond national borders, the inadequacies of domestic legal systems in regulating these global corporations are highlighted. In many of the developing countries where MNCs operate, the rule of law is ineffective, there are no legal remedies, no possibilities of redress and thus it has been claimed that they can act with almost total impunity.³ Even though there are international calls to develop mechanisms to force the global economy to respect human rights,

¹ Aguirre D., *The Human Right to Development in a Globalized World*, Ashgate Publishing Ltd, Hampshire, 2008, p. 1.

² Egle E., *Corporate Social Responsibility (CSR): Market-Based Remedies for International Human Rights Violations?*, Willamette Law Review, Vol. 40, No. 103, 2004, p.103.

³ Hubbard A.C., *The Integration of Human Rights in Corporate Principles*, in: Organisation for Economic Co-operation and Development, *OECD Guidelines for Multinational Enterprises 2001*, Annual Report, OECD, Paris, 2001, p. 99

prevent environmental damages and social issues, today there are no clear and effective international regulations that hold MNCs legally accountable for their conduct.⁴

However, corporations are increasingly expected to widen their agency and perform as political actors in relation to the environment, human rights, working conditions and welfare provisions. The global reach has given MNCs great economic and political power while the powers of the states are constantly waning.⁵ Of the world's 100 largest economies today, more than half are corporations and not countries.⁶ Thus, in many social sectors and global regions, corporations are probably able to provide more services and a more sustainable infrastructure than governments.

The rise of corporate power has generated a growing pressure on the MNCs from their stakeholders; consumers, investors, employers, trade unions, campaign groups known as non-governmental organizations (NGOs), and the general public, to take responsible actions against human rights abuses and environmental damages in the developing world. They are now, more than ever, expected to use their tremendous impact on society to contribute to social justice and community welfare, promote human rights and act as agents of world benefits. They are increasingly being held socially, legally and consequently economically accountable not only for their activities, but also for their suppliers, the communities where they are located and the people who use their products.⁷ This suggests that the objective of strategic supply chain management is not only to obtain high quality products at low prices, but also do so in an ethical and responsible manner in regard to the corporation's social effects and environmental impacts, often referred to as the ecological or social footprints.

Even though this might look like a contradicting equation, it is my firm conviction that the success of the corporations in the 21st century will be depending upon how they can satisfy these new demands of Corporate Social Responsibility (CSR). Only corporations that manage to reduce their social and environmental footprints in order to carry out their business in a sustainable manner may be able to compete successfully on the global market. Or, in the words of the financial industry in the report *"Who cares, who wins"*;

"...in a more globalised, interconnected and competitive world the way that environmental, social and corporate governance issues are managed is part of

⁴ Stephens B., *Corporate Liability: Enforcing Human Rights through Domestic Litigation*, Hastings International & Comparative Law Review, Vol. 24, Iss. 3, 2001. p. 401.

⁵ Ofek-Ghendler H., *Globalization and Social Justice: The Right to Minimum Wage*, Law & Ethics of Human Rights, Vol. 3, Iss. 2, 2009, p. 265.

⁶ See: www.corpwatch.com

⁷ Savitz A.W. with Weber, K., *The Triple Bottom Line: How Today's Best-Run companies Are Achieving Economic, Social, and Environmental Success - and How You Can Too*, Jossey-Bass, San Francisco, 2006, p. xiv.

companies' overall management quality needed to compete successfully. Companies that perform better with regard to these issues can increase shareholder value by, for example, properly managing risks, anticipating regulatory action or accessing new markets, while at the same time contributing to the sustainable development of the societies in which they operate. Moreover, these issues can have a strong impact on reputation and brands, an increasingly important part of company value.”⁸

The globalization, the growing power of MNCs, the rise of NGOs and a number of corporate scandals at the beginning of this century (e.g. Enron, WorldCom and Parmalat)⁹ have raised awareness of the broader social impact of corporations and formed the new business environment. The current global financial crisis which struck in 2008 can also be seen in the same context and calls for more responsible corporate conduct.¹⁰ The crisis is a definitive example of a direct result of lack of sufficient CSR and corporate governance progress, which enabled irresponsible banking and corporate behaviour linked to the short-termism of public companies driven solely by shareholder value and has tainted confidence in business. As concluded by *the Special Representative of the Secretary-General (SRSG) on the issue of human rights and transnational corporations and other business enterprises*, John Ruggie, society is calling for fairness and remedy where wrong has been done, hence, “*the terms transparency and accountability resonate more widely than ever before.*”¹¹

In addition, information technology has enabled consumers to easily access and spread information about corporations and their activities, which makes their reputation extremely vulnerable. It is also suggested that one of the most important changes in the role of the corporations today is that they are subject to new controls on their behaviour to a degree never before achieved.¹² As investors and other stakeholders are starting to demand that corporations justify their global operations, they are requesting information, transparency and accountability to facilitate the companies' fiduciary and social responsibilities. Thus, a growing important part of debates surrounding CSR practices revolves around how corporations are governed. The need for corporate governance - including corporations' ownership and control, the objectives they pursue, the responsibilities they recognize, the rights they respect and how they distribute the value they create has become a matter of great significance, not only for directors and shareholders, but for the entire communities they serve.¹³

⁸Global Compact report, *Who Cares who wins: Connecting Financial Markets to a Changing World*, Global Compact, 2004, p. i.

⁹ See note 109-111.

¹⁰ Spitzack H., “The development of governance structures for corporate responsibility”, *Corporate Governance*, Vol. 9, Iss. 4, p. 495.

¹¹ Ruggie J., *Business and Human Rights: Towards Operationalizing the “Protect, Respect and Remedy” Framework*, A/HRC/11/13, 22 April 2009, p.6.

¹² Epstein M.J. & Hanson K.O., *The Accountable Corporation*, Vol. 1, Praeger Publishers, 2006, p. viii.

¹³ Clarke T. & Dela Rama M. (eds), *The Governance of Globalization*, SAGE Publications Ltd, London, 2006, p. xix.

The sources for success and competitive advantage are constantly changing and a corporation's intangible assets such as reputation and brand image have become crucial managerial tasks today. CSR has persistently been seen as a vague and undefined concept, but as more and more international standards, guidelines and regulations are merging, it is becoming easier to actually measure companies' social performances and consequently their brand image.

This thesis departs from this new transparent and interdependent global business market in relation to the uncertain legal environment, and endeavours to shed light on the actual influence on corporate behaviour. The thesis also aims to explore market forces that may contribute to controlling corporate behaviour and the internal regulatory structure of the corporation; often referred to as corporate governance. I argue that corporate governance is not only becoming highly important because of the new social-economic market, it is also the most important tool when enforcing MNCs to embrace the concept of CSR.

The study focuses on the global market, the relationship of the western and the developing world in general, and the situation regarding Swedish corporations operating in the Peoples' Republic of China (hereinafter China) in particular. China, due to its reputation of sweatshops, human rights abuses, the weak legal framework and supposedly low ethical standards, serves as a very good example when analyzing the drivers of the CSR development in the wake of globalization. But most importantly, China is experiencing tremendous economical development and is set to become the world's biggest manufacturer of goods.¹⁴

This thesis suggest that, even though rule of law is still lacking in China and despite the fact that MNCs may act in legal impunity; the international market forces will eventually, if not already, make MNCs take responsible actions that go beyond legal requirements in order to remain on the market field. Thus, I argue that it is the competitive market, rather than the law, that is the main driver when obliging MNCs to adopt a certain corporate behaviour, including CSR activities and corporate governance practices. The power has moved from the states to non-state actors, such as MNCs, NGOs, investors and consumers. Together, they are creating the new ground rules of successful business conduct, which can be thought of as a new form of market driven *lex mercatoria*,¹⁵ and might transform voluntary CSR initiatives into a legal framework.

¹⁴ Marsh P., *US manufacturing crown slips*, Financial Times, 20 June 2010.

¹⁵ Lex Mercatoria is the Latin expression for a body of trading principles used by merchants throughout Europe in the medieval, which evolved as a system of custom and best practice.

1.1 Purpose

The overall objective of this thesis is to identify and analyze the legal as well as the societal requirements of corporate conduct, and provide a state-of-the-art presentation of successful corporate governance in the 21st century, which can be thought of as the precondition to CSR.¹⁶

At a minimum, corporate governance must ensure that corporations have tools required to comply with applicable laws, regulations and policies. However, as these minimum standards are gradually becoming insufficient to ensure its purpose; to give the company a competitive advantage, increase shareholder value or to ensure that social responsibility is a significant contributor to the company's financial growth, corporations are challenged to move "beyond compliance" to fulfil the market expectations.¹⁷ The development suggests that the link between corporate governance and CSR are becoming stronger and stronger. This thesis intends to examine this development by highlighting the importance of corporate governance and CSR as part of corporate business strategy and exploring potential business benefits available.

The aim is to create an understanding of how legal, social and economical accountability for the MNC are closely interrelated when facing the growing demands of social responsibility, and finally analyze if these forces might develop a uniform international framework for business conduct.

1.2 Hypotheses

Recognizing the trends towards a changing business environment and possibly also changing future legal standards regarding MNCs social and environmental responsibilities on the competitive global market, this thesis will be carried out following a few hypotheses.

First, I firmly believe that corporations that follow this trend and genuinely respect human rights and integrate social, economic and environmental considerations into their business plan will gain a competitive advantage, while unethical companies that take short turns and don't operate in a long-term sustainable way will not be able to survive. This theory is underpinned by the general assumption that civil actions, such as NGO and activists campaigns, consumer boycotts etc., will cause reputational damage to the corporation severe enough to cause a decrease in the corporation's financial performance. If the corporation's ethical behaviour increases, so does the

¹⁶ Roselle J., *The Triple Bottom Line: Building Shareholder Value*, in: Mullerat R. (ed), *Corporate Social Responsibility: The Corporate Governance of the 21st century*, Kluwer Law International, The Hague, 2005, p. 113.

¹⁷ *Ibid.*, p. 117.

corporation's financial performance, and vice versa.¹⁸ The view of CSR as an argument for long-term business profitability is used as the underlying framework for this thesis.

Second, I believe that this competitive advantage will remain regardless of legality. Therefore I propose that the development of business behaviour and corporate governance in the 21st century is mainly driven by the competitive global market forces and not by the law itself. Consequently, there is a significant gap between the business "game rules" formed by the market and the actual judicial rules. This may be explained by a natural legislative inertia, which is extra significant on the international process of law enforcement.

Third, if there is proven to be a substantial gap between the law and the market "game rules" and if the market forces corporations to use corporate governance and CSR standards far beyond legal requirements, I propose that this CSR movement is creating a new civil regulatory framework, which could be considered as the new market-based *lex mercatoria*.¹⁹ In addition, I believe that it is this *lex mercatoria* rather than typical legislative forces that are shaping the future international legal framework.

1.3 Methodology and Theory

As this thesis sets out to explore how corporate behaviour are influenced by the law in relation to the market force, it is obviously necessary to examine the legal framework and current corporate governance regulations in comparison to the voluntary initiatives on the competitive market, both on an international and a national level. A legal positivistic viewpoint will be applied when examining the regulatory environment. Consequently, the sources of law studied are international treaties, statutory law, soft-law, legal doctrine and various kinds of self-regulations.

CSR and corporate governance are both fairly new concepts in transition, and there are a great variety of theories, definitions and different approaches concerning these issues. Some scholars even suggest that there are as many definitions of the terms as there are writers on the subject.²⁰ In order to conclude the purpose of the study, it is therefore necessary to examine different theories and opinions regarding the concepts.

In general, this thesis adopts a *stakeholder approach* to CSR. The stakeholder view focuses on the corporation and its responsibilities towards the people affected by the corporation's operations. The

¹⁸ Zadek S., *The Civil Corporation: The New Economy of Corporate Citizenship*, 2nd ed., Earthscan Publications Ltd, London, 2007, p. 82.

¹⁹ See: *supra* note 15.

²⁰ Blowfield M. & Murray A., *Corporate Responsibility: A Critical Introduction*, Oxford University Press, Oxford, 2008, p. 55.

analysis is used in a descriptive and normative manner, which constitutes a useful tool to examine potential links between CSR, corporate governance practices and increased corporate performance. The normative element of the stakeholder theory suggests that stakeholders have a legitimate interest in different aspects of corporate activity.²¹

Another approach which is highly influencing this thesis is the “Creating Shared Value Model” (CSV). This view is most prominently advocated by Michael E. Porter, a leading authority on competitive strategy and head of the Institute for Strategy and Competitiveness at Harvard University.²² The theory focuses mainly on the opportunities for competitive advantage from building a social value proposition into corporate strategy. In order to examine the market force and demonstrate my first hypothesis, that CSR may work as a competitive weapon, several concrete examples of how corporations have contributed to a better and more sustainable world while increasing sales and reducing costs will be presented. As jurists use legal cases to support their arguments, I believe that practical examples of how the best-run corporations are developing ways of doing business in a sustainable way resulting in both increased profit and social and environmental values is a very effective way of undermining the CSR-sceptics arguments. Therefore, attention is drawn to concrete examples, both failures and successes. Since transparency is a crucial part of good corporate governance, the corporations’ efforts to prove themselves responsible are well communicated to the public, meaning that some materials are coming directly from the corporations themselves. Although, I am aware of the fact that such material is partial and therefore has to be well investigated, it serves as good evidence of the corporations’ commitment to CSR.

In addition, a few interviews with corporate managers have been conducted. The corporations I have chosen to interview are western, primarily Swedish, corporations operating in China.²³ They represent a broad range of different industries, and I am convinced that the connection between CSR, sustainable business and profit exists in every industry, even if it appears more complicated in some industries.

The socialist market economy in China is still an undefined concept and the development of the legal environment in China is indeed uncertain. Also, when it comes to Chinese culture there are many differences from the western world, which presents several barriers one has to overcome as both a researcher and a businessman in China. In order to gain enough knowledge and relevant background

²¹ Donaldson T. & Preston L. E., *The Stakeholder Theory of the Corporation: Concepts, Evidence and Implications*, The Academy of Management Review, Vol. 20, No. 1, 1995, p. 71.

²² See: Porter M. E., *On Competition (Updated and Extended Edition)*, Harvard Business School Publishing, Boston, 1998.

²³ Nike Inc., Ocean Trawlers, SKF, IKEA.

to carry out an analysis within the subject of this thesis, I conducted a Minor Field Study in China for 10 weeks. During that time I experienced that the Chinese approach to the issue illustrates how the CSR-framework is developing.

I have also attended seminars and conferences, and I have conducted interviews with lawyers, experts and NGO representative, both Chinese and foreign.

1.4 Swedish MNCs in China

In many ways, CSR involves the relationship between the developed world and the developing world. In this study, many examples are drawn from Swedish corporations in China.

Thanks to the reform and “open door” policy introduced by China’s late leader Deng Xiaoping in 1978, China is clearly the most rapidly developing country in the world and has established its economic status as “the world’s factory.”²⁴ China’s remarkable strides in economic development, maintaining a GDP growth of almost 10 percent per year, have catapulted the country into the rank of the world’s third largest economy (or second largest in terms of purchasing power parity).²⁵

Despite the economic boom, China is still struggling with high unemployment rates, growing income disparities and a high level of corruption within the bureaucratic system. It is also a country of great socio-economic inequalities and millions of migrant workers labouring under poor working conditions, low wages and lacking social security. In addition, the country’s environmental situation is claimed to be deteriorating, as China has moved into the economics of mass-production. Considering the trend towards more outsourcing to low-cost countries and China’s mayor importance among them, I find it to be a suitable site for studying the processes of MNCs deploying CSR practices.

Also, because of the lack of effective law enforcement in China, it is a very useful target when analyzing how corporations are introducing voluntary initiatives as a response to the global market forces and its potential impact on legal regulation as well as factors such as human rights, equality and democracy.

Even though Sweden is not a large player on the global business market, its relationship with China is very well developed. The Sino-Swedish relation²⁶ dates back to the 18th century and Sweden was the first country to establish diplomatic relations with China in the 1950s.²⁷ Many Swedish corporations

²⁴ About 20% of all manufactured goods in the world are produced in China.

²⁵ World Bank, “World Development Indicators Database”, revised 24 April 2009, available at: www.economywatch.com/economies-in-top

²⁶ Sino-Swedish = Chinese-Swedish

²⁷ See: www.sweden.gov.se/sb/d/3822

are expanding their businesses to the Chinese market and according to *Ulf Berg*, CEO at the Swedish Trade Council, the number is increasing with more than two businesses per week.²⁸ In addition, the major Swedish MNCs currently operating in China are growing and they are increasingly taking market shares on the Chinese market.²⁹

As Thomas Lagerqvist observes; “it’s no coincident that Sweden is the only country in the world that has a CSR-agreement with China”,³⁰ referring to the *Memorandum of Understanding* on CSR cooperation signed by Sweden’s Minister of Foreign Affairs Carl Bildt and China’s Minister of Commerce Bo Xilai in June 2007. Also, as a result of this agreement, the Swedish government has recently established a Centre for Corporate Social Responsibility in Beijing.³¹

1.5 Delimitation

The primary object of study is the concept and development of CSR and its close relation to corporate governance. The concept is multi-faced, complex, wide and involves a huge amount of different areas such as law, economics, business management as well as politics. This thesis will particularly focus at the legal aspects, without excluding any of the other areas.

Many CSR issues are connected to supply chain management and the relations between the developed and the developing world. As mentioned, this thesis uses China, the world’s supplier, and Sweden, a western country, as an example for this relationship. Naturally, a particular, but not exclusive, focus will be on workers’ rights since the area is closely connected with supply chain management. Also corporations’ responsibilities to respect human rights will have a prominent role in this thesis, even though CSR involves responsibilities in many other areas as well.

Moreover, this thesis chooses to focus on the global market and, consequently, foreign domestic legislation will only be discussed insofar that it supports the objectives of the study and contributes to the understanding of legal policies and principles.

Within the legal, economic and ethics doctrine, the debate on whether the corporate responsibility actually goes beyond increasing profits has been subject to a lot of attention. Even though my thesis rests on the foundation of CSR, I will not argue for the legitimacy of the concept simply because the assumption that a responsible and sustainable business manner is highly connected to the

²⁸ Opening Ceremony of Sweden - China Business Cooperation and Innovation Forum, Stockholm, 29 March 2010. See: www.skane.se/templates/page.aspx?id=300661

²⁹ Vilenius M., *Kina allt tyngre för storbolagen*, Dagens Industri, 11 augusti 2010.

³⁰ Thomas Lagerqvist, Breakfast Seminar, *Sustainability and CSR: a strategic choice and a leadership issue*, Swedish Chamber of Commerce in China, 27 October 2009, Beijing.

³¹ Press release, *Centre for Corporate Social Responsibility to be set up in Beijing*, Swedish Ministry of Foreign Affairs, March 29 2010. Available at: www.sweden.gov.se/sb/d/9545/a/142970

corporations' bottom line. Although moral arguments over CSR still have intellectual interest, they are largely irrelevant to today's corporate executives, who have, for the most part, accepted the business necessity of addressing issues of social responsibility.³²

Nor will I delve any further into the debate whether the CSR framework should be binding or voluntary. The thesis does not primarily aim at analyzing how corporations can be held legally liable for their operations in developing countries, such as China. Rather it concerns how companies respond to the "civil regulatory framework" drafted by their stakeholders, and argues that business conduct is mainly driven by the market force which requires actions that goes beyond the current legal obligations. The changing legal environment will be dealt with as just another CSR driver besides the market force. However, in order to conclude the purpose of the thesis and examine the relationship between the market and the law, it is necessary to discuss the international as well as the domestic legal framework and its potential development. Especially since issues that lead to legal rules and regulations are likely to start out as public expectations about business.

Furthermore, the thesis is focusing primarily on larger corporations, even though the concept may be applicable to small and medium-sized enterprise (SMEs) and large domestic enterprises as well.³³

1.6 Disposition

After the introductory chapter, which is design to frame the research topic and purpose, the three following chapters present the theoretical framework of the study before the last chapters present my findings, arguments and final discussion.

The second chapter provides an overview of the international legal environment related to MNCs and the fundamental challenges of international law today. Also, the most prominent initiatives to self-regulation and soft-law legislation on the international level as well as the national legal framework which might foster corporate cultures respectfulness of human rights and other issues are briefly introduced.

The third chapter aims to examine the emerging importance of CSR and corporate governance by study the concepts as well as its purpose and objectives. In addition, a presentation of how the relationship between the two concepts are about to develop will be presented.

³² Boatright J.R., *Ethics and the Conduct of Business*, 6th ed., Pearson International Ltd, New Jersey, 2009, p. 361.

³³ CSR often pertains to the realm of the larger corporations, which mostly are MNCs. But there are certainly developing initiatives to apply CSR to the SMEs.

The fourth chapter is focusing on non-legal incentives to CSR by providing an overview of the contemporary business environment, introducing how the process of globalization has influenced the operating scene for MNCs and their sources of success. Further on, the main CSR drivers, such as the rising impact of stakeholders and the importance of corporate branding will be highlighted.

The fifth chapter aims to assess the findings in the previous chapter and discuss how successful corporations run their businesses far beyond legal requirements. This will be done by introducing a three levelled model of corporate compliance that illustrates how market forces can ensure that companies adopt best practices with regards to social and environmental issues. In order to support my arguments, examples of MNCs doing business in China will be presented. These examples highlight different practical consequences in the field, and illustrate *how* and *why* MNCs' are dealing with CSR related activities and corporate governance practices.

The sixth chapter presents my concluding remarks on the issue and lays out a glimpse to the future. Moreover, discussion on CSR as the new *lex mercatoria* of corporate governance will be presented as the tool of connecting accountability to MNCs. Finally, the conclusion will be analyzed from a Chinese point of view by illustrating how *lex mercatoria* is applied in a Chinese context.

2. The International Legal Environment

Obviously, compliance with the law is a fundamental responsibility of the corporation as well as a necessity in order to remain on the market place. However, linking MNCs to international law, such as human rights regulation, has certainly proved to be controversial amongst international lawyers.³⁴ Some international jurists would argue that significant progress has been achieved in getting corporations to respect human rights without recourse to legal regulation. Similarly, it is claimed that voluntary initiatives by companies are ultimately a more effective tool for changing corporate behaviour than legal regulations. However, there are also arguments stating that there is a pressing need for binding legal rules governing the conduct of international businesses.³⁵

The rationale behind CSR is based on de-regulation. Therefore, any reference to CSR legislation raises questions of paradox.³⁶ Although the main topic of discussion of this thesis is to demonstrate how the market force may be the key driver for corporate behaviour, and not the inappropriateness of the regulatory approach, it is certainly important to address from the outset if it is possible to link human rights to MNCs under traditional treaty and customary international law. Hence, the purpose of this chapter is to introduce the limited scope of application of the international legal framework applicable to MNCs, in relation to human rights and other issues.

The chapter commence by introducing the fundamental challenges of regulating business enterprises under international law. It then proceeds to present the international legal instruments addressing MNC issues, which are channelled in two ways; (1) through binding treaties in which State entities are the direct addressees of rights and obligations, and (2) “soft law” that is directly addressed to MNCs although not legally binding.

2.1 Fundamental Challenges of International Law

Philosophers and legal theorists have long debated the role of law and its relationship with ethics and morality. Although this discussion falls outside the scope of this thesis it is important to keep in mind that the question of what constitutes responsible business conduct is highly based on ethical values, in addition to the legal responsibilities of corporations.

³⁴ Kinley D. et al., *The politics of corporate social responsibility: Reflections on the United Nations Human Rights Norms for Corporations*, Company and Securities Law Journal, Vol. 25, No. 1, 2007, p. 33.

³⁵ The International Council of Human Rights Policy, *Beyond Voluntarism: Human Rights and the Developing International Legal Obligations of Companies*, The International Council of Human Rights Policy, Versoix, 2002, p. 7-10.

³⁶ Bantekas I., *Corporate Social Responsibility in International Law*, Boston University International Law Journal, Vol. 22, p. 312.

Regulations of MNCs are subject to several problems and the initiatives taken on the international level have been widely criticized for their failure to provide enforcement. Some commentators even argue that there is no real transnational legal field.³⁷ This sought to address one of the most significant barriers to regulating MNCs on the international level. Due to their transnational nature in today's global economy, they are subject to different legislation in different countries and prosecution for international law violations are arguably blocked by *the corporate veil*. The corporate veil is a legal concept used to describe the personality of a corporation or affiliate which is separated from the personalities of its shareholders or parent company. The complicity surrounding the corporate veil may be used in the advantage of the corporation and it is claimed that MNCs often operate in a legal vacuum, particularly in states acting as human rights violators themselves or in states too weak to prevent violators, for example in China.

The public international legal structure was originally developed as a system to regulate the conduct for international relationships between states. Although globalization has turned MNCs into powerful political and economic international actors, MNCs have not traditionally been considered actors within the international legal system, i.e. having *international legal personality*.³⁸ Scholars have advocated the typical traditionalist theory which allows only states international personality under international law by distinguishing corporations from states by recognising the particular purposes of their international activities.³⁹ Such objections may be explained by certain fears that "*the creation of a new layer in the international arrangement... [would] ...privatise human rights by making private persons the duty-bearers weaken State regulation,*" which would leave the State out of the picture, weakening State regulation and trivialise human rights.⁴⁰

This would also questioning *the principle of sovereignty*,⁴¹ meaning that the national law of a particular country can only be applied within its territory, and thus, only concerns corporations resided or incorporated within State's territory.⁴² Due to the complex structure of MNCs, the national

³⁷ Koh H. H., *The Globalization of Freedom*, The Yale Journal of International Law, Vol. 26, 2001, p.305, citing: Bryant G. Garth, *Research Themes in Respecting the Growth in Transnational Law*, Paper delivered to a panel on Beyond State and National Borders: The Growth of Transnational Law at the Yale Law School Tercentennial Conference on "Dissolving Boundaries", April 28 2001.

³⁸ See: Healy, M., *Business Enterprises, Legal Personality and Responsibility: A consideration of some Contemporary Questions in International Law*, Mémoire, Geneva, 2005.

³⁹ Brownlie I., *Principles of Public International Law*, Oxford University Press, New York, 2003, pp. 66-67.

⁴⁰ International Organisation of Employers (IOE) and International Chamber of Commerce (ICC), *Joint views of the IOE and ICC on the draft "Norms on the responsibilities of transnational corporations and other business enterprises with regard to human rights"*, IOE and ICC, March 2004, p. 4.
available at www.reports-and-materials.org/IOE-ICC-views-UnitedNations-norms-March-2004.doc

⁴¹ The principle of sovereignty is one of the UN's fundamental principles and recognized as a universal principle of international law.

⁴² Rinwigati Waagstein P., *Corporate Human Rights Responsibility: A Continuous Quest for an Effective Regulatory Framework*, Uppsala University, Uppsala, 2009, p. 19.

law of a country may therefore not *per se* apply to their activities abroad, often on the basis of *forum non-conveniens*.⁴³ Thus, one could imagine situations where national courts' jurisdictions are blocked by *forum non-conveniens* and prosecution for international law violations are blocked by the *corporate veil*. This precarious situation confronts legal policy with enormous problems and such challenge have led some to suggest that an entire re-structuring of international law may be the only way to move forward.⁴⁴

2.2 Applicable International Legal Framework

An entire re-structuring of international law will certainly not happen any time soon. However, in the meantime, creative approaches have been adopted to enforce respect of human rights against corporations through their CSR activities under a variety of legal frameworks. Some of these will be presented below. From the outset, it is important to keep in mind that while individually these frameworks may appear fragmented, together they form a highly complex, dynamic and living process. As McBarnet states;

*"[w]hat is emerging in the area of CSR is a complex interaction between government, business and civil society, private law, state regulation and self-regulation, at national and international levels, with social, legal, ethical and market pressures all being brought to bear in ways that cut across traditional pigeon-holes, and which[...] interrelate and foster each other."*⁴⁵

2.2.1 States Duty to Protect Human Rights

At the very foundation of international human rights law, it has been firmly established that states not only have an obligation to respect and fulfil their own human rights obligations, both substantively and procedurally, but also to take appropriate actions to prevent human rights abuses by non-state actors within their jurisdiction and to redress such abuse when it occurs.

In 2005, Ruggie, proposed a framework to the *Human Right Council* which comprises three core principles; the state duty to protect against human rights abuses by third parties; the corporate responsibility to respect human rights; and the need for more effective access to remedies. In the latest report, he highlighted that while the extraterritorial dimension of the State duty to protect

⁴³ See: *Piper Aircraft Co. v. Reyno*, 454 U.S. 235 (1981); *In re Union Carbide Corp. Gas Plant Disaster at Bhopal, India* in 1984, 634 F. supp. 842 (S.D.N.Y. 1986); *Wiwa v Royal Dutch Petroleum (Shell)* US District Court for the Southern District of New York, decided 22 February 2002, I.C.2.

⁴⁴ Teubner G., *The Anonymous Matrix: Human Rights Violations by "Private" Transnational Actors*, *Modern Law Review*, Vol. 69, 2006, p. 330.

⁴⁵ McBarnet D., *The New Corporate Accountability: CSR Beyond Law, Through Law, For Law*, in: McBarnet D. et al (eds), *The New Corporate Accountability Corporate Social Responsibility and The Law*, Cambridge University Press, Cambridge, 2007, p. 55.

under international human rights law remains unsettled, current guidance suggest that states are not required to regulate or adjudicate the extraterritorial activities of business incorporated in their jurisdiction. However, he continues by stating that “...nor are they generally prohibited from doing so.”⁴⁶

While the state’s duty to protect seems to be well understood by states, this does not automatically mean that it is the most effective approach for relating human rights obligations to business enterprises. Ruggie points out that states often fail to address the policy dimensions surrounding this legal duty, and as a result, are unable to reconcile the various societal needs for investment and commerce with human rights’ duties.⁴⁷ Such failures undermine to a great extent the potential of this international legal framework to enforce international human rights obligations against business enterprises through their CSR activities.⁴⁸

Ruggie also maintain that states are not held responsible for corporate-related human rights abuses *per se*, but may be considered in breach of their obligations when failing to take appropriate steps to prevent it and to investigate, punish and redress it when it occurs.⁴⁹ Several examples show how a state may be obligated under international law if it fails to exercise “due diligence” over a corporations behaviour. *OECD Anti-Bribery Convention* obligates states to exercise its jurisdiction on corporations of their nationality abroad.⁵⁰ Also, Article 139 of *The United Nations Convention on the Law of the Sea* (UNCLOS) obligates states to ensure that corporations which posses the nationality of the State carry out their activities in accordance with the convention.⁵¹

Another recent example of this obligation is highlighted in the ECOS report, “*Unpaid Debt: The Legacy of Lundin, Petronas and OMV in Sudan, 1997-2003*”, which argues that the Swedish government have failed in their international obligations to prevent human-rights violations and international crimes.⁵² The allegations against the oil consortium led by Sweden’s *Lundin Petroleum*

⁴⁶ Ruggie, J, *supra* note 11, p. 7.

⁴⁷ Ruggie, J., *Business and Human Rights: Mapping International Standards of Responsibility and Accountability for Corporate Acts*, Human Rights Council, 4th Session, A/HRC/4/035, 9 February 2007, p. 5.

⁴⁸ Ruggie, J., *Protect, Respect and Remedy: a Framework for Business and Human Rights*, Human Rights Council, A/HRC/8/5, 7 April 2008, pp. 9-14.

⁴⁹ *Ibid.*

⁵⁰ See: *OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions* of 15 February 1999.

⁵¹ The United Nations Convention on the Law of the Sea of 10 December 1982, Article 139.1: “*States Parties shall have the responsibility to ensure that activities in the Area, whether carried out by States Parties, or state enterprises or natural or juridical persons which possess the nationality of States Parties or are effectively controlled by them or their nationals, shall be carried out in conformity with this Part. The same responsibility applies to international organizations for activities in the Area carried out by such organizations.*”

⁵² See: ECOS, *Unpaid Debt: The Legacy of Lundin, Petronas and OMV in Sudan, 1997-2003*.

Available at: www.ecosonline.org/reports/2010/UNPAID_DEBT_fullreportweb.pdf

were that its activities enabled and contributed to the commission of international crimes by others, and since Sweden is a State Party to the *Rome Statute of the International Criminal Court*, it is obligated to criminalize crimes against humanity.⁵³

2.2.2 Corporations' Obligation to Respect Human Rights

The state is the basic unit of international law and there is no unanimous acknowledgement of human rights which are related to corporations and relative CSR activities. On the other hand, Ruggie advocates that the second pillar of his report, *the corporate responsibility to respect*, exists independently of state's duties.⁵⁴

Although international law is primarily intended to regulate relations between states, treaties can impose certain obligations directly on companies, even though they are usually enforced by states.⁵⁵ Commentators have pointed towards the fact that companies in some situations have been granted the benefit of certain rights that are found in human rights documents along with access to international tribunals to enforce them. The European Court of Human Rights (ECHR) has, for instance, recognized that the legal status of a company does not deprive the protection of the *European Convention on Human Rights* (ECHR).⁵⁶ Therefore, it has been claimed that no conceptual obstacle prevents states from requiring companies to abide by legally binding human rights obligations.⁵⁷

Corporations may have a legal obligation to avoid certain prohibited actions in their conduct under the application of *international criminal law*.⁵⁸ Even though these rules have traditionally aimed directly at individuals, they could also potentially apply to business enterprises.

Said Mahmoudi, professor of International Law at Stockholm University, commenting the above mentioned *Lundin Oil case*, emphasize the corporation's social responsibility rather than its legal obligation by comment; "...the very important thing is not whether Lundin Oil has the law on its side or not, the fact is that they should feel ashamed - they have an ethical and a moral obligation not to sleep there, or stand there, and look at it. Nobody believes if they say they didn't know what was

⁵³ The Rome Statute of the International Criminal Court, UN Doc A/CONF.183/9, 17 July 1998, Article 5 & 7.

⁵⁴ Ruggie J., *supra* note 48, p. 17.

⁵⁵ The International Council of Human Rights Policy, *supra* note 35, p.55.

⁵⁶ *Autronic AG v. Switzerland*, Eur. Ct. H.R. Series A.178 (1990); 12 (1990) E.H.R.R. 485. at para. 47.

⁵⁷ The International Council of Human Rights Policy, *supra* note 35, p.57.

⁵⁸ Clapham, A., *Multinational Business and Corporate Governance*, in Heere, W. P. (ed), *From Government to Governance 2003 Hauge Joint Conference on Contemporary Issues of International Law*, Cambridge University Press, The Hague, 2004, p. 241.

*happening [in Sudan].*⁵⁹ Jonas Ebbesson, Professor of Environmental Law at Stockholm University, on the other hand claims that although it is only individuals, not companies, who may be charged with crime today, there is a possibility to claim compensation from the company.⁶⁰ He further elaborates and observes that Swedish courts are prevented from rejecting a case based on *forum non-conveniens*, in accordance with the Brussels Regulation.⁶¹

Indeed, scholars are arguing that the application of international criminal law to MNCs in order to protect against human rights violations may be “simply a matter of time”.⁶² This seems even more possible in the context of the recent development of international criminal liability being applied in a national context under U.S. domestic law. The “rediscovery” of the Alien Tort Claims Act (ATCA) 1789 as a civil cause of action imply that MNCs may be held responsible for violations of international law, regardless of whether the actions take place in the U.S. or extra-territorially.⁶³ This provision has been subject to an evolving judicial interpretation; in the federal *Talisman* decision, Judge Schwartz held that “business enterprises may be held liable for *jus cogens* violations of international law”, in the *Wiwa v Royal Dutch Petroleum (Shell)* case it was claimed that Shell had not only committed international crimes but also violated the “right to life, liberty and security of the person and peaceful assembly and association”.⁶⁴ In 2007, an ATCA case was filed against Yahoo! Inc, alleging that the company knowingly took actions that led to plaintiffs’ arbitrary arrest, detention, and torture by revealing identifying user information to authorities in China which sought information regarding individuals accused of anti-government speech.⁶⁵ The case was, like many other ATCA cases later settled.

Moreover, English courts have in several cases accepted trials against British MNCs for violations of human rights outside the British jurisdiction. For example in the case *Rachel Lubbe et al. v. Cape PLC*, Britain's House of Lords authorized 3,000 South African asbestos victims to continue their case in the U.K. courts against a British MNC's overseas actions. Similarly, in the case of *Connelly v. RTZ Corp. PLC and RTZ Overseas Ltd* the Court of Appeal held that it was “in the interest of Justice” to take in the

⁵⁹ Goldstein R., *Sudanese blood spills into Asia*, Asia Times, 25 June 2010. available at www.atimes.com/atimes/Global_Economy/LF25Dj01.html

⁶⁰ Ebbesson J., *Brott i Sudan kan prövas i Sverige*, Svenska Dagbladet, 11 June 2010. available at www.svd.se/opinion/brannpunkt/brott-i-sudan-kan-provas-i-sverige_4848977.svd

⁶¹ Ebbesson J., interviewed by e-mail, 6 August 2010; Council Regulation (EC) No 44/2001 of 22 December 2000 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters.

⁶² Clapham A., *supra* note 58, p. 238.

⁶³ 28 U.S.C. § 1530: “The district courts shall have original jurisdiction of any civil action by an alien for a tort only, committed in violation of the law of nations or a treaty of the United States.”

⁶⁴ Presbyterian Church v. Talisman Energy Inc. 244 F. Supp. 2d 289 (S.D.N.Y. 2003), at 13-14; US District Court of Southern District of New York, decided 22 February 2002, filed 28 February 2002, I.C.2, para. 21-126.

⁶⁵ *Wang Xiaoning v. Yahoo! Inc.*, No. C07-02151 CW, N.D. Cal. July 30, 2007.

case and Lord Hoffman stated that “...any multinational with its parent company in England will be liable to be sued here in respect of its activities anywhere in the world.”⁶⁶

These cases have alerted civil society prompting calls for direct accountability of corporations. Although, the ATCA’s jurisprudence and the British cases still represents an exception to national jurisprudence, *Clapham* asserts that it may also prove to be important for understanding how the issue might be dealt with in other jurisdictions.⁶⁷ This may also be relevant for the development of the international legal framework as a “general principle common to civilized nations”.⁶⁸

Ruggie sums up the development by suggesting that;

*“...corporations will be subject to increased liability for international crimes in the future. They may face either criminal or civil liability depending on whether international standards are incorporated into a state’s criminal code or as a civil cause of action... ...companies cannot be certain where claims will be brought against them or what precise standards they may be held to because no two national jurisdictions have identical evidentiary and other procedural...In short, the risk environment for companies is expanding slowly but steadily – as are remedial options for victims.”*⁶⁹

In the latest report of *Ruggie*, it is emphasised that the corporate responsibility to respect human rights in essence means “[acting]... with due diligence to avoid infringing on the rights of others.” The concept of human rights due diligence, which calls on companies to have a human rights policy, to make assessments of company impacts, to integrate human rights into business processes and to track and report performance on human rights, is becoming a generic view of the future development of international law and human rights in relation to businesses. The concept also received a great deal of attention at the *Global Compact Leaders Summit 2010*.⁷⁰

2.2.3 Soft Law Standards

Lately several voluntary initiatives of non-binding regulations in relation to corporation have emerged. These stretch over a wide spectrum from private individual corporate codes of conduct

⁶⁶ See: *Rachel Lubbe et al. v. Cape plc* (CA 29 Nov. 1999) (2000); *Connelly v. RTZ Corp. plc.* (1998) AC 854, HL. Lloyd’s Rep. 139.; at 876.

⁶⁷ Clapham A., *Corporate complicity in Violations of International Law: Beyond Unocal*, in Heere, W.P. (ed), 2004, p.238.

⁶⁸ International Court of Justice Statute, Article 38 (1)(c).

⁶⁹ Ruggie J., *supra* note 47, p. 9.

⁷⁰ See: www.leaderssummit2010.org/

established by the industry, the company itself or within private organizations,⁷¹ multi-stakeholder initiatives⁷² and pressure groups' initiatives on an international or governmental level.⁷³

Individually, these soft law standards may not be very effective, but together with other regimes, they can encourage improved human rights protection.⁷⁴ Further, it is generally accepted that these standards may help to complete, re-interpret, or even reform existing provisions of international law. For example, the OECD has suggested that the weight of a joint recommendation of OECD Governments alongside with national laws form part of the legal infrastructure.⁷⁵

2.2.3.1 The Universal Declaration of Human Rights

The Universal Declaration of Human Rights (UDHR) was adopted by the UN General Assembly in 1948 and it is the source of most modern human rights norms. The preamble of the UDHR proclaims;

"[UDHR]...is a common standard of achievement for all peoples and all nations, to the end that every individual and every organ of society, keeping... [the] Declaration constantly in mind, shall strive by teaching and education to promote respect for rights and freedoms and by progressive measures, national and international, to secure their universal and effective recognition and observance, both among the peoples of Member States themselves and among the peoples of territories under their jurisdiction."

[My underlining]

Concerning the application of the Declaration, Professor *Louis Henkin*, a noted scholar of International Law, emphasised that; *"every individual' includes juridical persons. 'Every individual' and 'every organ of society' excludes no one, no company, no market, no cyberspace. The Universal Declaration applies to them all."*⁷⁶ [Emphasis in original]

The UDHR is not a treaty, and was not originally intended to create legally binding obligations. However, it is now widely accepted that some provisions of the Declaration have become customary binding international law on states, since they have accepted it through their "repeated words and deeds."⁷⁷ The definition of "every individual," also suggest that the Declaration, in some parts, may become binding towards companies in the same manner as the case is for states.

⁷¹ E.g.; International Business Leaders Forum (IBLF) in London; World Economic Forum in Geneva; and Global Reporting Initiative (GRI) in Amsterdam.

⁷² E.g.; The Ethical Trading Initiative in Great Britain.

⁷³ E.g.; UN Global Compact, the OECD Guidelines and the ILO Tripartite Declaration.

⁷⁴ Egle E., 2004, p. 106. Citing: Macek E. E., *Scratching the Corporate Back: Why Corporations Have No Incentive to Define Human Rights*, Minnesota Journal of Global Trade, Vol.11, 2002.

⁷⁵ OECD, *Foreign Direct Investment, Development and Corporate Social Responsibility*, OECD, 2000, available at www.oecd.org/dataoecd/52/47/25555208.pdf

⁷⁶ Henkin L., *The Universal Declaration at 50 and the Challenge of Global Markets*, Brooklyn Journal of International Law, Vol. 25, Iss. 1, 1999, p. 25.

⁷⁷ International Council on Human Rights Policy, *supra* note 35, p.58-60.

However, in the view of *Ruggie*, although he agrees that the UNDHR aspirations and moral claims apply to all humanity, the UDHR does not have the status of a legally binding document.⁷⁸

2.2.3.2 The Global Compact

The Global Compact, announced by the UN Secretary-General *Kofi Annan* in 1999, is probably the most influential public international CSR instrument.

It is a voluntary effort to coordinate corporations in the course of the UN to recognize and enact ten principles, in the area of human rights, labour and environment, into their corporate practices and policies within their sphere of influence.⁷⁹ It is important to point out that the Global Compact does not substitute for effective action by governments, nor does it present a regulatory framework or code of conduct for companies. Rather, its value can be described as a learning network “*designed to promote institutional learning with few formalities and no rigid bureaucratic structures*”.⁸⁰

Hans Cornell, former Under-Secretary-General for Legal Affairs and the Legal Counsel of the UN, describes the Global Compact as “*a voluntary corporate citizenship initiative with two main objectives; to mainstream the [ten] principles in business activities around the world and to catalyze actions in support of UN’s goals.*”⁸¹ Participating companies undertake three commitments; to advocate the Global Compact, to post on the Global Compact website all the steps they have taken to act on the principles, and to join the UN in partnership projects of benefit to developing countries.

The monitoring mechanisms are, however, undeveloped and rely mainly on the corporations’ evaluation of the importance of their public image under the scheme.⁸² However, multi-stakeholders initiatives with developed monitoring systems, such as the Global Reporting Initiative⁸³ (GRI) and various Social Accountability schemes (e.g. SA8000), offer the opportunity for companies to complement the Global Compact by providing instrument to demonstrate accountability by having their environmental and social performances audited according to the principles. Such standards and reporting initiatives can enable stakeholders to compare rights-related performance. Sweden, for

⁷⁸ Ruggie J., *supra* note 47, p. 12.

⁷⁹ See: UN Global Compact, Principle 1 & 2.

⁸⁰ Kell G. & Levin D., *The Evolution of the Global Compact Network: An Historic Experiment in Learning and Action*, Paper presented at: The Academy of Management Annual Conference “Building Effective Networks”, Denver, 11-14 August, 2002, p. 2.

⁸¹ Corell H., *The Global Compact*, in: Mullerat R. (ed), *supra* note 16, p. 240.

⁸² Global Compact Leaders Summit, Final Report, 2004.

available at www.unglobalcompact.org/docs/2004SummitReport.pdf

⁸³ See: www.globalreporting.org

instance, requires independently assured sustainability reports using GRI guidelines for its State-owned enterprises, and China recently issued an advisory opinion on this exact matter.⁸⁴

2.2.3.3 *The OECD Guidelines for Multinational Enterprises*

The OECD Guidelines are non-binding recommendations addressed by governments to MNCs operating in or from adhering countries. The Guidelines provide voluntary principles and set standards for responsible business conduct in a variety of areas including employment and industrial relations, human rights, environment, information disclosure, combating bribery, consumer interests, science and technology, competition, and taxation. The aim of the Guidelines is to ensure that the operations of enterprises are in harmony with government policies, to strengthen the basis of mutual confidence between enterprises and the societies in which they operate, to help improve the foreign investment climate and to enhance the contribution to sustainable development made by MNCs.⁸⁵

Although the guidelines are non-binding, they have been used to interpret national law, and their application is reviewed through a system of governmental National Contact Points responsible for encouraging observance of the Guidelines in a national context, handling inquiries and promotional activities.⁸⁶

2.2.3.4 *The ILO's Tripartite Declaration of Principles*

In 1977 the International Labour Organization (ILO) adopted a specific *Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy*.⁸⁷ The Declaration was updated in 2000, in the light of the *1998 ILO Declaration of Fundamental Principles and Rights at Work*.⁸⁸

Although the ILO Declaration is a recommendatory instrument, it has provided a unanimous interpretation of the International Labour Conventions and Recommendations from which it has

⁸⁴ *Guidelines for external reporting by Swedish State-owned companies* adopted 29 November 2007, available at <http://www.sweden.gov.se/se/sb/d/8194/a/93506>; and *Instructing opinions about central State-owned enterprises fulfilling social responsibility*, issued by China's State-owned Asset Supervision and Administration Commission of the State Council, 4 January 2008.

⁸⁵ See: OECD Guidelines for Multinational Corporations, OECD, 2008, p. 9. available at www.oecd.org/dataoecd/56/36/1922428.pdf.

⁸⁶ Horn, N., *Codes of Conduct for MNEs and Transnational Lex Mercatoria: an international Process of Learning and Law Making*, in Horn, N., (ed.), *Legal Problems of Codes of Conduct for Multinational Enterprises*, Kluwer, Deventer, 1980, p. 58; and OECD, *Review of National Contact Points*, OECD, 2003, available at www.oecd.org/dataoecd/3/47/15941397.pdf

⁸⁷ Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy, adopted by the Governing Body of the ILO, at 204th Session, Geneva, November, 1977.

⁸⁸ Declaration of Fundamental Principles and Rights at Work, adopted by the General Conference of the ILO, at 86th Session, Geneva, June 1998. See: www.ilo.org/

developed. In turn, this interpretation has been influential for purposes of independent investment evaluation measures such as the FTSE4Good which refer to the ILO core labour standards as a point of reference and may have significantly influence on investors, customers and even employees.

Also, the ILO Declaration provides, at minimum, strong evidence of a consensus that corporations have certain duties toward their employees and that the international labour regime has come to include human rights obligations for enterprises.⁸⁹

2.3 Self-Regulation

Self-regulation may be defined as “the policies and practices business itself adopts voluntarily, triggered by its assessment of human-rights related risks and opportunities, often under pressure from civil society and local communities.”⁹⁰ To respond to the global expectations in terms of CSR, MNCs have incorporated corporate social accountability standards into their supply chain operations which address various social issues.⁹¹ These standards can be internal voluntary codes of conduct established by the corporation itself or external voluntary standards established by non-governmental organizations. Compared to legislation, self-regulation provides the corporations with a voluntary and flexible tool to address these concerns. This flexibility allows for creative and innovative solutions to complex social and environmental problems. It also allows for rapid changes to commitments required to keep pace with the changing needs of the marketplace, corporations or stakeholder.⁹² The power of such approach has also been asserted to be that companies will be more likely to respect rules they design themselves and that external regulation by governments might be counter-productive.⁹³

The underlying premise is that the code of conducts may force suppliers in the developing world to follow the values and standards set by the western MNCs. When the buyers think that some suppliers are compliant with their code of conduct, they are then willing to place the orders with that specific supplier. However, the code of conducts themselves cannot guarantee compliance. A code can only reveal core values and is not a corporate compliance program in itself. Hence, the two most

⁸⁹ Clapham A., *Human Rights Obligations of Non-State Actors*, Oxford University Press, New York, 2006, pp. 212-216; Rudolph P. H., *The Tripartite Declaration of Principles concerning Multinational Enterprises*, in: Mullerat R. (ed), *supra* note 16, p. 219.

⁹⁰ Ruggie J., *supra* note 47, p. 18.

⁹¹ As many as 95% of all Fortune 500 companies publish codes, a figure that is now rapidly approaching 100%.

⁹² Bondy K. et al, *Codes of Conduct as a Tool for Sustainable Governance in MNCs*, in: Crane A. et al (eds), *Corporate Social responsibility: Readings and Cases in a Global Context*, Routledge, New York, 2008, p. 443.

⁹³ International Council on Human rights Policy, *supra* note 35, p. 7

common critiques of codes of conduct are the inability of corporations to effectively implement the commitments and the lack of monitoring mechanisms.⁹⁴

Moreover, the codes are often drafted in the “west” based on western values and thereafter implemented in the “east”. MNCs ask their business partners along the supply chain to sign their codes and thus promise to adhere to the set of principles. By doing so, the MNCs wish to gain trust of their stakeholders, ensuring that their products are produced under good circumstances.

In developing countries, codes of conduct may serve as a complement or even substitute to a national labour law. In China, however, there are examples of this, but also situations where corporate codes of conduct are in direct opposition to national law. One example is China’s refusal to allow freedom of association. Thus, it is suggested that MNCs may be more successful if they adapt their codes and the ways they are implemented to local environments.⁹⁵ Since the costs for implementing the standards may be heavy for the suppliers it is also important that there is a long-term relationship between the corporation and the suppliers in order to facilitate the work with improving the conditions for the workers.⁹⁶ It has also been pointed out that the suppliers are only disposed to implement the codes if they see that the orders are big enough to make the effort worthwhile.⁹⁷

Self-regulation has been criticised, due to its voluntary nature and the role it admits to non-state actors to create international law. Nevertheless, it certainly offers potential for the enforcement of international law in the context of corporations’ CSR activities and supports the other legal frameworks in this domain.

2.4 Concluding Discussion

As discussed in this chapter, the current public international legal structure was originally developed as a system to regulate the conduct of international relationships between states. Thus, the international legal CSR-framework is still weak and the enforcement of binding human rights obligations against corporations has proven extremely complex. In any case, it is suggested that the norms and activities of business enterprises have already begun to inform an international legal

⁹⁴ Bondy K. et al, *supra* note 92, p. 443.

⁹⁵ Keinert C., *Corporate Social Responsibility as an International Strategy*, Physica-Verlag, Heidelberg, 2008, p. 107.

⁹⁶ Kaiming L. interviewed, e-mail, 10 November 2009.

⁹⁷ Liang X., Chief for Social Responsibility, China National Textile and Apparel Council (CNTAC), interviewed in Beijing, 9 December 2009.

framework relating to MNCs' activities through policies and codes of conduct, whether theorists acknowledge it or not.⁹⁸

Indeed, there is a multi-faced framework building up to relate social issues, including human rights, to MNCs under international law. In particular international "soft law" standards and self-regulation frameworks demonstrate the innovation being used to relate human rights obligations and other issues to corporate activities. This development suggests that the application of human rights and other social issues to MNCs exists at the very edge of what is traditionally considered international law, if not "outside the strictly legal sphere".⁹⁹ In conclusion, it can be noted that the international legal framework are changing. However, as illustrated in this chapter, the development is driven more by voluntary initiatives taken by the private sector rather than international legislative forces. This leads us into the next chapter which examines the rise of such voluntary initiatives.

⁹⁸ Leary V., *Non-binding Accords in the Field of Labor*, in: Brown Weiss, E., *International Compliance with Non-binding Accords*, American Society of International Law, Washington, 1997, p. 255.

⁹⁹ Baker Mark B., *Private Codes of Corporate Conduct: Should the Fox Guard the Henhouse?*, University of Miami Inter-American Law Review, Vol. 24, 1993, p. 401.

3. The rise of CSR and Corporate Governance

“At current time it is quite noticeable how much more prominent the concepts of corporate governance and corporate social responsibility have become – not just in the academic world or in the business world but also in everyday life”¹⁰⁰

Both corporate governance and CSR have become major international issues, but there is arguably confusion between the two terms. There are a great variety of theories, definitions and different approaches concerning these issues. The general opinion seems to be that corporate governance is about binding enforceable law and that CSR is concerned with ethical, voluntary, non-enforceable rules.¹⁰¹ However, as will be discussed in this chapter, this assumption is incorrect. The rise of CSR as an extended version of corporate governance suggests that the definitions are changing and that the scope of corporate governance is widening to include not only legal compliance but also considerations outside binding enforceable law.

Besides presenting the underlying theories behind the two concepts, this chapter discusses this development and highlights how corporate governance and CSR intertwine with each another.

3.1 Corporate Governance

A corporation brings together many different groups, most notably managers, employees, suppliers, customers and investors, for the purpose of conducting business. Because these various corporate constituencies have different and sometimes conflicting interests, the question arises; in whose interest the corporation should be run and who should control the corporation? This is the subject matter of corporate governance. In the standard system, corporate governance generally refers to the way boards of directors and corporate executives manage the corporate decision-making and policy-setting processes in accordance with the governing shareholders interests and objectives.¹⁰² However, since the beginning of the 21st century increasing attention has been drawn to the development of corporate governance in a close relation with issues concerning globalization, business ethics and accountability, suggesting that corporations ought to be operated for the use benefit of more than just the shareholders. The need for better corporate governance has emerged as a way of controlling these operations.

¹⁰⁰ Aras G. & Crowther D. (eds), *Global Perspectives on Corporate Governance and CSR*, Gower Publishing Ltd, Farnham, 2009, p. xix

¹⁰¹ Mullerat R. *The Global Responsibility of Business*, in: Mullerat R. (ed), *supra* note 16, 2005, p. 4.

¹⁰² These definitions and descriptions that have been advanced over the years also reflect their origin. For example, lawyers tend to focus on the contractual and fiduciary aspects of the governance function; finance scholars and economists think about decision-making objectives; while management consultants tend to adopt a more task-oriented or behavioral perspective; Mullerat R (ed.), *supra* note 16, p.38-39.

3.1.1 Agency Theory

The most widely used definition of corporate governance is “*the system by which companies are directed and controlled.*”¹⁰³ The importance of this system is known to have existed ever since the corporation itself, where there is a separation between power and capital, became the paramount form of business organization.¹⁰⁴ The main function of corporate governance is then often understood as a tool to deal with the explosive demand for capital and the consequential need to protect diffused investors.

Traditionally, corporate governance consists of two elements,¹⁰⁵

- (1) *The long term relationship*, dealing with the separation of power between the owners of the company and the management, often referred to as “the agency problem”.
- (2) *The transactional relationship*, which involves dealing with disclosure and authority.

The agency theory dealing with the relationship of shareholders and managers, often described as a contract in which a principal engages an agent to perform a service on his or her behalf which involves delegating some kind of decision-making authority, is commonly explained as the underlying framework of understanding corporate governance.¹⁰⁶ A problem of this separation arises when the interest of managers (the agents) and shareholders (principals) diverge and managers opt to act in their own self-interest or the interest of someone but the shareholders. The study of corporate governance was hence developed to solve this problem, based on the premise of managers’ and directors’ role to maximize shareholder value.

3.1.2 Stakeholder Theory

However, the call for social and environmental responsibility as a component of the corporations’ sustainable development suggests that the scope of sound corporate governance is in fact broadening and also involves value-creating relationships with all stakeholders, including; creditors, investors, employees, customers, suppliers, governmental bodies and the wider community. This development is expressing the *stakeholder theory* which argues that the need and wishes of all these parties shall be addressed by the company.

¹⁰³ The Cadbury Report: Report of the committee on the Financial aspects of Corporate Governance 1992, available at www.ecgi.org/codes/country_pages/codes_uk.htm

¹⁰⁴ Millstein I. M., *A perspective on Corporate Governance: Rules, Principles, or Both*, in Epstein M. J. & Hansson K. O. (eds), *supra* note 12, 2006, p. 3.

¹⁰⁵ See: <http://www.applied-corporate-governance.com/definition-of-corporate-governance.html>

¹⁰⁶ Jensen M. & Meckling W., *Theory of the Firm: Managerial Behavior, Agency costs and Ownership*, of Financial Economics, Vol. 3, 1976, p. 305.

In the light of the development towards a stakeholder approach, corporate governance of the 21st century is arguably known to be more than the just checks and balances adopted by a company to protect the shareholders. Klaus Schwab, founder and executive chairman of the World Economic Forum, proclaims that corporate governance means *“that a company complies with local and international laws, transparency and accountability requirements, listing rules, ethical norms, and environmental and social codes of conduct.”*¹⁰⁷ This would include all sets of laws, regulations and listing requirements as well as all voluntary private-sector practices that enable corporations to attract capital, perform efficiently, generate profit and meet both legal obligations and general societal expectations.¹⁰⁸ Schwab further claims that good corporate governance ensures that the company’s conduct meets or exceeds what is required on paper by *“not doing any harm because it is following the rules and possibly even doing good by going beyond the mandated minimum.”* In conclusion, he states that; *“corporate governance is how a company behaves when nobody is looking... [and]...without good corporate governance, no other form of corporate engagement is credible.”*¹⁰⁹

Examples that are frequently brought to attention when illustrating the importance of good or consequences of poor corporate governance and business ethics are the traumatic corporate scandals of Enron,¹¹⁰ WorldCom,¹¹¹ and Parmalat¹¹² in the early-2000s, where fraudulent unethical corporate behaviour more or less lead to the collapse of these firms. The shockwaves of these failures of corporate governance also proved that not only the shareholders of the companies where

¹⁰⁷ Schwab K., *Global Corporate Citizenship; Working With Governments and Civil Society*, Foreign Affairs, Vol. 87, Iss. 1, 2008, p. 110.

¹⁰⁸ De Kluyver, C.A., *A Primer on Corporate Governance*, Business Expert Press LLC, New York, 2009, p. 1.

¹⁰⁹ Schwab, K., *supra* note 107, p. 110.

¹¹⁰ Enron was an American multi-billion corporation in the energy industry that collapsed without any warning whatsoever in 2001. As the investors were driven by growth, executives were offered huge bonuses and stock options which encouraged senior executives to cheat and manipulate earnings in any way they could to maximize the share value and the value of their options. By taking advantage of some weaknesses the financial reporting system, Enron managed to hide a mountain of debt from their investors while the executives were rewarded hundreds of millions dollars from salary, bonuses and exercised options and perks.

See: McLean B. & Elkind P., *The Smartest Guys in the Room: The Amazing Rise and Scandalous Fall of Enron*, Penguin Group Inc., New York, 2004.

¹¹¹ WorldCom was a major player in the global communications industry. When the stock was declining, WorldCom answered by using fraudulent accounting methods to mask its declining earnings, painting a false picture of financial growth and profitability to prop up the price of the stock. This unsustainable behavior caused the largest bankruptcy in the U.S. history.

See: De Gini A. & Marcoux A. M. (eds), *Case Studies in Business Ethics*, 6 ed., Prentice-Hall, Upper Saddle River, 2009, p. 132-140.

¹¹² Italian food company Parmalat was one of the world’s largest companies in 2003 before creating the largest bankruptcy in European history, representing 1.5 % of Italian GNP in 2003. A government-led audit revealed that the company had created enormous fictitious assets and hid unreported debts, through illegal off-balance sheet transaction, to maintain an appearance of a successful firm.

See: De Gini A. & Marcoux A. M., *supra* note 111, p. 126-132.

affected by the business conduct, which underscores that corporate governance is concerned with not only economic and individual goals but also social and community goals.

The call for responsible corporate governance has also resulted in an increasing focus on transparency, accountability and accessibility. Investors are more and more focusing on “ethical investments” and corporate governance is becoming a tool to ensure that businesses are acting in a sensitive and responsible way, both at home and abroad. Transparency and disclosure in decision-making are obviously a mechanism to mitigate the problem and ensure the shareholders as well as the public that the management is running the corporation in their interests. The underlying premise is of course that better information enables investors to use their power to buy, sell, vote, sue etc., a power that lately has been extended to costumers, NGOs and the society at whole too. It is therefore natural that good corporate governance increases investor confidence and where companies introduce good governance practices share prices rise.¹¹³

3.1.3 Business Value

In a study of 172 companies in 19 industries over an 11-year period, Kotter and Heskett, favouring the stakeholder approach, found that large US companies which gave equal priority to employees, customers and shareholders delivered a sales growth four times higher and an employment growth eight times higher when compared to “shareholder first” companies.¹¹⁴ Another example highlighting the importance of good corporate governance is a survey carried out jointly by McKinsey & Company and Institutional Investor Inc. The report found that investors pursuing a value strategy paid premium price for well-governed companies on the basis that companies which display sound corporate governance practices perform better, reduce risk and over time become attractive to other investors who recognized the value of good governance.¹¹⁵ The findings illustrated that corporate governance can serve as a tool for attracting socially conscious investors as well as influencing stock prices with investors paying an additional premium of between 11 percent and 16 percent for a well-governed company.¹¹⁶

¹¹³ Empirical work has produced strong evidence that high levels of transparency are found to be associated with lower country risk premia and cost of capital and higher trading volumes or liquid, as well as good corporate governance arrangements affect the ability of companies to manage risk and react to macroeconomic shocks.

¹¹⁴ See: Kotter J.P. & Heskett J.L, *Corporate Culture and Performance*, Free Press, London, 1992.

¹¹⁵ Agrawal Raj et al., *Capital productivity: Why the US leads and why it matters*, The McKinsey Quarterly, 1996, p. 38-55.

¹¹⁶ Ibid.

Another study from 2000, also carried out by McKinsey & Company illustrates the particular importance of corporate governance in China.¹¹⁷ In the survey 200 international institutional investors were asked if they would pay more for the shares of a “well-governed company” than for those of a “poorly governed company” with comparable financial performance.¹¹⁸ The survey concluded that in Asia, where financial reporting is both limited and often of poor quality, higher premiums clearly reflected the need for more fundamental disclosure of information and stronger shareholder rights. On the other hand, the survey showed that Sweden, where the quality of accounting rules is high meaning that transparency in Swedish Companies is high as well (especially in comparison with China) and the companies tend to choose to voluntarily disclose their strategic information in annual reports, was the country with the smallest “corporate governance discounts.” This suggest that Chinese corporations has a lot to win by implement better corporate governance practice, while investors feel that Swedish companies have already addressed many fundamental governance issues.

3.1.4 Bonding and Cross-listing

Since there are clear incentives to implement good corporate governance practice in order to attract investors, the question arises if companies in China can develop non-legal means to ensure good corporate governance. One indication of the willingness to improve corporate governance among Chinese corporations is that many Chinese corporations choose to list themselves on overseas stock exchanges in Hong Kong, the United States, Singapore, and the United Kingdom. Subsequently, they voluntarily become subject to stricter insider trading prohibitions, limitations on tender offers, stricter corporate governance and disclosure requirements and thereby signal to their investors the strong commitment of not expropriating the minority shareholders’ interest. This strategy has been recognized as “a new and desirable form of regulatory competition.”¹¹⁹ *John Coffee Jr.* suggests that when a firm lists in the United States, as an example, it make a “*credible and binding commitment...not to exploit whatever discretion it enjoys under foreign law to overreach the minority*

¹¹⁷ McKinsey & Company, *Investor Opinion Survey June 2000*, McKinsey & Company, London, 2000, available at <http://www.oecd.org/dataoecd/56/7/1922101.pdf>

¹¹⁸ A “well-governed company” was defined as having a majority of outside directors on the board with no management ties; holding formal evaluations of directors; being responsive to investor requests for information on governance issues; with directors holding significant stockholdings in the company; and a large proportion of directors’ pay being in the form of stock options.

¹¹⁹ Coffee Jr. J.C., *Racing Towards the Top: The Impact of Cross-listings and Stock Market Competition on International Corporate Governance*, Columbia Law Review, Vol. 102, 2002, p. 1757.

investor... [so as to] induce minority shareholders to invest in it.”¹²⁰ This phenomenon is commonly referred to as “bonding premium” or “cross-listing premium.”

A research made in 2006 in the context of Chinese firms listed in Hong Kong presented supportive evidence that cross-listed firms earn a higher valuation.¹²¹ In conclusion, Chinese entrepreneurs who are dedicated to improve corporate governance may bond themselves and build up internal corporate structures to ensure compliance, and parties may not need to rely upon the Chinese government to enforce their rights.¹²²

It is of course ultimately the role of the judiciary to uphold the law, but in a Chinese context it is the judiciary itself where the problem arises. Therefore, I believe that voluntary initiatives may not only improve corporate governance among Chinese companies, it can also pressure the government to cope up with the global standards. This is also where the development is going. For example, recently both the Shenzhen and Shanghai Stock Exchanges have taken actions in promoting CSR disclosure.¹²³

3.1.5 Concluding Discussion

Certainly, the shareholders are the dominant stakeholders and the corporate governance systems throughout the world are known to be based on a shareholder-centric ideology with the role of ensuring the interest and creating value for shareholders.¹²⁴ Indeed, the willingness to invest is the fundamental condition for the capital market’s continuous existence. Thus, the interest of the shareholders must be of primary importance. However, the interest of the shareholder is evidently affected by the interest of other stakeholders. Hence, ultimately all stakeholders’ costs, risks, and contributions should be factored into any decisions regarding the benefits they receive.¹²⁵ Also, it is important to point out that the shareholder does not necessarily have a common sole interest of wealth maximization. They may vary in their investment horizons, their trust levels, risk preferences,

¹²⁰ Coffee Jr. J.C., *The Future as History: The Prospects for Global Convergence in Corporate Governance and its Implications*, Northwestern University Law Review, Vol. 93, 1999, p. 690-91.

¹²¹ Su Q. et al, *Bonding Premium: A General Phenomenon*, Working Paper, March 2006, p. 5-6 & 13-28. available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=890962

¹²² Cai, H., *Bonding, Law Enforcement and Corporate Governance in China*, Stanford Journal of Law, Business & Finance, Vol. 13 No. 1, 2007, p. 120.

¹²³ In 2006 the Shenzhen Stock Exchange released “The Guide on Listed Companies’ Social Responsibility” and in 2008 the Shanghai Stock Exchange promulgated the “Guide on Environmental Information Disclosure for Companies Listed on the Shanghai Stock Exchange” and “Notice on Strengthening Social Responsibility of Listed Companies”.

¹²⁴ Buchholtz A.K. et al, *Corporate Governance and the Corporate Social Responsibility*, in Crane A. et al (eds), *The Oxford Handbook of Corporate Social Responsibility*, Oxford University Press, Oxford, 2008, p. 328.

¹²⁵ Ibid., citing: Philips R. et.al, *What Stakeholder Theory Is Not*, Business Ethics Quarterly, Vol. 13. Iss. 4, 2003, pp. 479-502.

goals etc.¹²⁶ Institutional investors, for example, often embrace concepts of CSR and value stakeholder welfare maximization,¹²⁷ and pension fund groups are generally more likely to invest in firms that have good social performance.¹²⁸

Thus, shareholders and stakeholders are not necessarily opposing forces and since not only investors, but also employees, customers, suppliers and the local community have increasing interest in how the corporation should be run, the framework for corporate governance must actually serve the interests of a wider range of constituencies.

3.2 Corporate Social Responsibility (CSR)

Along with the changing approach of corporate governance, CSR has emerged as an extended version of the *stakeholder theory* dealing with the responsibilities of the corporation towards its broad range of stakeholders.

3.2.1 An Ancient Concept in a New Time

However, the desire to encourage, or require, corporations to assume greater responsibility for their action is not a new idea and can be traced back over many decades. Still, the beginning of the modern period of CSR arguably started in the 1950s, when Howard R. Bowen, who has been called the father of Corporate Social Responsibility, published his landmark book *"Social Responsibilities of the Businessman."*¹²⁹ Although the term has been in use for more than half a century, especially in countries of Anglo-Saxon culture, scholars argue that it has only been during the last decade the reflections about the relationship between society and corporation have gained a new and extraordinary importance. In other words; CSR has never been as important as it is today and the popularity of the CSR movement is undeniably growing.

¹²⁶ Ibid., p. 328.

¹²⁷ See: Neubaum, D. O. & Zahra, S. A., *Institutional ownership and corporate social performance: The moderating effect of investment horizon, activism and coordination*, Journal of Management, Vol. 32, No. 1, 2006: proving evidence that long-term institutional ownership was positively correlated with corporate social performance.

¹²⁸ E.g.; in UK, pension funds have to disclose their social, ethical and environmental policies in relation to investment, which in turns requires quoted companies to report on their activities in the social, ethical and environmental field.

¹²⁹ Carroll A.B, *Corporate Social Responsibility: Evolution of a Definitional Construct*, Business & Society, Vol. 38, Iss. 3, 1999, p. 268; Bowen H. R., *Social Responsibilities of the Businessman*, Harper, New York, 1953, defining CSR as *"the obligations of businessmen to pursue those policies, to make those decisions, or follow those lines of action which are desirable in terms of the objectives and values of our society."*

CSR expert Per Granqvist, argues that corporations taking more responsible actions in the society today are not a trend, but rather a recurrence to the time before the recent form of capitalism when it was obvious that corporations would be successful in societies that were successful.¹³⁰

The difference is that the new era of CSR is highly related to the debates and criticism of the worst social consequences related with globalization. As MNCs are increasingly doing business in foreign markets with different legal rules and different views on issues such as human rights, their responsibilities are becoming increasingly global. In addition, as the power and influence of the MNCs have assumed greater proportions, so have also the calls to make corporations responsible and accountable for the consequences of their corporate behaviour. Keith Davis expresses this point concisely in the proposition that “social responsibility arises from social power.”¹³¹ He also cites what he calls the *Iron Law of Responsibility* claiming that “[i]n the long run, those who do not use power in a manner which society considers responsible will tend to lose it.”¹³² Thus, the need for greater social responsibility can be understood as an inevitable result of the MNCs increasing size and influence on the global society. As a result of this development, CSR has emerged as a legitimate and widely accepted counter-balance to corporate power.¹³³

Simultaneously, the “third green wave”, which escalated after the 2007 Nobel peace Prize was jointly awarded to *Al Gore* and *the International Panel on Climate Change*, has brought environmental issues to the centre stage in public debates.

Michael Hopkins states that ethically or responsible behaviour means “*treating stakeholders in a manner deemed acceptable in civilized societies*”.¹³⁴ However, what is deemed acceptable by the civilized society has undoubtedly changed in the course of the 20th century, which suggests that so is also the case for CSR.

3.2.2 Carroll’s Pyramid

One of the most prominent scholars in the area of CSR is Archie B. Carroll, who in 1979 proposed a CSR model (which was revised in 1991) that introduced four levels of requirements shaped as a

¹³⁰ Granqvist P., *CSR i praktiken: Hur företag kan jobb med hållbarhet för att tjäna pengar*, Liber, Malmö, 2009, p.10.

¹³¹ Boatright J.R, *supra* note 32, p. 536, citing: Davis K., *Five Propositions of Social Responsibility*, Business Horizon, 18 June 1975, p.20.

¹³² *Ibid* p. 356, citing: Davis K. and Blomstrom R.L., *Business and Society: Environment and Responsibility*, 3rd ed, McGraw-Hill, New, 1975, p.50.

¹³³ Keinert, C., *supra* note 95, p. 19

¹³⁴ Hopkins M., *Corporate Social Responsibility and International Development: Is Business the Solution?*, Earthscan, London, 2007, p. 15-16.

pyramid.¹³⁵ The model is one of the most cited theories in CSR literature and has had a lot of influence on the subsequent decades. The pyramid depicts; (1) the economic responsibilities at bottom and then build upward through (2) the legal system and the responsibilities arising from there, (3) the ethical responsibilities which the company must respect, and finally (4) the voluntary responsibilities not expressly required by law but which show commitment with the community and supporting social objectives. Carroll summarized his view of CSR stating that *"The CSR firm should strive to make a profit, obey the law, be ethical, and be a good corporate citizen."*¹³⁶

A corporation's economical responsibility is about running the business in order to earn money and thus be accountable towards shareholders, give return on investment and ensure the corporations fiduciary position and remaining on the market place. Indirect, it does also imply a duty to contribute to the creation of wealth, jobs and good wages to the work force and production of goods and services needed by the community. A corporation can be the world's greatest citizen and offer the best product imaginable, but it can never be sustainable if it is not making profit.

The second responsibility in Carroll's pyramid, comply with the legislation in force, is an obvious requirement for a corporation to be sustainable, otherwise it cannot obtain a license to operate on the market. One of the corporation's legal responsibilities is to act as a fiduciary, managing the assets of a corporation in the interest of shareholders, but corporations also have numerous legal responsibilities towards employees, customers, suppliers, and other parties.

A company's ethical behaviour as a part of the CSR pyramid concerns norms within the society that are not legally founded but nevertheless expected of business by the members of society.

Carroll's fourth level of the pyramid, the discretionary responsibilities, is built on the idea that corporations shall return benefits to the community and be a good corporate citizen. These responsibilities are not legally required or even demanded by ethics, but corporations may accept them in order to meet society's expectations. Philanthropic behaviour is arguably one of such responsibilities. However, in my opinion, there is a general misunderstanding of donations as a part of CSR. For example, Parmalat was a very philanthropic corporation, but certainly not socially responsible, as emerged from the 2003 scandal.¹³⁷ As stated by Young-Chul Kang and Donna Wood, one of the confusions over defining and acting upon CSR is the flawed assumption that CSR is an

¹³⁵ Carroll A. B., *The Pyramid of Corporate Social Responsibility: Toward the Moral Management of Organizational Stakeholders*, Business Horizons, vol. 34, No. 4, 1991. pp. 40-47.

¹³⁶ Ibid, p. 43.

¹³⁷ See note 110.

“after-profit obligation”.¹³⁸ Instead, embedding socially responsible principles in corporate management is what these authors call a “before-profit” obligation.

The truly sustainable company would have no need to write checks to charity or “give back” to the local community, because the company’s daily operations would not deprive the community, but would enrich it.¹³⁹ Likewise, I emphasize that only the way profits are made is the concern of CSR practitioners. Hopkins represent the same view, arguing that CSR is sustainable in that CSR actions become part and parcel of the way in which a company carries out its business and *“its link to the bottom line of a company must be clearly laid out because if it does not contribute to the bottom line it will eventually be rejected by hard-nosed directors and shareholders.”*¹⁴⁰ Even Bill Gates, the greatest philanthropy of all time, agrees that philanthropy is not sustainable unless it can be linked to some kind of profit incentives.¹⁴¹ With this said, I am not in any means suggesting that donations and charities are a wrongful act, only that it is not necessarily a sustainable ingredient of CSR.

Even though the development of CSR and the view of sustainable business have changed since Carroll introduced his theory, it is helpful when explaining the way corporations reason and prioritize between responsibilities. Carroll suggests that business corporations have an economic, legal, ethical and philanthropic aspect. I believe, like argued by *Michael E. Porter* and *Mark R. Kramer*, that the main problem in discussions regarding CSR is that these responsibilities are often described as separated from the core business operation, which prevent us to see the actual possible benefits.¹⁴²

3.2.3 The Triple Bottom Line

Another prominent scholar in the development of CSR is Paul Hawken, who in 1993 argued that the rewards for businesses needed to be transformed from producing the lowest-priced products to a new business reward model that embrace social and environmental responsibility by identifying and paying for their costs up front.¹⁴³ This winning business strategy, measuring corporate performance not only by financial result but also by how the business reduce negative environmental impact and

¹³⁸ Hopkins M., *supra* note 134, p. 113, citing: Kang Y.-C. & Wood D.J., *Before-Profit Social Responsibility: Turning the Economic Paradigm Upside Down*, Proceedings of the Sixth Annual Meeting of the International Association of Business and Society, Vienna, 1995, pp. 408-418.

¹³⁹ Savitz A.W. with Weber, K., *supra* note 7, p. 21.

¹⁴⁰ Hopkins M., *supra* note 134, p. 115.

¹⁴¹ Kinsley M., *Creative Capitalism: A Conversation with Bill Gates, Warren Buffet, and Other Economic Leaders*, Simon & Schuster, New York, 2008. p. 7-16, citing: Gates B., Remarks delivered at the World economic Forum, 24 January, 2008, Davos.

¹⁴² Porter, M.E. & Kramer M.R., *Strategy and Society: The link Between Competitive Advantage and Corporate Social Responsibility*, Harvard Business Review, Vol. 84, No. 12, 2006, p. 83.

¹⁴³ See: Hawken, P., *The Ecology of Commerce: A declaration of sustainability*, Harper Business, New York, 1993.

contribute to social welfare, are commonly known as the triple bottom.¹⁴⁴ The phrase, initiated by the sustainability expert John Elkington is also known as “*the three pillars*” or “*people, planet and profit*” and is one of many initiatives made in order to facilitate and concretize what the corporations shall account for in the context of CSR.

A corporation’s *economic responsibility* is obviously crucial to its survival. *Social responsibility* generally embraces labour and human rights issues. It is about running a corporation characteristic of being a good member of the society, with regards to other citizens’ health and well-being, regardless if they are employees, suppliers, business partners or members of the local society. *Environmental responsibility* is about managing the corporation in a manner that does not affect our world and our resources in a negative way.

Today, the triple bottom line, valued in word and deed, is certainly beginning to show its benefits in business philosophy, consumer purchasing, and ultimately reductions in environmental impacts and improvement of working conditions around the world.¹⁴⁵ At the outset, these three categories are the cornerstones of CSR and sustainable business, and that other categories such as ethical management and corporate governance can be built upon.

3.2.4 Conceptualization

It is important to acknowledge that there is no universally accepted definition of the term CSR. Many ambiguities surround the concept, including what business practices count as responsible behaviour. The expectation of corporations in the society is constantly growing and changing. Consequently, the abstract definition of CSR is constantly evolving, as it becomes more popular and international.¹⁴⁶

Also, the term appears to touch upon several overlapping terms also attempting to conceptualize the responsibilities of business in society, both from the academic and the business areas, such as;

- *Corporate Ethics*, which is about implementing the sense of acting responsibly and avoiding wrongdoing within the “corporate culture”;

¹⁴⁴ Elkington, J., *Towards the Sustainable Corporation: Win-win-win Business Strategies for Sustainable Development*, California Management Review 36, No. 2, 1994, pp. 90-100; Elkington, J., *Cannibals with Forks: the Triple Bottom Line of 21st Century Business*, capstone, Oxford, 1997.

¹⁴⁵ Dickson, M.A. et al, *Social Responsibility in the Global Apparel Industry*, Fairschild Books, New York, 2009, p. 21.

¹⁴⁶ Franklin D., *The Just Good Business: A Special Report on Corporate Social Responsibility*, The Economist, January 2008, p.18.

- *Corporate Social Responsiveness*, referring to corporations' ability of meeting ethical and social expectations and responding in a responsible manner to new challenges;¹⁴⁷
- *Corporate Social Performance*, focusing on the result of those requirements;¹⁴⁸
- *Corporate Citizenship or Global Corporate Citizenship*, referring to the idea that corporations, as one of the major actors within society, has a duty to act as good citizens and almost fulfil a role similar to the role of governments in solving social problems;¹⁴⁹
- *Environmental and Social Governance*, a term closely related to corporate governance, which is often used within the financial sector in order to label environment and social accountability as a tool for analysts when valuating corporations;
- *Corporate Sustainability*, best described as a development that meets the needs of the present without compromising the ability of future generations to meet their own needs which requires the reconciliation of environmental, social and economic demands;¹⁵⁰
- *Social Entrepreneurship*, which is the transformation of socially responsible principles and ideas into commercial value.

The main criticisms that CSR faces is that the concept is far too vague and consequently that it is too hard to tell whether a corporation is fulfilling its responsibilities or not. Academics, theorists and corporate managers may keep working on the perfect definition of businesses engagement in society, and some people might say that it is all a question of "semantics" and therefore definitions are not important. However, these various terms can lead to a great deal of confusion and without a common language it is impossible to really know whether the dialogues are being heard and interpreted in a consistent way.¹⁵¹ It is therefore important to distinguish between different types of corporate activities in order to achieve a better understanding of corporations' engagement in society and so that they can be able to benchmark themselves against the performance of different enterprises and learn from example.¹⁵² However, it is unanimously accepted that CSR is concerned with the socially responsible treatment of stakeholders. If they do not live up to the expectations of their stakeholders and do not take long-term actions to minimize their negative impact, I believe that they will be penalized either by legal or market forces.¹⁵³ In my opinion, corporations that manage to

¹⁴⁷ Garriga E. & Melé D., *Corporate Social Responsibility Theories: Mapping the Territory*, Journal of Business Ethics, Vol. 53, Iss. 1, 2004, pp. 52, 59-60.

¹⁴⁸ Melé D., *Corporate Social Responsibility Theories*, in: Crane A. et al (eds), *supra* note 124, p. 49.

¹⁴⁹ Ibid. p. 48; Crane, A & Matten, D, *Business Ethics – Managing Corporate Citizenship and Sustainability in the Age of Globalization*, Oxford University Press, New York, 2007, pp. 70-79.

¹⁵⁰ Developed by former Norwegian Prime Minister Gro Harlem Brundtland and used by the World Business Council for Sustainable Development.

¹⁵¹ Hopkins M., *supra* note 134, p. 120.

¹⁵² Savitz A.W. with Weber, K., *supra* note 7, p. 155.

¹⁵³ See further elaboration in Chapter 5.

work productively and positively with their stakeholders and make sure that their actions are value-creating in connection with the society, environment and financial result are truly responsible corporations.

Actually, I think the most prominent component to CSR is the concept of sustainability, as opposed to short-term exploitative thinking. Even though I choose to use the term CSR in this thesis, because it is the most recognized and well-known term, I believe that sustainability is the term that best describes the responsibility of corporations and highlights that the pursuit of economic objectives should coincide with environmental and social growth.

To sum up, it comes back to the above cited statement of Hopkins concerning what is deemed acceptable in a civilized society. Today, running your business in a responsible and sustainable manner is the only way that is *“deemed acceptable in a civilized society”*. That is why CSR has become a necessity for every corporate manager today.

3.3 The Relationship between Corporate Governance and CSR

It seems clear that the value and need of both CSR and corporate governance have become well established. As mentioned in the outset of this section, it has been suggested that corporate governance is concerned with binding and enforceable laws while CSR is about ethical, voluntary, non-enforceable rules. However, it does not mean that both rules do not have areas in common and do not overlap and intertwine with one another and are not interchangeable.¹⁵⁴

CSR is concerned with treating the stakeholders of the corporation ethically or in a socially responsible manner. Simultaneously, the broadening scope of corporate governance including ethical consideration suggests that it also encompasses the concerns of CSR notions. It can also be observed that there is an increasingly recognition that corporate governance should not be seen only as a compliance issue. Hence, I would argue that corporate governance is primarily about values rather than rules and goes beyond the traditional core governance functions. By advocating an integrated approach to good governance in the interest of a wide range of stakeholders and by having regards to the fundamental principles of good financial, social, ethical and environmental practices corporate governance may be defined as the precondition to CSR,¹⁵⁵ and CSR as an extended model of the values deriving from good corporate governance.¹⁵⁶ Thus, the more the fundamentals of corporate

¹⁵⁴ Mullerat R. (ed), *supra* note 16, p. 4.

¹⁵⁵ Roselle J., *supra* note 16, p. 113-141.

¹⁵⁶ Sacconi L., *Corporate Social Responsibility (CSR) as a Model of “Extended” Corporate Governance: An Explanation Based On the Economic Theories of Social Contract, Reputation and Reciprocal Conformism*, Liuc Papers No. 142, Serie Etica, Diritto ed Economia, 2004, p. 7.

governance, such as ethics and disclosure, are clarified, consistent, and integrated into the business, the greater the CSR performance.¹⁵⁷ This may also be explained as follows;

*“Since CSR is founded on the reasoning that the company owes duties not only to its shareholders but also its stakeholders, it follows that corporate governance structures and management regimes that accommodate the former to the detriment of the latter must be replaced.”*¹⁵⁸

In conclusion, there are strong incentives for corporations to establish a corporate governance practice that exceeds the legal requirements. For example, the Corporate Governance Code in both Sweden and China follows the principle of comply or explain, which means that it allows for deviation, as long as an explanation is given in the company’s annual report. The lack of legal sanctions for violating the rules may raise the question of how a good standard really can be ensured.¹⁵⁹ Since there is no official authority governing and accepting the companies explanations for the departed rules, it is instead the role of the market to judge and indirect adjudge sanctions against corporations that are not fulfilling the stakeholders’ demands. Consequently, corporate governance practice may just like the case for CSR be on a voluntary basis. Mainly because CSR issues have become a substantial part of corporate governance and the new global market requires business managers to disclose the frequency and nature of their CSR discussions. CSR as well as corporate governance is about governing the corporation in accordance with the expectations and demands of the market. Hence, the next chapter are examining the market and the incentives for CSR and higher corporate governance practices.

¹⁵⁷ Strandberg C., *The Convergence of Corporate Governance and Corporate Social Responsibility: Through Leaders Study*, Strandberg Consulting, Burnaby, 2005, p. 11.

¹⁵⁸ Bantekas I., *supra* note 36, p. 339.

¹⁵⁹ Svernlöv C., *Styrelse- och VD-ansvar i Aktiebolag*, Norstedts Juridik, Stockholm, 2008, p. 45.

4. The New Competitive Global Market

*"Being socially responsible is no longer an option...it is now a business requirement."*¹⁶⁰

In the second chapter, it was concluded that the current legal obligations governing MNCs corporate conduct related to human rights and environmental issues are far from fully comprehensive. This has resulted in a need for voluntarily commitments to socially responsible business behaviour and high standards of corporate governance, as discussed in the third chapter. This chapter on the other hand is focusing on the major non-legal market forces that necessitate these corporations to run their businesses in a socially, environmentally and ethically responsible manner.

The success of a voluntary approach to CSR is based on two beliefs. Firstly, corporations must respond to the new social demands as the market rewards responsible behaviour and punishes a company's lapses. Secondly, good social performance makes sound business sense and can be a source of competitive advantage.

The market has indeed been a powerful force in bringing some measurable changes in corporate behaviour.¹⁶¹ Assuming that MNCs will not adopt CSR policies simply for altruistic reasons, this chapter is set out to present the trends in the competitive business environment that may have made it inconceivable for MNCs to ignore their responsibilities in regards to human rights, working conditions, environmental impact etc. Subsequently, it can be confirmed that these various market forces should induce managers to lead socially responsible corporations.

4.1 Sustainability and Interdependence

As concluded by Patric J. Cescau, CEO at Unilever, there can be few people in business today who could doubt that social and environmental sustainability will be the defining business drivers for MNCs in the first part of the 21st century.¹⁶² The principle of sustainability suggests that *"companies should operate in ways that secure long-term economic performance by avoiding short-term behaviour that is socially detrimental or environmentally wasteful."*¹⁶³ Globalization and trade liberalization has compelled corporations to adapt business to the new global economy, and new factors have become imperative to survive competition. It has become increasingly important for

¹⁶⁰ Idowu, S.O. & Filho, W.L. (eds), *Global Practices of Corporate Social Responsibility*, Springer, Heidelberg, 2009, p. 3.

¹⁶¹ Doane D., *The Myth of CSR Bringing Some Measurable Changes In Corporate Behavior*, Stanford Social Innovation Review, Fall 2005, p. 24.

¹⁶² Laszlo, C., *Sustainable Value: How the World's Leading Companies Are Doing Well by Doing Good*, Stanford University Press, Stanford, 2008, p. 11.

¹⁶³ Porter M. E., *supra* note 22, p. 484.

corporations to build deeper relationships with business partners, employees and customers. As mentioned in the introduction, corporations today operate in a world that is becoming more closely interdependent and there is certainly a vast demand for sustainable development of the socio-economic system. The authors Andrew W. Savitz and Karl Weber put these two trends together and define sustainability in practice as *“the art of doing business in an interdependent world”*. They state that companies are becoming more dependent on one another as their interests become more closely entwined.¹⁶⁴

Thomas Lagerqvist, special counsel at Mannheimer Swartling Law Firm, explains global interdependence with the metaphor that everybody *“lives from, lives for and lives with something”*.¹⁶⁵ It is thus logical that also corporations respect and recognize the relationship between their businesses and the society affected by their operations. Also the worldwide impact of the interrelated crisis in the financial-, climate-, energy-, food-, water-, political-, and security sectors has highlighted the unprecedented degree of interconnectivity and interdependence between conduct and society.¹⁶⁶

Kramer and Porter describe the relationship between business and society by stating that corporations need a healthy society¹⁶⁷ and, at the same time, a healthy society needs successful companies.¹⁶⁸ They further claim that, ultimately, a healthy society creates expanding demand for business; as more human needs are met and aspirations grow, any business that pursues its ends at the expense of the society in which it operates will find its success to be illusory and temporary.¹⁶⁹

4.2 Empowered Stakeholders

As previously concluded, the corporation is linked economically and socially, voluntarily and involuntarily with numerous stakeholders who may contribute to, or be impacted by, its success or failure. CSR and good corporate governance is concerned with satisfying these stakeholders. Even

¹⁶⁴ A.W. Savitz with Weber K., *supra* note 7, pp. x-xi, 48-49

¹⁶⁵ Thomas Lagerqvist, lecture at Peking University, Beijing, 26 October 2009.

¹⁶⁶ Chip Pitts III, J.W., *Corporate Social Responsibility: Current Status and Future Evolution*, Rutgers Journal of Law & Public Policy, Vol. 6, Iss. 2, Spring 2009, p. 335.

¹⁶⁷ *“Education, health care, and equal opportunities are essential to a productive workforce. Efficient utilization of land, water, energy, and other natural resources makes business more productive. Ultimately, a health society creates expanding demand for business, as more human needs are met an aspirations grow. Any business that pursues its ends at the expense of the society in which it operates will find its success to be illusory and ultimately temporary.”*

¹⁶⁸ *“No social program can rival the business sector when it comes to creating the jobs, wealth, and innovation that improve standards of living and social conditions over time. If governments, NGOs, and other participants in civil society weaken the ability of business to operate productively, they may win battles but will lose the war, as corporate and regional competitiveness fade, wages stagnate, jobs disappear, and the wealth that pays taxes and supports nonprofit contributions evaporates.”*

¹⁶⁹ Porter M.E. & Kramer M. R., *supra* note 142, p. 83.

though stakeholder concerns have always been an important part of running a business, the network of stakeholders that affects every business today has become more vocal, skilful, influential, tenacious, and effective than ever before.¹⁷⁰

The *stakeholder theory*, originally detailed by R. Edward Freeman in the 1980s,¹⁷¹ rejects the strict definition between private and public spheres normally found in the relationship between government and private actors. Many scholars have also described this change as “*from government to governance*” imposing a new landscape where private entities such as NGOs, MNCs and private interest groups have replaced domestic government’s traditional roles of regulating quality, imposing standards and providing public goods. In short; customers, workers, investors, suppliers and neighbours are demanding a say in how a business is run and its impact on their lives.¹⁷²

When integrating the components of CSR with organizational stakeholders, it is obviously necessary to clearly define exactly who the stakeholders are. They can be described as having a stake, a claim or an interest (or a combination of the three) in the activities of the corporation. For instance, the stake can be in the form of a legal (laws, contracts, etc.) or moral (fair treatment, consideration for opinions, etc.) claim.

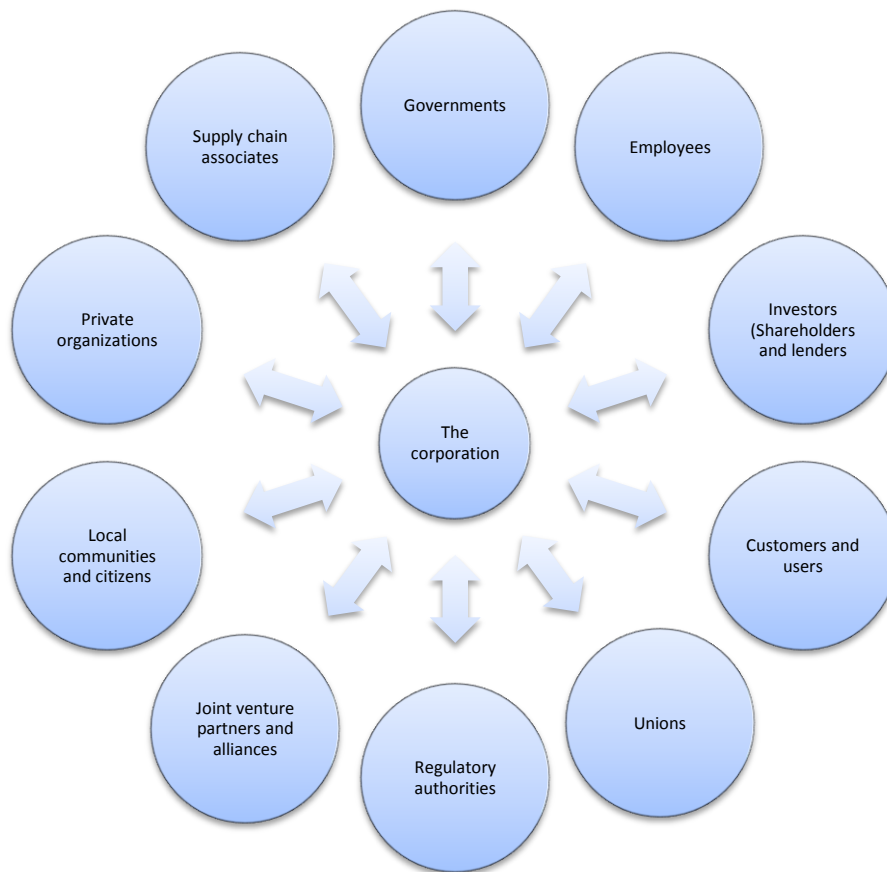
A conventional diagram of the stakeholder model, intended to show the multiple link between the corporation and its diverse stakeholders, is presented below. As illustrated, the flows between the corporation and its stakeholder move in both directions.¹⁷³

¹⁷⁰ Savitz A.W. with Weber, K., *supra* note 7, p. 59.

¹⁷¹ See: Freeman R. E., *Strategic Management: A Stakeholder Approach*, Pitman, Boston, 1984.

¹⁷² Savitz A.W. with Weber K., *supra* note 7, p. 48.

¹⁷³ Post J.E. et al, *Redefining the Corporation: Stakeholder Management and Organizational Wealth*, Stanford University Press, Stanford, 2002, p. 22.



The stakeholders are surely one of the most powerful forces when it comes to encouraging, demanding and necessitating corporations to be socially responsible. In this section, a variety of the most prominent stakeholders that may oblige corporations to be socially responsible will be presented. Simultaneously, the significance of creating stakeholder value as a driver for CSR will be highlighted.

4.2.1 Consumer awareness

Satisfying customers by meeting their demands is obviously the corporation's primary business driver. To become a successful company it is essential to build long-lasting relationships with customers. Hence, a lot of money is spent on identifying what the customer preferences are and the customer perspective often embraces the entire company operations; from research, production and finance to selling and marketing.¹⁷⁴

Consumer purchasing power has long been understood as a significant driver for product quality, safety and innovation. Today, informed western consumers, aware of global issues, human rights and how their choices of products may contribute to a healthier and more sustainable future, are becoming more concerned about the products they buy and how these are created. Thus, building a

¹⁷⁴ Löhman O. & Steinholtz D., *Det Ansvarsfulla Företaget: Corporate Social Responsibility i Praktiken*, 2003, p. 45.

company brand and a reputation of being committed to human rights and social issues is most likely to improve customer loyalty. Mounting evidence indicates that consumers are increasingly allowing factors such as corporate ethical and social behaviour influence their buying decisions, even if there is a price difference.¹⁷⁵ This point was made compellingly by the *Wall Street Journal*;

*"In an era when companies must work harder than ever to sell their products, anything that turns the consumer off has to be avoided at any cost ... Take Burma, where orders for exported garments produced by Burmese factories have fallen by two-thirds ... You may ask, 'What does Aung San Suu Kyi have to do with fashion?' The answer is, 'A lot'."*¹⁷⁶

Consumers can use the market to ensure that corporations act responsibly. If they don't, consumers can retract their purchase dollars or even boycott the company. If however, they do act responsibly, they will gain the approval of consumers with ethical preferences and be rewarded as competitive actors in the marketplace. Hence, market-based regulation of responsibility standards relies on consumers to play a key role. To quote John Enoch Powell, *"Everyone who goes into a shop and chooses one article over another is casting a vote in the economic ballot box."*¹⁷⁷

A persistent argument against the idea of consumer power's ability to bring greater CSR to the market place is that consumer influence on producer decisions in a market economy is overrated. Rhys Jenkins suggests that the threat of consumer action in fact constitutes political pressure from society.¹⁷⁸ Although he admits that there is a certain demand for ethically produced goods, he states that these are niche markets that primarily supply middle class consumers, and the problem of consumers acting collectively still stands. There are certainly some exceptions to collective purchasing, for example various institutions acting as bulk purchaser from a corporation, which can have a direct effect on company behaviour. Also in this scenario Jenkins claims that it is a result of political decision and mobility, rather than the development of consumer preferences.¹⁷⁹

In any event, the threat of changing consumer preferences is likely to have an increasing impact on the human rights and labour practices of MNCs wishing to sell their products. Whether this change is

¹⁷⁵ E.g.; A study conducted in 2002 by Cone revealed that of U.S. consumers aware of corporation's negative CSR practice, 91% would most likely prefer another firm, 85% would disseminate this information to family and friends, 83% would refuse to invest in that company, 80% would refuse to work at that company and 76% would boycott its products. Opinion Research Corporation International, 2002 Cone Corporate Citizenship Study, Cone, 2002, available at www.coneinc.com/Pages/pr_13.html

¹⁷⁶ Driscoll D., *The Positive Role of Corporate Social Responsibility: Notes on the Business Case*, Wall Street Journal, 9 April 1996.

¹⁷⁷ Dickson, M.A. et al, *supra* note 145, p. 145, citing: Powell, J.E., *Freedom and Reality*, Abington House, New Rochelle, 1969, p. 22.

¹⁷⁸ Jenkins R., *Corporate Codes of Conduct: Self-Regulation in a Global Economy*, United Nations Research Institute for Social Development (UNRISD), Programme Paper No. 2, April 2001, pp. 14-15.

¹⁷⁹ *Ibid.*

a result of pressure by consumers as such or has political reasons is a matter of how one chooses to look at the problem. The fact still remains that consumers, whether directly or indirectly, constitute an important driver for CSR.

4.2.2 Non-Governmental Organizations¹⁸⁰

In the absence of strong governmental controls of MNCs operating in developing countries, perhaps the most significant market force pushing companies toward greater CSR is the explosive growth of NGOs.¹⁸¹ These advocacy groups have had a substantial impact on corporate business behaviour through their service- or development-related activities associated with social, environmental, or political concerns. NGOs, which range in size from giant international organizations such as *Greenpeace* and *Oxfam* to very small local operations, often launch campaigns to pressurise and advocate changes in government policy, consumer behaviour and business conduct.

In a survey carried out by *Edelman PR Worldwide/Strategy One* in 2002 that sought to measure public perceptions of the trustworthiness of major world organizations, *Amnesty International*, *Greenpeace* and the *World Wildlife Fund* outranked the leading multinationals in Europe and were ranked among the top fifteen most trusted organizations in the United States.¹⁸² Thus, when one of these groups denounces a particular company, it is most likely that the public majority will immediately assume that the charges are correct and that the corporation's attempts to defend itself are only self-serving and probably dishonest.

Even though some NGOs are using tactics of direct confrontation with the goal of expose, criticize and protest, evidently the most successful tactic for NGOs is to work in partnership with corporations to help them improve their social and environmental profile. Such mutually beneficial exchanges between corporations and stakeholders are probably the best way of improving social welfare as well as corporate performance. Indeed, corporations struggling to fully embrace CSR are realizing that one of the most attractive first steps in a strategy is to reach out to an NGO who has "been there, done that". As Hawken claims; "*almost every responsible corporation in the world [...] has turned to NGOs to assist, teach, inspire, and urge them on.*"¹⁸³ The challenge lies in finding the right

¹⁸⁰ Defined as non-profit organizations in the private sector operating outside of governments.

¹⁸¹ Boatright, J.R., *supra* note 32, p. 362.

¹⁸² Edelman PR Worldwide/Strategy One, *Non-Governmental Organizations, the Fifth Estate in Global Governance: Second Annual Study of NGO and Institutional Credibility*, The Conference Board, New York, 2002.

¹⁸³ Hawken P., Speech at the Bioneers Conference on the World's Largest Movement, 2007, available at: www.youtube.com/watch?v=N1fiubmOqH4

organization to partner. For example, IKEA states that by co-operating with NGOs *“we are able to learn, share experiences and accomplish more than we could have done by working on our own.”*¹⁸⁴

In addition, NGOs are turning to corporations looking for solutions for various issues. For example, in 2003, the German corporation Foron, in collaboration with Greenpeace, developed a Freon-free refrigerator and thereby reduce damage to the world’s ozone layer.¹⁸⁵ According to a report from Greenpeace, they have now sold almost 300 million today worldwide.¹⁸⁶ In 2000, the organization Environmental Defence approached FedEx with an offer to help reduce the emissions of its delivery fleet, which besides good publicity and reduced pollution provided a third benefit: cost savings.¹⁸⁷

Moreover, Wayne Visser observes that such partnerships may be successful in creating or developing new markets. For example the AED/Mark Partnership with Exxon Mobil was created on the basis of developing a viable market for insecticide-treated mosquito nets in Africa, while improving women’s access to these nets through the delivery of targeted subsidies.¹⁸⁸

Some NGOs are pure collaborations between companies in certain industries and other groups. For example, the membership of the *Fair Labor Association*, which grew out of concerns over working conditions in contract factories in the apparel industry, includes companies, NGOs, and universities.¹⁸⁹

In conclusion, corporations have a lot to gain by co-operating with stakeholders, but potentially also a lot to lose if they fail to fulfil expectations. This may be illustrated by the slogan of Greenpeace; *“we can either dance with you, or dance on you.”*¹⁹⁰

4.2.3 Investors

As previously concluded, the financial market and investors are major stakeholders because of the power they wield over the corporation’s corporate governance practices, company policies and continued availability of funding.

Investors have started to ask for disclosure of information going beyond traditional reporting and are thereby putting pressure on the corporations to implement policies on corporate governance and

¹⁸⁴ Eva Ståhl, interviewed by telephone, 8 January 2010.

¹⁸⁵ King A., *Cooperation between Corporations and Environmental Groups: A Transaction Cost Perspective*, Academy of Management Review, Vol. 32, No. 3, 2007, p. 897.

¹⁸⁶ Press release, *Greenpeace technology successful worldwide for 15 years*, Greenpeace, 14 March 2008.

¹⁸⁷ www.worldwatch.org/node/585

¹⁸⁸ Visser W., *Corporate Social Responsibility in Developing Countries*, in Crane A. et al (eds), *supra* note 124, p. 484.

¹⁸⁹ See: www.fairlabor.org

¹⁹⁰ Savitz A. W. with Weber K., *supra* note 7, p. 191.

CSR. From the investors' point of view, this is necessary to better identify success and risk factors inherent in a company and its responsiveness to public opinion. Partly as a consequence of consumer and NGO behaviour, investors are registering their concerns about the social impact of business by engaging in *socially responsible investments* (SRI).

In 2001, eight leading European pension funds¹⁹¹ with more than £400 billion under management together put pressure on MNCs doing business in Burma, requiring them to justify the risks to shareholders and stating that firms operating there should "adopt responsible business practices" which do not contribute to human rights abuses and publish risk and social impact assessments. The argument of the funds was that companies operating in unstable political climates could be exposed to loss of shareholder confidence, negative press and publicity campaigns, safety risks and corruption.¹⁹² "We cannot be written off as lefty fund managers as we have £400bn of investment under our control," said Rob Lake of Henderson Global Investors.¹⁹³

In 2009, a similar initiative was undertaken in Sweden by 13 financial institutions, with a collective capital of SEK 4 000 billion,¹⁹⁴ where the 100 largest enterprises on the Swedish stock market were invited to participate in a survey concerning responsibilities and sustainability. The purpose of the survey was to serve as a foundation for the institutions' future investments and activities as shareholders.¹⁹⁵

Growth in SRI offers the possibility that investors are increasingly factoring ethical and moral considerations into their investment making process. There are also quantitative indicators showing that profit is not necessarily sacrificed. For example, the Domini 400 Social Index shows superior performance on both nominal and risk-adjusted bases among social investors.¹⁹⁶ Various studies have also demonstrated that enhanced shareholder return is achieved by visionary corporations that include social responsibility within their corporate imperatives; shareholder value is increased by the lower risk of environmental or social liability of corporations that have embraced social responsibility.¹⁹⁷

¹⁹¹ The Dutch firm PGGM, the Co-operative Insurance Society, the Universities' Superannuation Fund, Henderson Global Investors, Jupiter Asset Management, Morley Fund Management, Friends Ivory & Sime and Swiss group Ethos Investment Foundation.

¹⁹² Macalister T., *Oil Firms called to Account*, The Guardian, 3 December 2001.

¹⁹³ Ibid.

¹⁹⁴ Whereof 550 SEK is invested in the Swedish stock market (NASDAQ OMX Stockholm).

¹⁹⁵ www.hallbartvardeskande.se/

¹⁹⁶ The Domini 400 Social Index, is an index of the share prices of 400 common stocks of American companies which were chosen based on their performance on environmental and social performance screens.

¹⁹⁷ See: Roselle J, *supra* note 16, p. 120; Hollender J. & Fenichell S., *What Matter Most: How A Small Group Of Pioneer Is Teaching Social Responsibility To Big Businessm And Why Big Business Is Listening*, Basic Books, New

Interestingly, even though the growing interest in SRI has mainly been a western phenomenon, reports suggest that the trend is about to develop even in China.¹⁹⁸ In 2008, the first CSR-focused fund was launched, the Industrial Social Responsibility Fund, by *Aegon-Industrial Fund Management Co* and in the summer of 2009 the first Chinese market index with CSR-criteria, the SSE Social Responsibility Index, was founded by the Shanghai Stock Market. In addition, China's largest pension fund, the *National Social Security Fund of China* (NSSF), lists "responsible investments" as one of its four core principles and has expressed interest in learning more about responsible investment practices overseas.¹⁹⁹

In conclusion, despite the difficulty in assessing what determines a corporation's financial return on socially responsible initiatives, the investors are a primary stakeholders of MNCs and hence a major CSR driver.

4.2.4 Employees

Employees are also considered primary stakeholders, since the corporation's continuing existence is depending on them.²⁰⁰ There are generally three main reasons why employees deserve special attention as stakeholders.

First, the manner in which companies discharge their responsibilities towards society will affect their ability to recruit committed employees.²⁰¹ A survey conducted by *Whitehouse* in the UK presents evidences that potential employees, especially the "younger and newly examined", rank CSR among the three most important factors at future employers.²⁰² The ability to attract a motivated and committed workforce through CSR activities is also supported by various articles in *McKinsey Quarterly*.²⁰³ Hence, CSR ought to be even more important in the service sector, where the employees are the key element of competition.

Second, strengthening the internal brand by linking it to corporate values through CSR activities creates and maintains loyalty, well-being and pride among the employees.

York, 2006; Earle R., *The Emerging Relationship Between Environmental Performance and Shareholder Wealth*, Assabet Group, Concord, 2000.

¹⁹⁸ See: BRB, Sustainable Investment in China 2009, 1 September 2009.

¹⁹⁹ Ibid., p. 9.

²⁰⁰ Clarkson, M. B. E., *A Stakeholder Framework For Analyzing and Evaluating Corporate Social Performance*, Academy of Management Review, Vol. 20, Iss. 1, 1995, p. 107.

²⁰¹ Chambers A, *Corporate Governance Handbook*, 4th ed, Tottel Publishing, West Sussex, 2008, p. 861.

²⁰² Whitehouse L., *Corporate Social Responsibility: Views from the Frontline*, Journal of Business Ethics, Vol. 63, No. 3, 2006, p. 288.

²⁰³ See: Bonini S.M.J. et al., *When Social Issues Become Strategic*, No. 2, McKinsey Quarterly, 2006, p. 26.

Third, it is not very controversial to conclude that satisfying the company's workers is an essential part of running a successful business because those happy employees are more productive. In 2009, when Fortune Magazine analyzed the common factors of the companies on its annual list of the 100 best companies to work for, it found that the corporate culture was the single most important component which makes a company successful.²⁰⁴ In addition, Bekke and Nyborg claim that CSR attracts more cooperative and morally motivated workers, who demand lower wages and work harder in firms with a high ethical profile.²⁰⁵

CSR has also been exemplified as the "key to retention" and the solution to high staff turnover rates, which is common in many factories in China.²⁰⁶

4.2.5 Concluding Discussion

The core concept behind the CSR framework is that business value created by a company is always associated with a stakeholder value. This value can be either positive or negative. Value is created when a business adds to the capital or well-being of its stakeholders and it is destroyed when a business reduces or undermines their well-being.²⁰⁷ The growing social expectations and the free flow of information have empowered the stakeholders, who together are the most powerful CSR driver. Craig N. Smith argues that the business case is grounded in three key drivers; that consumers, employees, and investors care in ways that create economic incentives for corporations to give attention to CSR.²⁰⁸ As Starbucks observed in its 2001 Corporate Social Responsibility Annual Report,²⁰⁹

"Consumers are demanding more than 'product' from their favourite brand. Employees are choosing to work for companies with strong values. Shareholders are more inclined to invest in a business with an outstanding corporate reputation. Quite simply, being responsible is not only the right thing to do; it can distinguish a company from its industry peers."

Clearly, stakeholder engagement is fundamental to improving social responsibility and a logical way for a company to understand the needs of the groups that are affected by its business or are in a position to influence it. As explained by Waddock and Bowell; *"by engaging in a dialogue process to*

²⁰⁴ Granqvist P., *supra* note 130, p. 96.

²⁰⁵ Brekke K. A., & Nyborg K., *Moral hazard and moral motivation: Corporate social responsibility as labor market screening*, Memorandum 25/2004, Departments of Economics University of Oslo, 2004, p. 17.

²⁰⁶ Donaldson, C., *CSR key to retention*, Human Resources Magazine, 5 August 2008.

²⁰⁷ Lazlo, C., *supra* note 162, p. 120-121.

²⁰⁸ Smith N. C., *Consumers as Drivers of Corporate Social Responsibility*, in: Crane A. et al, *supra* note 124, p. 281-282.

²⁰⁹ Starbucks, Annual Corporate Social Responsibility Report, 2001, p.3.

*improve stakeholder relationships, a company will be better prepared for problems when they arise and more likely to be able to avert many altogether”.*²¹⁰

4.3 The Age of Accountability

Modern technologies, especially information and communication technologies (ICTs), and the mass media have tremendously increased the reach of corporate influence. Keinert states that, with information that can be communicated in virtually no time around the world, *“a new transparency has been created, and with it, what is of particular importance to corporations, a hitherto unknown degree of public scrutiny of corporate (mal-)practices around the world.”*²¹¹ Today’s business environment has been referred to as an “age of transparency” and that is *“a time in which business will be forced to operate on the premise that all of its actions will ultimately be made public, and in which corporate reputation will be based less on the information that a company’s professional communicators can shape and control and more on third-party perceptions....”*²¹² Simultaneously, to an ever increasing extent, rules valid in MNCs’ home countries are expected to be applied equally in any host country as technological changes bring countries closer together.

The flow of information is also keeping the public updated about global issues, human rights and environmental changes, meaning that corporations now have to respond to more well-informed stakeholders. The internet and its low-cost collaborative platforms have enabled stakeholders to band together into self-organizing virtual communities where information can be shared and corporations can be targeted. Information portals have already exhibited some spectacular successes in influencing the fortunes of corporations, driving stock prices up and down, providing timely data on executive pay, serving as an forum for employers and consumers to complain about management practices and subsequently acting as a tool to force change.²¹³

In conclusion, the social advancement reached through ICT has affected MNCs concerned with CSR, opening up huge opportunities to them on the one hand, but on the other exposing them to increased surveillance of their own activities and also making them more vulnerable to civil society pressure and activism. Just as the financial rewards from running a genuinely responsible corporation are likely to increase, the consequences of negative media exposure for unethical business practices can be devastating. It has thus been claimed that this historically unprecedented degree of

²¹⁰ Dickson M. A., *supra* note 145, p. 49.

²¹¹ Keinert C., *supra* note 95, p. 27.

²¹² Argenti P. A. & Forman J., *The Power of Corporate Communication*, McGraw-Hill, New York, 2002, p. 12.

²¹³ *Ibid.*

technology-driven transparency, scrutiny, and accountability is probably the most important and enduring of all the drivers for CSR.²¹⁴

4.4 Risk Management

Savitz emphasizes that running a socially responsible and sustainable business helps the management of the business to “*reduce risk of harm to customers, employees, and communities; identify emerging risks and management failures early; limit regulatory interventions; and retain the explicit or implicit license to operate granted by government or by the community at large.*”²¹⁵

Legal risks, reputational risks and financial risks are vastly interrelated. A changing legal baseline for CSR, as described in the second chapter, generates new business incentives for improved social performances. Many scholars point to the usefulness of CSR for “reputation management” and for anticipating and warding off government regulation.²¹⁶

Increased civil and criminal litigation against corporations may be seen as a risk for corporations failing to address CSR. However, even though the risk of being held accountable for any violations of international human rights norms that may arise from MNCs operations is uncertain today, it is not only an actual judgment or litigation costs that constitute the real risk. The risk of litigation is today closely connected with a decline in reputation and the loss of market shares and competitive advantage.

Bearing in mind that CSR and the law often take opposite starting points, Ward points out that it is important to build an understanding between these different mind-sets. She argues that legal and reputational risk management has to be integrated so as not to damage reputation and, conversely, so that management of reputation does not give rise to litigation.²¹⁷ Take the example of Coca-Cola’s agreement to settle a lawsuit against the company for racial discrimination under the US Civil Rights Act. Even though the company had a legally very strong case, the senior executives of the company took the view that Coca-Cola as a company could not withstand the many months of bad publicity which fighting a class action would have caused.²¹⁸ The settlement gave an outside panel, appointed by the company and the plaintiffs’ lawyers, authority to revise company personnel policy and serve

²¹⁴ Chip Pitt III J. W., *supra* note 166, p. 337.

²¹⁵ Savitz A.W. with Weber, K., *supra* note 7, p. 36.

²¹⁶ See: Amalric, F. & Hauser J., *Economic Drivers of Corporate Responsibility Activities*, The Journal of Corporate Citizenship, Vol. 20, Winter 2005; Adams C. A., *A Commentary On: Corporate Social Responsibility Reporting and Reputation Risk Management*, Accounting, Auditing & Accountability Journal, Vol. 21, Iss. 3, 2008.

²¹⁷ Ward H. et al, *Corporate Citizenship: Revisiting the Relationship between Business, Good Governance and Sustainable Development*, International Institute for Environment and Development (IIED), 2002, p. 27.

²¹⁸ See: www.findjustice.com/ms/cases/coke/summary1.htm.

as a watchdog for at least four years. The panel was charged with ensuring that Coke's record of paying and promoting all minority workers and women did improve. *"We need to have outside people helping us,"* said Douglas N. Daft, Coca-Cola's chairman and chief executive.²¹⁹

The Coca-Cola case is an excellent example of the relationship between the legal and reputational parts of risk management posture, where CSR is often seen as a tool to protect reputational value and avoid damage.²²⁰ Even though this particular case was decided in the courtroom, such stakeholder engagement is what CSR is all about.

Also, the environmental and social harms caused by the recent event of British Petroleum's (BP) oil pipeline leak in Alaska as well as the economic and social harms triggered by poor risk management on the part of banking firms in the lead up to the Global Financial Crisis of 2008 are examples of irresponsible and unsustainable business practices, which will have not only legal but also reputational and financial consequences.

This exemplifies that sound CSR practice can reduce the risk of costly conflicts, since the corporation can prevent and minimize these potential disputes. CSR may also offer an investment in the company brand: the stipulated corporate values can be drawn upon to ease potential setbacks in the event of misdeeds.

4.5 Competitiveness and Brand Differentiation

Surely, there is a growing consensus about the correlation between CSR and overall corporate competitiveness. As expressed by the business guru Peter Drucker; *"every single pressing social and global issue of our time is a business opportunity."*²²¹ Generally, in mature efficient and competitive markets, it is very difficult for companies, especially those producing basic commodities, to gain a significant, long-term competitive advantage. Any difference that will enhance a company's products in a crowded market is a valuable corporate asset. In the increasingly conscience focused marketplaces of the 21st century, social responsibility, outstanding ethical principles and adherence to such core values in business activity are important components in building *reputational capital*.²²² Hence, a major CSR driver is that it can be a source of competitive advantage.

²¹⁹ Ibid.

²²⁰ Castelló I. & Lozano J., *From Risk Management to Citizenship Corporate Social Responsibility: Analysis of Strategic Drivers of Change*, Corporate Governance, Vol. 9, No. 4, 2009, p. 379.

²²¹ As cited in: Laszlo C., *supra* note 162, p. 73.

²²² Reputational capital is often defined as the difference between the book value of an organization and its market valuation.

Also, MNCs might use CSR as a strategy for achieving market niches that protect them, at least temporarily, from competition. Amalric and Hauser argue from a neoclassical perspective that firms can use socially responsible behaviour to differentiate their products and attract customers who are concerned about such issues. They even claim that it is possible to construct an entire organization around social responsibility, making it harder for rivals to compete on these grounds.²²³ A repeatedly used example of a successful organization built on their socially responsible values is the cosmetic corporation The Body Shop, which is known as one of the pioneers of the “ethical differentiation strategy”. Since its foundation, The Body Shop has pushed for the intrinsic value of animal life, by selling cosmetics based on natural products, while paying a fair price and allowing no animal testing. The Body Shop’s policy on animal testing was revolutionary, and made it possible for the company to gain a first-mover advantage by distinguishing itself clearly from the competition.²²⁴

Porter and Kramer, who advocate that CSR can be used as a competitive tool, states that strategy is about choosing a unique position.²²⁵ They mention the case of Toyota’s response to concerns over automobile emissions as an example of how corporations may use CSR as a competitive tool. By developing a hybrid electric-gasoline vehicle, the Prius became the fastest-selling car in the world and the corporation gained a competitive advantage *and* environmental benefits.

The Body Shop was sold to L’Oreal for £652 million in 2006,²²⁶ Unilever paid \$326 million for Ben & Jerry’s in 2000²²⁷ and Starbucks paid \$8 million for Ethos Water in 2005.²²⁸ These are just some of many examples of successful corporations whose tremendous focus on CSR has been proven to pay off.

The importance of CSR as a source of competitive advantage is even greater given the difficulty in the present-day global economy of finding any means to differentiate a company and its products from competitors.²²⁹ As traditional sources of competitive advantage such as financial strength, technology, and location become less significant, it is observed that in response, “*senior management is searching for new, hard-to-imitate, less-tangible sources of competitive advantage.*”

²²³ Amalric F. & Hauser J., *supra* note 216, pp. 27-38.

²²⁴ See: van de Ven B. et al., *Sticking to Core Values: the Case of The Body Shop*, in Mallin, C. A., *Corporate Social Responsibility: A case Study Approach*, Edward Elgar Publishing Ltd., Cheltenham, 2009, p.59-78.

²²⁵ Porter M.E. & Kramer M.R., *supra* note 142, p. 88.

²²⁶ van de Ven, B. et al, *supra* note 224, p. 59-78.

²²⁷ Press release, *Ben & Jerry’s & Unilever to join forces*, 12 April 2000, available at www.benjerry.com/our_company/press_center/press/join-forces.htm

²²⁸ Scanlon J., *Buy water, help children*, Business Week, 22 March 2006.

²²⁹ Boatright J. R., *supra* note 32, 2009, p. 364.

These “soft sources” have been noted to “include the benefits achieved through the successful implementation of corporate social initiatives.”²³⁰

This suggests that creating a socially responsible reputation and a brand name that is associated with good social behaviour might, from the company’s point of view, be one of the most important conditions in order to be successful.

4.6 New Standards

“It is not money, but standards that make the world go round,” claims Kristina Sandberg, Business Area Manager of Management Systems at the Swedish Standard Institute (SIS).²³¹ All industries and technologies have a code of written and approved standards and specifications, which is essential if the products are to be widely used and if they are to make a productive contribution. In the same way, the demand for some measurement of social performance has given rise to a CSR standardization movement variously described as *social and ethical auditing, accounting and reporting* (SEAAR) and *triple-bottom line accounting* (3BL). Standards, whether multi-stakeholder or company initiatives, can create a benchmark from which corporations can be measured, audited and held publicly accountable.

In addition, due to the lack of effective institutions in the international context, governments and corporations recognize the importance of uniformed standards and codes of conduct in creating some consistency in cross-border operations and resulting transactions.²³²

Boatright points out that the movement towards more practical and comprehensive CSR and corporate governance standards comes from several sources. First, companies themselves seek to evaluate the benefits of their CSR activities, and, more importantly, demonstrate the value of their CSR activities to shareholders and the public. Second, several influential rating organizations, such as the *Dow Jones Sustainability Index* and *FTSE4Good Index*, rank companies on social performance. These indexes are primarily intended for use by investors, but they are also widely followed by other stakeholders. Third, SRI funds generally apply their own measures to company performance in addition to using the ranking of rating organizations. Fourth, there is an increasing body of academic research devoted to measuring corporate social performance and comparing this with financial

²³⁰ Hess D. et al, *The Next Wave of Corporate Community Involvement*, California Management Review, Vol. 44, Iss. 2, 2002, p. 113.

²³¹ Sandberg K., speech at *Social Responsibility Day*, Stockholm, 14 October 2009.

²³² Bondy K., *supra* note 92, p. 442-443.

performance, which generally show a significant positive correlation between social and financial performance.²³³

Several organizations have also created highly sophisticated and specific tools and guidelines for measuring social and environmental performances. In particular;

- *Global Reporting Initiative (GRI)*, claimed to be “...the steward of the most widely used reporting framework for performance on human rights, labour, environmental, anti-corruption, and other corporate citizenship issues ... created through a multi stakeholder, consensus-seeking approach...”,²³⁴
- *Institute of Social and Ethical AccountAbility (ISEA)*, offering a certification, the AA1000, that is similar in concept to awards for quality control, such as the ISO 9000.
- *Social Accountability International (SAI)* developed the certifiable standard SA 8000 based on the UNDHR and various ILO conventions, which is now widely used as a screening mechanism for MNCs in selecting their suppliers in developing countries.
- *International Organization for Standardization (ISO)*, which is about to present guidelines for social responsibility, ISO 26000, in late 2010. The ISO 2600 has been called “the new global reference point for responsibility-taking.”²³⁵ Even though the ISO 26000 will not be a certification standard it has been predicted that many nations are likely to implement the ISO 26000 through domestic statutes requiring any company doing business in their countries to comply with the standard.

Even though social and ethical reporting cannot be fully comparable to financial reporting, such reporting is likely to encourage greater corporate performance and increase the transparency of CSR and corporate governance which enables stakeholders to measure, compare and assess the performance of corporations in relation to their social and environmental demands. I believe this is about to develop as a part of a new form of multi-stakeholder governance.

In addition the emerging of sector-based initiatives such as the *Forest Stewardship Council for sustainable forestry* and the *Marine Stewardship Council for sustainable fishing* are also examples of the impetus in the standardization movement.

²³³ Boatright J. R., *supra* note 32, p. 368-369.

²³⁴ www.globalreporting.org

²³⁵ Steinholtz D., *supra* note 231.

Finally, there is also ample evidence that CSR codes and standards are a key driver for CSR in developing countries. For example, Baskin's survey of CSR practices in emerging markets indicates growing adoption rates of ISO 14001 and the GRI's Sustainability Reporting Guidelines.²³⁶

4.7 Concluding Discussion

Probably the single most convincing argument for implementation of CSR strategies is that it frequently makes good business sense, which has been proven by various studies in connection with long-term interest, survival, and success of the company.²³⁷

The underlying assumption for the market to pursue MNCs to embrace CSR is that consumers and investors reward ethically and socially responsible corporations by their purchasing and investments; civil actions, such as NGO and activists campaigns, may cause reputational damage to a corporation which affects the corporation's financial performance.

In this chapter it has been argued that the market is increasingly demanding more responsible behaviour; new technologies and mass media puts the corporation under increased scrutiny and new standards make it easier for empowered stakeholders to examine the behaviour of MNCs. In addition, I argue that there is a strong business case for CSR. Adopting a proactive approach to social and environmental issues can help MNCs to develop a new customer base, enhance customer loyalty, avoid legal as well as business risks, gain access to capital, attract and retain talented employees, gain acceptance by local communities and consequently achieve a competitive advantage because the value of intangible assets has become increasingly important. All of these forces in support of CSR are present in the marketplace as well as in the social and political environment in which corporations operate.

It should however be pointed out that fortunes indeed have been made, and are still being made, through unacceptable business methods. Nevertheless, the development has been toward more transparency and corporate accountability.²³⁸ All the trends in this chapter indicated that, in this new business environment, business conduct that is contrary to the values of society are jeopardizing the sustainable long-term growth of the corporation.

In addition, the dramatic changes within society and business methods during the last century have considerably extended the life expectancy of corporations. Consequently, the need to focus on long-

²³⁶ Visser W., *supra* note 188, p. 476.

²³⁷ Keinert C., *supra* note 95, p. 34.

²³⁸ Council of Bars and Law Societies of Europe, *Corporate Social Responsibility and the Role of the Legal Profession: A guide for European Lawyers*, 3rd ed, CCBE, June 2008, p.1.

term survival and sustainable development has arisen and only a long-term balanced view of profit maximization may be considered responsible. Hence, good corporate governance practices and CSR can constitute an opportunity for MNCs to protect their own economic and existential interest when balancing the interest of a wider number of stakeholders than just owners and managers.²³⁹

Ironically, Milton Friedman's fear was that unrestrained managers would use their discretion to squander corporate resources for feel-good cause. The reality today is that highly constrained managers with little discretion are being forced by the market to engage in socially responsible behaviour.²⁴⁰

²³⁹ Keinert C., *supra* note 95, p. 34.

²⁴⁰ Boatright J. R., *supra* note 32, p. 263.

5. CSR in Practice

In the foregoing theoretical chapters the limited legal environment relating social responsibility to MNCs has been discussed, the concepts of CSR and corporate governance on the global competitive market have been presented and corporate governance has been defined as a precondition to CSR. In addition, the key drivers have been highlighted in order to demonstrate the emergence of CSR as a business requirement.

Based on this reality, the aim of this chapter, which takes on a more empirical and practical viewpoint, is to present selected case studies which illustrate how market leading MNCs are conducting their businesses in China. The chosen corporations represent different business sectors and highlight different forces and incentives to run their businesses in a manner that exceeds not only legal but also societal requirements with regards to social and environmental issues.

This will be done by introducing a model of corporate compliance. This model illustrates different levels of social responsibility with the aim of highlighting how the above discussed CSR drivers may work in practice. The MNCs case studies showing different aspects of CSR and illustrating why and how the corporations are dealing with these issues will then be presented and analysed in the light of the compliance model.

5.1 The Three Tier Compliance Model

Some would describe CSR as corporate compliance with the “spirit as well as the letter of the law” and others may refer to it as a business approach by which an organization takes into account the impact of its activities upon different stakeholders.²⁴¹ With the law as the foundation, commitments to CSR made by corporations can be divided into various levels.

This was for instance illustrated in Carroll’s pyramid.²⁴² I, on the other hand, have chosen to look at the issue in terms of different levels of compliance. As I see it, three distinct levels of a corporation’s CSR engagements have been crystallized, namely *legal compliance*, *societal compliance* and *beyond compliance*.

²⁴¹ Nehmne M. & Wee C. K. G, *Tracing the Historical Development of Corporate Social Responsibility and Corporate Social Reporting*, James Cook University Law Review, Vol. 15, 2008, pp. 198-200.

²⁴² See: 3.2.2.

5.1.1 Legal compliance

Obviously, the very basic level of compliance that all companies always must reach is legal compliance. As Ruggie observes; “[c]ompanies know they must comply with all applicable laws to obtain and sustain their legal licence to operate.”²⁴³ This level constitutes the very foundation that all actors have to fulfil and respect. In return for complying with the minimum requirements of the law, corporations are granted certain legal privileges, such as limited liability. Social and environmental regulations as well as required corporate governance practices dictated by Stock Exchanges are all regulatory versions of minimum standards of compliance that needs to be fulfilled in order for the corporation to subsist in the market.

However, the vast body of business law is constantly increasing as legislatures, regulatory agencies, and the courts respond to greater societal expectations and impose new legal obligations.²⁴⁴ In addition, the complex contemporary international legal framework related to MNCs is evidently in a grey zone, as described in the second chapter of this thesis. The required level of legal compliance is therefore also likely to change. This suggests that legal compliance alone may not be a long-term sustainable approach; particularly since ethical rules and public expectations are often metamorphosed into legal rules.

5.1.2 Societal Compliance

It has been concluded that not complying with the demands of stakeholders in terms of social and environmental responsibility as well as corporate governance practices may put corporations at substantial risk. Compliance with these public requirements may be just as important to business success as the legal norms. Hence, one step up from the legal requirements, we find societal compliance, which is a non legally-granted right to operate a business. Although there are no legal sanctions, if not operating in accordance with these norms the corporation will still be sanctioned by the public, as well as by their consumers, investors and employees.

Sawitz explains that “minimization” provides a fruitful way of strategically working with social compliance, by reducing the corporate footprint in terms of the adverse environmental, social, and economic impact of the activities.²⁴⁵

Often the corporate social impacts cannot be fully and specifically anticipated or spelled out in advance. Hence it may be in the interests of corporations to operate above the moral minimum of

²⁴³ Ruggie, *supra* note 11, p. 13.

²⁴⁴ Boatright J.R., *supra* note 32, p.352.

²⁴⁵ Sawitz A.W. with Weber K., *supra* note 7, p. 151.

the market. Corporations that adhere only to the minimum level of societal compliance leave themselves open to pressure from society and regulation from government. One of the major reasons advanced for corporations to exercise greater social responsibility is to avoid such external interference. By “internalizing” the expectations of society, corporations retain control over decision making and avoid the costs associated with government regulation.²⁴⁶ Consequently, every manager must ensure that their business runs above the minimum societal expectations in order to remain competitive on the market.

5.1.3 Beyond compliance

Corporations that are doing more than they are asked to do and actually exceed the demands from their stakeholders find themselves pushing towards the third level; beyond compliance. As concluded by Keith Slack, Senior Policy Advisor at Oxfam America, globalization has increased the exposure of corporations to risks posed by operating in new areas for which they, and the people impacted by their operations, are not prepared. He argues that moving beyond the “social licence” by respecting the principle of community consent in policy and in practice can be an effective way to control those risks and to create mutual benefits for corporations and communities.²⁴⁷

Sawitz, who introduced the term minimization, states that the next step is optimization which can be explained as producing positive benefits in the three areas of environmental, social and economic impact. He argues that “[o]ptimization is a powerful form of sustainability jujitsu – transforming a problem into a solution by looking for the hidden opportunity. Today’s most successful companies are shifting from defence to offence on sustainability, moving from ‘How can we minimize this problem?’ to ‘How can we gain from it?’.”²⁴⁸

It may also be explained in terms of tightening and inverting the “business gaps”, meaning that the corporations not only reduce their corporate footprints (whether environmental, social, or economic), but also manage to run their business so it results in a positive outcome.²⁴⁹ By integrating these issues into the corporation’s business strategy and move beyond compliance, the corporation will also gain a competitive advantage in comparison to corporations that do not offer the same social benefits.

²⁴⁶ Boatright, J.R., *supra* note 32, p. 356.

²⁴⁷ Slack, K., *Corporate Social License and Community Consent*, Policy Innovations, 21 Nov 2008, available at <http://www.policyinnovations.org/ideas/commentary/data/000094>

²⁴⁸ Sawitz A. W. with Weber K., *supra* note 7, p. 159-160.

²⁴⁹ Lagerqvist T.

5.2 Case studies

Keeping the above presented framework in mind, this section sets out to examine four different MNCs with the common objectives of fulfilling the demands of society as well as using their impact on society as a competitive weapon. I believe that case studies are a useful complement to the study as they may show how certain corporate practices are unfolded.

5.2.1 NIKE Inc. – Learning CSR the Hard Way²⁵⁰

Often, the tipping point for corporations to realize the importance of CSR is following attack or criticism. This was the case for the American market leading manufacturer of athletic goods; NIKE Inc. (Nike). The case of Nike illustrates the challenges MNCs face while trying to respond and comply with the changes in ethical sensitivity of their customers, who are demanding accountability not only for the activities carried out by the manufacturers but also for their suppliers' and subcontracted factories.

Nike were found on two simple ideas; (1) it would minimize costs by outsourcing all manufacturing to developing countries where production costs were lower and (2) the money saved would be invested in marketing in order to build brand identity and awareness, mainly through celebrity endorsement.²⁵¹

5.2.1.1 Nike under attack

In the 1990s, Nike's business conduct in developing countries with regards to working conditions at its suppliers started to become an object of discussion. In 1996, the New York Times published a harsh op-ed piece which boldly criticized the company and stated that its wealth and products was built on the slave labour of young Asian women.²⁵² The article created a nationwide stir among consumers, activists and international corporations. Nike's initial response to the growing criticism was to deny any responsibilities for the practices of its contractors, since the workers were not Nike employees and their wages were above the legal minimum. When asked about the labour practices in some factories supplying Nike, John Woodman, the company's general manager for Indonesia, said

²⁵⁰ If not otherwise stated, the information in this section is taken from Kelly Lau, Corporate Social Responsibility Director, Nike China, interviewed 10 December 2009; or publications on Nike's website; www.nikebiz.com

²⁵¹ Bartlett, C. et al, *Transnational Management: Text, Cases, and Readings in Cross-Border Management*, 4th ed, McGraw-Hill, Boston, 2004, p. 137.

²⁵² Herbet B., *Nike's Pyramid Scheme*, New York Times, 10 June 1996.

that he did not know the causes and added; “*I don’t even know that I need to know.*”²⁵³ The negative publicity was devastating for the company which faced extensive consumer boycotts, resulting in a sharp profit-decrease.²⁵⁴ Consequently, the corporation was pressured to respond and Phil Knight, the founder and CEO of Nike, even admitted that “*the Nike products [had] become synonymous with slave wages, forced overtime, and arbitrary abuse.*”²⁵⁵

Porter and Kramer argue that a firm that views CSR as a way to calm pressure groups often finds that this approach devolves into a series of short-term defensive reactions; “a never-ending public relations palliative” with minimal value to society and no strategic benefit for the business.²⁵⁶ This is exactly what happened to Nike, who responded to the complaints by initiating a PR campaign which stated that Nike’s products were manufactured throughout the world in accordance with strict internal standards free from sweated labour.²⁵⁷ In 1998, Nike formally addressed the broad range of criticisms of the company by issuing a statement of corporate responsibility.²⁵⁸ To ensure compliance with these standards, Nike established a code of conduct to be enforced in all Nike manufacturing facilities by safety committees and trained supervisors. In addition, Nike sent scores of form and personal letters to some of the most important clients. The company also made proactive efforts to answer the concerns of students by creating a specific page on its website, visited college campuses and spoke to students. Nike even invited a few teams of Dartmouth graduate students to tour Asian factories for three weeks on Nike’s expense, and later posted the student teams’ reports on the Nike website, providing further evidence of reasonable manufacturing practices.²⁵⁹

However, as Nike began aggressively assessing its own factories, one Ernst & Young audit of a Vietnamese facility was leaked to the New York Times, which claimed its unsavoury results to an international audience in a front-page story.²⁶⁰

²⁵³ Boatright J.R., *supra* note 32, p. 416, citing: Schwarz A., *Running a Business*, Far Eastern Economic Review, 20 June 1991, p. 16.

²⁵⁴ In 1998, earnings fell by 69 percent.

²⁵⁵ Boatright J. R., *supra* note 32, citing: Cushman, Jr. J.H., *Nike to Step Forward on Plant Conditions*, San Diego Union-Tribune, 13 May 1998, p. A1.

²⁵⁶ Porter, M.E. & Kramer M.R., *supra* note 142, 2006, p. 83.

²⁵⁷ DeTienne, K. B. & Lewis, L.W., *The Pragmatic and Ethical Barriers to Corporate Social Responsibility Disclosure: The Nike Case*, Journal of Business Ethics, Vol. 60, 2005, p. 361 (359-376)

²⁵⁸ In the Statement of corporate responsibility Nike committed to six new standards for its manufacturing facilities; including factory monitoring, minimum age requirements, environmental safety standards, employee education programs, expansion of its micro-loan program, and greater transparency of corporate responsibility practices. *Ibid.*

²⁵⁹ *Ibid.*, p.363

²⁶⁰ *Ibid.*

5.2.1.2 *Kasky v. Nike*

This article led to a lawsuit, filed against Nike under Californian State Law for false advertising in April 1998.²⁶¹ Nike defended itself based on the First amendment of the US Constitution on freedom of speech and claimed that communications with media were not advertising, rather policy. However, in 2003, after five years of litigation, California's Supreme Court stated that the company statements amounted to "commercial speech" and would therefore be subject to the stricter standard of truth required by advertising law. The case was thereafter settled where Nike was to pay \$1.5 million to the Fair Labor Association (FLA) to be used for worker development programs. Even though the amount is only about half of one day's advertising budget, the intangible value of the corporation's brand had undeniably suffered a severe loss.

5.2.1.3 *Moving Beyond Compliance*

Nike has learned the importance of CSR the hard way, and has actually made remarkable changes in their CSR practice throughout the entire corporation, with its value moving from the periphery to the core of business strategy. In 1998, Nike established a Corporate Responsibility department, but more importantly it assembled a team of senior managers and outsiders that concluded that the root of the problem was not so much the quality of the corporation's programs to improve worker conditions, it was rather its approach to doing business. Consequently, Nike realized that it had to manage CSR as a core part of their business. By instrumentally enhancing the long term economic value by incorporating responsible business practices into the daily operations, Nike gradually managed to transform the business behaviour of their contractors through ethical supply chain management.²⁶²

Today, the corporation is participating in, facilitating, convening, and financing several initiatives to improve worker conditions in global supply chains and promote CSR more generally. Mark Parker, CEO claims that *"It is an integral part of how we can use the power of our brand, the energy and passion of our people, and the scale of our business to create meaningful change."*

The corporation uses a rather hard-line approach towards suppliers, drawing a sharp line on how much non-compliance will be tolerated before the supplier's contract will be terminated. In general, Nike accepts a maximum limit of three non-conformances before terminating a contract and forever excluding the supplier from their sourcing. Some scholars argues that in perspective of the possible

²⁶¹ Kasky v. Nike, 27 Cal. 4th 939 (2002), cert. granted, 123 S. Ct. 817, and cert. dismissed, 123 S. Ct. 2254 (2003).

²⁶² Ip P.K., *The Challenge of Developing a Business Ethics in China*, Journal of Business Ethics, Vol 88, 2009, p. 216.

consequences of termination, this strategy may seem to be more about protecting a brand name than the supplier's workforce. Also, the point has been raised by advocates for a more soft-line approach focusing on long-term commitment to suppliers' development, that Nike's strategy may create incentives to dedicate time and effort to cover up bad labour standards rather than actually working on improving them. Nevertheless, Nike has certainly achieved control over their practices and is arguably among the leading MNCs in the market in terms of social responsibility. Among many notable steps, Nike was the first corporation that published a complete list of all its suppliers on its website. That move spurred similar supply chain transparency among other companies, but placed Nike ahead of the game in social and environmental reporting.

In addition, Nike has made substantial efforts to improve operational efficiency in manufacturing through offering training to employees and suppliers and to boost innovation through new technologies and the use of more environmentally friendly materials. It has been acknowledged that the company is able to improve its own practice and affect real change only by working in collaboration with others. Nike has for example partnered with other companies to improve conditions in their shared supply chain through the International Labour Organization's Better Work program. Nike is also leading an initiative, GreenXchange, a digital platform that enables companies to promote sustainability innovations.

Also, Kelly Lau, Corporate Responsibility Director at Nike China, proudly explains that Nike was involved in the drafting of the China's Labor Contract Law, providing comments to the NPC Legal Affairs committee.

5.2.1.4 *Concluding Discussion*

The Nike case clearly shows the ever-growing importance of ethics and social responsibility while conducting business abroad, especially when profiting from low skilled labour employment in developing countries. It also illustrates a corporation gradually experiencing the different levels of the previously described compliance model. At first, Nike was satisfied by complying with the strictly legal requirements and rejected any other responsibilities claiming the legal liability was on the suppliers and sub-contractors, and not Nike itself. Faced with unexpected criticism and higher societal requirements of workers' rights, Nike did not know how to respond but took a defensive approach, denying the links between its practices and the working conditions at its suppliers.

After realizing that its practice caused severe damage to the brand image, Nike made a half-hearted attempt to demonstrate its commitment to the emerging demands of CSR. The company responded to the criticism using multiple PR tactics, and as a result, entered an unusual forum that blended the

relatively tolerant ethical standards of typical advertising with the stringent requirements of CSR reporting. This response illustrates the decisions to remedy the problem of negative public image and aggressive criticism in an environment of legal uncertainty. It also shows that attempting to improve the brand image by stipulating codes of conducts and CSR principles may be counterproductive if there is a lack of honesty and transparency.

Finally, the corporation realized that it is facing a long-term problem that cannot be swatted away by short-term compliance or public relations strategies. Instead, Nike had to adjust the entire organization and business strategy in order to solve the problems. Nike and other leading corporations in the apparel industry now understand that compliance with agreed-upon labour standards in their global supply chains is difficult if not impossible without changes to how they set procurement incentives, forecast sales, and manage inventory. Consequently, Nike is now learning how their responsible business practice can provide a leg up on the competition and contribute the corporation's long-term success.

Nike is now setting the apparel-industry standard for reform of wages, hours and minimum working ages in its contract factories. It is certainly trying to reach the beyond compliance level. Yet, it is arguable whether the corporation has regained the trust lost in the 1990s. As described by Warren Buffet; *"it takes 20 years to build a reputation and five minutes to ruin it. If you think about that you'll do things differently."* If Phil Knight had thought of that in the 1990s, Nike would possibly have done things differently twenty years ago.

5.2.2 SKF – CSR and Sustainability in the DNA of the Corporation²⁶³

As highlighted by many scholars and business strategy experts, a crucial element of implementing CSR activities and adopting sustainable practices successfully is that they cannot exist in isolation from other corporate initiatives.²⁶⁴ Rather, CSR has to be integrated into all business strategies and practices pervaded throughout the entire organization from the top management.²⁶⁵

5.2.2.1 CSR in the DNA

Tom Johnstone, President and CEO at the Swedish industrial corporation SKF, acknowledges that CSR may work as a "distinctive competitive advantage" and highlights its importance of being a "part of

²⁶³ If not otherwise stated, the information in this section is taken from Sim Tee Lam, Communication Manager, Corporate Responsibility, SKF, interviewed 13 January 2010, Gothenburgh; SKF Annual Report 2008, or publications on SKF's website; www.skf.com/

²⁶⁴ Roselle J., *supra* note 16, p. 139.

²⁶⁵ Savitz A. with Weber K., *supra* note 7, 2006, p. 69.

the company's DNA."²⁶⁶ The SKF Group (SKF) is the world leading producer and supplier of products relating to roller bearings, seals, mechatronics and lubrication systems. SKF is represented in more than 130 countries, has over 100 manufacturing sites, holds about 15 000 distribution locations, and employs around 44 800 workers. SKF has multiple factories in China and is one of the biggest Swedish corporations on the Chinese market, with more than 13 percent of their revenue deriving from the Chinese market during 2010.²⁶⁷

The corporation holds a very high focus on social and environmental sustainability and ethics, and has managed to successfully incorporate it into their overall vision,²⁶⁸ mission,²⁶⁹ drivers and values.²⁷⁰ In 2009, it was awarded the *Hallvarsson & Halvarsson Award*, chosen to be the best Swedish company at CSR initiatives and communication and in 2010 the magazine *Veckans Affärer* ranked SKF as the most sustainable corporation on the Swedish Stock Market.²⁷¹

Moreover, SKF has clearly embraced sustainability and CSR as a source of business success from the top management throughout the DNA of the company. Sim Tee Lam, Communication Manager at SKF's Corporate Sustainability Department, highlights the top management's true involvement in the work as a crucial success factor of the company's social and environmental performance. She also points to the tendency in SKF of combining a top-down and a bottom-up approach as a reason for their winning CSR practice. For example, SKF provides sustainability awareness training for all employees across the entire organization. But most importantly, the CEO has a personal interest and true faith in CSR as an important competitive tool for the corporation. In his own words, *"I strongly believe that our work in both reducing our negative impact and helping our customers reduce theirs is a key advantage for SKF and we will continue to drive these activities forward."*

5.2.2.2 SKF Care

SKF defines their social responsibility by addressing and abiding by the internal guiding principles of the *SKF Care* concept. This long-term approach to sustainable development emphasizes four inter-dependent areas; *Business Care*, *Employee Care*, *Environmental Care*, and *Community Care*.

²⁶⁶ SIDA, *Nya tankesätt för utvecklingssamarbete målades upp på Global Forum*, 7 October 2009, available at: www.sida.se.

²⁶⁷ Mikael Vilenius, *supra* note 29.

²⁶⁸ *"To equip the world with SKF knowledge"*

²⁶⁹ *"To be the preferred company for our customers, distributors and suppliers (delivering industry-leading, high value products, services and knowledge-engineered solutions) employees (creating a satisfying work environment where efforts are recognized, ideas valued, and individual rights respected) and shareholders (delivering shareholder value through sustainable earnings growth.)"*

²⁷⁰ *"Profitability, High ethics, Quality, Empowerment, Innovation, Openness, Speed, Teamwork, Sustainability"*

²⁷¹ Lindsten P.O., *Börsens bästa bolag*, *Veckans Affärer* Agenda, 24 June 2010.

In doing so, SKF follows relevant OECD and ILO conventions and it is also part of the UN Global Compact initiative. The strive to be acknowledged as an economically, socially and ethically responsible company is further emphasized in SKF's *Code of Conduct*, which was introduced in 2002 in order to "enable systematic compliance assessment and risk identification." The code of conduct is applicable to all of the SKF Group's operations worldwide and has also been used as a reference to establish other documents such as the SKF Code of Conduct for Suppliers and Sub-contractors, and the SKF Code of Conduct for Distributors, demanding similar high levels of commitment from their business partners.

Lam maintains that it is important for SKF that its internal operation in terms of codes of conducts, environmental and social standards and demands are the same in all units all over the world. One way of securing SKF's high standards in their internal organization, is to ensure that the entire SKF Group is under the same ISO 14000 certificate for the environment management system. This also applies to the health and safety certificate, which covers all manufacturers, warehouses and logistics centres. This implies that all factories, regardless of location, have to live up to one unified standard. Consequently, if one factory fails to live up to the standard, the entire organization loses its certificate, unlike the common case among other corporations where every factory has their own certificate. Hence, SKF can ensure that their core values and standards are met in all parts of the global company.

The *business care* aspect is built upon the recognition of CSR as one of the corporation's key business drivers and SKF endeavour to translate the environmental and social challenges into business opportunities. In the words of Bengt-Olof Hansson, former Vice President Corporate Sustainability; *"For SKF addressing sustainability is not a burden, not a requirement thrown upon us, but an opportunity for continually improving our business approach. To sustain the world leading position in our field and deliver value to our shareholders, we must never forget the basics of business, namely to always deliver excellent value to our customers and while doing so upholding the highest level of business, environmental and social ethics."*

The *employee care* aspect offers a safe, rewarding and respectful working environment and aims to improve the health and education of the employees. It is closely connected to the ability to attract and maintain employees, but also other business partners such as subcontractors and suppliers. Lam does not see investment or NGOs as main drivers for SKF's CSR activities. However, the reason for this is probably that they are generally satisfied with the company.²⁷² She points towards openness,

²⁷² E.g. "SKF is approved for Swedbank Robur's ethical funds and we highlight the company as a good example", Anna Nilsson, Head of SRI Analysis, Swedbank Robur.

honesty and transparency as key factors that have given SKF trustworthiness towards such stakeholders. The key driver for SKF's CSR and sustainability activities is the source of competitive value in comparison to competitors.

Community Care focuses on playing an active and positive role in the communities in which the company operates. For instance, SKF have invested in forestry in various areas around their factories in China as a step to decelerate deforestation.

The *environmental care* principle is built on the foundation that working proactively in resource conservation and waste reduction can bring both cost and environmental benefits. SKF strive for being more than CO₂-neutral and uses the expression BeyondZero. The initiative was launched in 2005 to challenge the limitations of conventional environmental targets and become the role model for sustainability in the industry.

5.2.2.3 *BeyondZero*

Interestingly, SKF recognize a similar model of three levels as the above described model of compliance, when they structure their reporting and work around the issue. Lam explains that the threshold of SKF's work is the "compliance, duty and legality level," which includes environmental, social and ethical business conduct. This level is the very foundation where policy controls system and procedures are implemented in order to make sure that the corporation complies with rules and regulation. On top of that is the level of "risk prevention", which is about capturing a problem before it even occurs and ultimately deploying a system to identify a risk of failure or non-compliance. Above and beyond that is the opportunity to make a positive impact and improve stakeholder value in terms of health, retention, CO₂ issues, etc. Lam illustrates the three tier level in the field of labour; *"First of all SKF have to make sure that it fulfils the labour regulations, and then make sure that it lives up to the aspects of respect and protect for the employees, and finally above and beyond that comes health & fitness programmes, development and training etc."*

Another example in respect to CO₂ emissions is the initiative BeyondZero. Obviously, the foundation level of CO₂ emission is environmental legislation, standards and other requirements. Many environmental targets aim to reduce negative environmental impacts down to zero net CO₂ emissions, which would be connected to the second level. SKF, on the other hand, aims to help customers and external partners become more energy efficient and, in combination with internal efforts, reduce negative environmental impacts, to exceed the zero target. Subsequently calculating SKF's global CO₂ footprints and comparing them to the CO₂ reductions that its customers receive by working with SKF's products and services, the result should be a positive number.

5.2.2.4 *World Works Councils*

Another example of how SKF is working with CSR in a creative manner is the operation of World Works Councils. At annual council meetings, representatives for the employees meet with Group Management to discuss matters of importance to the employees and SKF Group.²⁷³ The 2008 meeting was held in China. However, this is quite controversial in China since independent trade unions are prohibited in China and the only union allowed is the ACFTU, which is controlled by the Chinese Communist Party. Since it does not meet the criteria to be a member of the World Work Council, representatives from China participate as observers. By doing so, one can actually claim that SKF are slowly introducing the concept of freedom of association in China. This clearly exemplifies how the conduct of a MNC may influence the protection of human rights in China and how SKF are going beyond the law.

5.2.2.5 *Concluding Discussion*

The SKF Group is clearly one of the most successful MNCs in terms of CSR activities and sustainable development. This is because they have put social and environmental issues on the agenda and implemented the activities into its core business plan. The project “Beyond Zero” is an excellent example of a CSR activity that has reached the highest level on the Compliance Model and by being ahead of its competitors CSR at SKF is definitely a source of competitive advantage.

5.2.3 Ocean Trawlers – Public Judgment versus Legal Judgment²⁷⁴

The Ocean Trawlers Group, incorporated in Hong Kong, is part of the corporate group Three Towns Capital. The corporation is a market leader in supplying and processing cod and haddock from the Barents Sea and a leading distributor to Europe, Asia and the U.S.

5.2.3.1 *“The Cod Scandal”*

Since the corporation is operating on a market highly dependent on natural resources, sustainability has always been an important issue for Ocean Trawlers as well as for the entire industry. However, in 2004 and 2006 Ocean Trawlers was involved in a Norwegian and a Swedish TV documentary which accused the corporation of illegal fishing.²⁷⁵ The programme triggered a huge debate where NGOs urged consumer boycotts and Ocean Trawlers obviously received tremendous pressure from their buyers and customers. Even though much of the allegation, which was based on a draft report from

²⁷³ See: <http://www.skf.com/portal/skf/home/sustainability?contentId=509017>

²⁷⁴ If not otherwise stated, the information in this section is taken from Gunnar Mansfeld, CEO, Ocean Trawlers, interviewed on 28 December 2010, or Thomas Lagerqvist, chairman of Ocean Trawlers, continuous contact.

²⁷⁵ TV4, Kalla Fakta, 18 January 2006; NRK, Brennpunkt, 21 September 2004.

Norwegian authorities which actually did not demonstrate any illegal acts by Ocean Trawlers, turned out to be false, it caused serious consequences for the corporation which was unable to sufficiently defend its practice. According to Magnus Roth, former CEO at Ocean Trawlers, the program led to the closure of the office in Drøbak, Norway, 28 employees lost their jobs, the bank withdrew credit and the insurance was terminated.²⁷⁶ The case, which was later settled, highlights that a corporation may do everything correctly but still face media exposure as an irresponsible and unethical corporation. In this case, it should also be noted that the entire fishing industry has been struggling with a poor image. In 2007, the magazine *The Scotsman* described it as “...an unglamorous industry, with its reputation for low wages, unpleasant working conditions and tonnes of waste”.

5.2.3.2 Traceability and Accountability

Illegal, unreported and unregulated (IUU) fishing in the Barents Sea represents a significant environmental, social and economic problem in many areas of the world and has become a threat to the reputation and sustainability of the entire fishing industry. In response, Ocean Trawlers are now working closely with different organizations as well as business partners and competitors, to establish a routine to efficiently demonstrate their business conduct. Ocean Trawlers has together with WWF implemented a *Traceability Program* which follows the entire supply chain from the catch to the point where the product is delivered to the final customer. In addition, a control system guarantees that their cod and haddock are bought within the quotas granted by the Russian authorities and that the origin of the fish is rigorously documented. The certification authority *Det Norske Veritas* (DNV) has verified the accuracy, integrity and reliability of both the traceability and quota control system.²⁷⁷ This shows that Ocean Trawlers are striving to meet the public expectations of transparency and consequently to display its business practice if malpractice is suspected.

5.2.3.3 Sustainability as a Competitive Advantage

Working towards a more sustainable business industry has proven successful, and as a result Barents Sea cod is now recommended on the *WWF Sustainability list* as “safe for consumers”. Ocean Trawlers has also observed how consumer choices are shaping the seafood industry itself. Thomas Lagerqvist, chairman of Ocean Trawlers, explains that the corporation must not only focus on efficiency in the supply chain, but must ensure effective delivery of what the end-user wants, namely; “fresh, healthy, nutritious seafood products, delivered in a sustainable manner.”²⁷⁸ Consequently, Ocean Trawlers have entered full assessment with a view to certification under the

²⁷⁶ Olsen P. B., *Drøbak-selskap “frifunnet”*, Akershus Amtstidende, 7 March 2008.

²⁷⁷ www.illegal-fishing.info/item_single.php?item=news&item_id=2162&approach_id=13

²⁷⁸ www.fislatino.com/fis/techno/newtechno.asp?l=e&id=26174&ndb=1

*Marine Stewardship Council standard for sustainable and well-managed fisheries.*²⁷⁹ As a first-mover in the industry and with customers such as McDonalds and Walmart, Gunnar Mansfeld, CEO at Oceans Trawlers, believes that the MSC certification will give the corporation a competitive advantage by differentiating their products from their competitors’.

In January 2010, Ocean Trawlers adopted a Policy on Sustainable Fishery. The policy states that

“[a] sustainable business stands an excellent chance of being more successful tomorrow than it is today, and remaining successful, not just for months or even years, but for decades or generations. Sustainable organizations generate and live off interest rather than depleting their capital. Capital in this context includes natural resources, such as water, air, sources of energy and foodstuffs. It also includes human and social assets – from worker commitment to community support – as well as economic resources, such as a license to operate, a respective marketplace, and legal and economic infrastructure.”

5.2.3.4 Efficient Processing in China

Another crucial part of making a business sustainable is obviously to conserve and preserve the natural resources, in this case; the fish. Hence, Ocean Trawlers is working on efficient processes. The corporation’s Barents Sea cod is first taken to processing factories in Qingdao in China, where it is filleted, re-frozen and then shipped back to Europe. Ocean Trawlers work in close co-operation with the factory owners to invest in retention of workers, through improvement in working conditions, dormitories, training program for their leisure time, and investment in home villages. To secure sound working conditions at the factories, Ocean Trawlers has initiated its *Code of Conduct for Reprocessing*, based on UN and ILO standards.

One can question whether it is environmentally defensible to transport the products back and forth to China. However, Lagerqvist explains that the skilled workers reach up to 40% higher yield than modern filleting machines in Europe, meaning more than 20 million more food portions for the same amount of fish. Various reports have also concluded the benefit of hand-filleted fish in comparison with shorter transportation.²⁸⁰ According to a 2006 report, the carbon footprint for cod fillets trawled in the Barents Sea, processed in China and sold in Scandinavia is actually less than if processed by machine in Norway.²⁸¹

²⁷⁹ The independent MSC accredited certifier Food Certification International (FCI) will oversee this full assessment and is now in the process of contracting organizations and individuals with an interest in the fisheries.

²⁸⁰ See: www.mynewsdesk.com/se/pressroom/findus/pressrelease/view/torsken-fraan-kina-har-ungefaer-samma-klimatpaaverkan-som-den-svenska-grisen-222001

²⁸¹ Brænd et al, Bærekraftig transport av mat? *Miljømessige og sosiale konsekvenser av langreist mat*, Forum for utvikling og miljø, 2006, p. 21-22.

It is noteworthy that the CO₂ emission/kg for beef produced and sold locally is more than 7.5 times as much as Ocean Trawlers' fish. Based on those numbers, the entire fishing industry definitely has a competitive advantage against the beef industry.

5.2.3.5 *Concluding Discussion*

The case of Ocean Trawlers highlights the importance of transparency in order to respond to public demands. It also suggests that occasional oppositions in the media are often much more influential and momentous than actual legal judgements. In connection with the settlement, Ocean Trawlers received a public apology where all allegations were withdrawn, but the media scandal obviously stained their brand image. As the corporation has taken various steps towards Societal Compliance by increasing traceability and transparency it is certainly more prepared to identify risks and respond to allegations today. In addition, acting in a responsible and sustainable manner will bring the corporation more business opportunities since their buyers and customers will reward such behaviour.

5.2.4 **IKEA – The Master of Corporate Branding**²⁸²

The Swedish home furnishing retail corporation IKEA has been referred to as the “Teflon multinational,” since the corporation has managed to dodge and deflect brand-bashing attacks experienced by other MNCs.²⁸³ Eva Ståhl, coordinator for environmental and social responsibility at IKEA, explains that the reason for this is closely connected to IKEA's way of working with these issues from the very beginning. She claims that environmental and social responsibility is an *“integrated part of IKEA's business”*. IKEA's vision is concretized in the business idea; to create a better everyday life for the broad masses and the long term IKEA direction stating that IKEA business shall have an overall positive impact on people and the environment.²⁸⁴

The social and environmental responsibility at IKEA is meant to “encompass all parts of the operations, from product development, purchasing, transportation, warehousing and retailing”.

IKEA's business strategy is to focus on product design and development, efficient distribution and cost reduction wherever possible. At its core, the business idea is about economical use of resources.

²⁸² If not otherwise stated, the information in this section is taken from Eva Ståhl, Coordinator for environmental and social responsibility at IKEA, interviewed on 8 January 2010, IKEA's Annual Report 2008, or IKEA's website: www.ikea.com.

²⁸³ Lowry Miller K., *The Teflon Shield*, Newsweek, 12 March 2001.

²⁸⁴ “[to] offer a wide range of well-designed, functional home products at prices so low that as many people as possible will be able to afford them.”

Cost-consciousness, in terms of efficient use of raw materials and minimization of waste, goes hand in hand with environmental protection.

In the words of the jury for 2009 E Prize that IKEA won;

*"[IKEA] has systematically and in a well-thought manner worked with energy efficiency as part of a bigger strategy of sustainability and environmental issues. This has been done in ways that operate from production and transport all the way to the consumer."*²⁸⁵ [My translation]

5.2.4.1 Forestry

As a high-profile producer of consumer goods the MNC which employs around 1 000 people in 44 countries has been targeted by demands of environmental and social responsibility. In the early 1980s, IKEA was included in Greenpeace's campaign against furniture retailers that used wood from ancient forests. In response, IKEA soon adopted a best practice approach to stakeholder monitoring and consultation. IKEA now works closely with Greenpeace and the WWF to align its activities with the NGOs' objectives and to improve its environmental performance. Consequently, IKEA has received international praise for its environmental practices, which include only using wood certified by the Forest Stewardship Council and recycling 75 percent of waste from its stores. As revenues have steadily grown, IKEA believes its approach to environmental management has contributed to consumer loyalty.²⁸⁶

5.2.4.2 Child labour

A low-cost approach is not unproblematic or normally linked with advanced social responsibility. In the early 1990s a Swedish documentary discovered brutal production methods among several suppliers in Pakistan linked to IKEA and a German documentary raised the issue of child labour. Together with other companies IKEA was cited as a customer of wicker suppliers employing children, causing the corporation to review their supply-chain. As it turned out, IKEA was in fact not sourcing from the particular suppliers, but the critique sparked a debate within the corporation about the risk of child labour and other unacceptable practices possibly occurring at its suppliers. As a result of the media attention IKEA made what Ståhl calls a "classic mistake", namely to terminate contracts with suppliers in the region who subsequently went bankruptcy.

However, after realizing the risk of a lack of knowledge of the actual working conditions among the corporation's suppliers, IKEA contacted some NGOs, such as *UNICEF*, *ILO* and *Save the Children*, to

²⁸⁵ Pressrelease, <http://www.mynewsdesk.com/se/pressroom/ikea/news/view/ikea-vinner-e-prize-462>

²⁸⁶ Werther W.B. & Chandler D., *Strategic Corporate Social Responsibility: Stakeholders in a Global Environment*, Sage Publications Inc, London, 2006, p.284.

gather information and start a process of knowledge-transfer about what could be done to secure the supply-chain. This approach turned out to be successful, and the partnership resulted in *The IKEA Way on Preventing Child Labour*, which today is a separate part of the overall Code of Conduct. Collaboration and partnerships with NGOs and international organizations is something that IKEA proactively advocates. Ståhl explains that as soon as an issue arises beyond their own core competence, they must seek advice from others who know how to deal with such issues. For example, as a way of fighting child labour IKEA, together with UNICEF, has been setting up schools and other programs in hundreds of villages in Southeast Asia.²⁸⁷

5.2.4.3 *The IKEA Way*

IKEA's current Code of Conduct, *The IKEA Way on Purchasing Home Furnishing Products*, was officially launched in 2000 to secure their sourcing in developing countries such as China.

Today, the Code of Conduct describes minimum requirements on social and working conditions, environmental demands, forestry and child labour, with which IKEA suppliers as well as sub-contractors worldwide must comply. It includes provisions based on the UN Declaration of Human Rights, the ILO Declaration on Fundamental Principles and Rights at Work and the Rio Declaration on Sustainable Development. The code also states that IKEA suppliers as well as sub-contractors shall always comply with the most demanding requirements whether they are relevant applicable laws or IKEA's specific requirements.

Further, the code states that the supplier shall ensure that all measures required are implemented according to the code. Via a network of Trading Service Offices, having the direct responsibility to monitor the suppliers, IKEA supports their suppliers to improve their operations. In addition, IKEA has formed a global compliance and monitoring group to support and follow up developments on a global basis. As a complement, independent auditors are used to ensure compliance. Believing in long-term relations, IKEA does not break off relations due to non-compliance only, as long as there is a willingness to comply with the IKEA requirements with an agreed improvement plan within an acceptable time frame.

5.2.4.4 *The Down Breeding Scandal*

Ståhl states that the most challenging part of IKEA's socially responsible profile is the supply chain, and the corporation still faces some problems in that area. One example, as revealed in 2009 by a Swedish TV program, showed IKEA using down plucked from live geese for their products, despite

²⁸⁷ Fagerfjäll, R., *Mänskliga rättigheter – företagens ansvar?*, Amnesty International, Kristianstad, 2001, p.27-29.

stating clear policies against this practice.²⁸⁸ Ståhl admits that IKEA had failed in the monitoring process and subsequently the corporation had to enhance its efforts to increase traceability in the business. After consultation with the animal-rights organization *Wilder Dier*, IKEA announced that it was phasing out its down bedding brand from all its shops because it was thought to come from Chinese fowl which were plucked while still alive. China produces 80 per cent of the world's down and feathers.²⁸⁹

During the public pressure, IKEA posted detailed information on their website about how the corporation planned to deal with the problem, allowed customers to call in and ask questions and even opened up a chat on the internet for that very purpose.

However, Ni Yijun, general manager of the *Sichuan Duying Trading Company*, a down supplier for IKEA who was exposed on a the Swedish TV program and whose company was badly hit by the coverage as IKEA cancelled orders, was reported to have told Xinhua News at the time; *"we have never conducted live-plucking and will not do that, ever. I can tell you that 99 per cent of the Chinese makers are not engaged in that business. A very small number of such cases should not affect the whole industry."*²⁹⁰ However, as stated by Johann Frejme, Information manager at Intersport that was also involved in the down breeding scandal; *"One thing that we have learned is that the guarantees are not always worth very much."*²⁹¹ [My translation] Also, welfare charities admit that it is impossible to know what really is going on in any of the factory farms anywhere in the world or just where the down in your duvet or coat has come from, and what happened to the animal that provided it. But as Eva Ståhl points out; *"As soon as we cannot trace our products, we are at risk."* She also states that IKEA have now manage to establish a system where the farming of the animals can be traced back in several stages, just as IKEA have successfully implemented in the fields of forestry and cotton.²⁹² She calls the procedure "crisis management" or "risk management" where one of the main keys to success is to create good long-term relations with business partners as well as branch organizations and other organizations, which is something that IKEA has done successfully.

²⁸⁸ TV4, Kalla Fakta, February 2009.

²⁸⁹ ThePoultrySite, *Bright Future for China's Feather and Down Industry*, 12 December 2009, available at: <http://www.thepoultrysite.com/poultrynews/19123/bright-future-for-chinas-feather-and-down-industry>

²⁹⁰ China Feather and Down Information, *China feather and down producer says live-plucking report "untruthful"*, 26 February 2009, available at <http://www.cfd.com.cn/en/Information/show.php?itemid=10>

²⁹¹ Röhne J., *Så agerar företagen på dunskaandalen*, Miljöaktuellt, 10 February 2009.

²⁹² IKEA and WWF cooperate on a project aiming to enable millions of farmers around the world to grow cotton in a way that is healthier for the farming communities and the environment, and more economical. For example, about 3,000 farmers in southeast Asia are being trained in Farmer Field Schools where they learn how to reduce the amount of water and chemical use.

5.2.4.5 Concluding Discussion

By working in close partnership with various organizations as well as suppliers, IKEA are not only responding to societal demands, but also trying to exceed them. This approach, which differs from Nike's hard-line approach, has proven to result in stronger supplier commitments to any kind of requests, including CSR, because the relationship is more than just buyer-supplier.

5.3 Concluding Discussion

The above discussed cases demonstrate how the market reward as well as punish corporations based on their business conduct. It also shows that acceptance of moral liability for breach of the spirit of the law, rather than only focusing on the letter of the law, is a better corporate strategy in order to maintain support against reputational risks and liabilities that could severely affect the corporate value.

The role of corporations in society is often described as a social contract.²⁹³ Part of this contract is formalized in laws and regulations, where violating the contract has obvious legal ramifications. Part of it is semiformal, namely the stakeholders' implicit expectations, which if ignored can seriously harm a corporation's reputation and consequently financial performance, as illustrated by the Nike case. However, this contract is by nature a fluid one, as the expectations of societal compliance as well as the requirements for legal compliance are most likely to change over time.

The rising tide of expectations means that corporations must strive to anticipate and understand those expectations and to embed them in their business strategy. As the case studies indicate, by reaching for the beyond compliance level, the corporations may gain a competitive advantage as well as decrease the risk of future issues that may, over time, become social expectations.

One such example is the issue of obesity, where corporations are now widely expected to take responsible actions and modify the fat and sugar content of their products due to increased awareness of its impact and health concerns. Corporations like McDonalds are actually experiencing economic benefits from sales of healthier products. Sheila M.J. Bonini et al. argues that the momentum on this issue could already be so great that lawmakers or regulators will step in and formalize social expectations by imposing new legal restraints.²⁹⁴ This illustrates how CSR practices intertwine with market based economic value changes and the importance of assessing new

²⁹³ See e.g.: Bonini S. M. J., *supra* note 203, p. 22.

²⁹⁴ *Ibid.*, p. 23.

information and revisiting business models with an eye toward future social changes in public expectations which may lead to legal regulations.²⁹⁵

Another example is the issue of high executive bonuses. In response to the public opinion, in 2009 the Swedish bank SEB proudly announced that it had implemented a strict limitation in the bonus system for the corporation's top management. However, when it turned out that the CEO, Annika Falkengren, received compensation for the loss of bonus in terms of salary, it was seen by the public opinion as greedy and immoral, even though SEB was performing above the legal ethical minimum level as well as what it thought to be the societal compliance level. Since customers felt that the corporation did not take the expected ethical responsibility, they lost trust in the bank and choose to become customers elsewhere.²⁹⁶

This highlights the importance of trust as key to successful CSR practice. From the above cases it is also evident that gaining such trust requires more than just good intentions. Nike's tactic of using CSR as a defensive PR mechanism evidently did not result in regained trust. In the case of Ocean Trawlers, the corporation was, and still is to a certain degree, struggling with lack of trust in the entire industry. SKF's remarkable efforts to not only reduce but also make a positive environmental and social impact makes it a trustworthy corporation, thanks largely to the CEO's personal involvement and interest in the issue, which is necessary for a corporation to embed CSR the organization's culture and value. Further, Eva Ståhl explained that IKEA views trustworthiness as their number one priority. This was demonstrated in how they dealt with the "down scandal", where the corporation admitted its lack of control over its suppliers, but communicated its efforts to ensure compliance and offered returning rights to all its customers. Per Granqvist explains that; *"as a customer, we realize that IKEA screwed up, but that they now are making sure that they actually keep their promise."* [My translation] As demonstrated in the case studies, working in close partnership with NGOs is a very effective strategy to gain public trust. It's a logical step, since co-operation with these organizations demonstrates a sort of quality stamp for the CSR activities.

In conclusion, it can be stated that a corporation that does not go further than complying with legal requirements is unlikely to become successful, as it doesn't fulfil the higher expectations of the market. It may also be at risk of losing its "legal licence to operate" on the market, since the social expectations might lead to new laws and regulations. In complying with the public demands of social and environmental responsibility, a corporation can create value by protecting its reputation and

²⁹⁵ Atater D. & Suzuki S., *Obesity, Corporate Social Responsibility, and Economic Value*, Graziado Business Report, Iss. 2, 2006,

available at: <http://gbr.pepperdine.edu/062/csr.html>

²⁹⁶ Granqvist P., *supra* note 130, p. 152.

obtaining a “social licence to operate.” However, as public expectations are rising, it is not until the corporations view CSR as more than a compliance issue and truly embed it into their core business strategies will it serve as a sustainable and competitive business tool.

6. Concluding Remarks

“There is one thing stronger than all the armies in the world; and that is an idea whose time has come”²⁹⁷

In this thesis, the business behavior of MNCs on the new globalized competitive marketplace has been discussed. It has been concluded that in order to be competitive in the global market, MNCs are outsourcing their production to developing countries, such as China, where labour costs are low, there is no effective law enforcement and working conditions and human rights issues are not high on the agenda. This development has resulted in intensified public scrutiny of MNCs operations and ethical concerns have been raised regarding the conditions under which the products are manufactured. Moreover, the environmental threats are more substantial than ever and the information society has enhanced the visibility of corporate behaviour. In response, MNCs have developed voluntary codes and standards or engaged in multi-stakeholder initiatives in the field of their environmental and social performances. It has further been concluded that CSR is increasingly affecting corporate governance practices; determining the boundaries and accountabilities of the corporations in relation to a broad group of stakeholders and its social and environmental responsibilities, as well as opportunities. It has been declared that the *agency theory*, historically used to argue against managers engaging in CSR, is being replaced by a *stakeholder approach* as the prominent managerial theory related to business success. In conclusion, the market force has made it inconceivable for MNCs not to embrace the concept of CSR.

When examining whether MNCs’ corporate governance practices and CSR activities are mainly driven by the current law or the market forces, it has been established in the first part of this thesis that the international legal framework, due to the globalization, is facing tremendous challenges in regulating international business practices. Instead, the market has proved to be a more powerful tool when it comes to changing business behaviour by rewarding good corporate governance practices and social performances as well as punishing shameful business conducts.

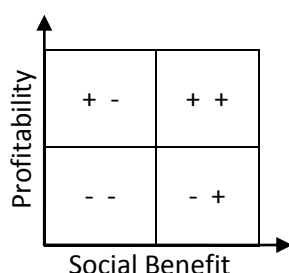
I have further advanced the argument that good corporate governance practice as well as good social and environmental performance is well connected to the success of the corporation on the global competitive market. Various examples have highlighted how MNCs perceive the increasing demand from their key stakeholders to act in a responsible manner in relation to issues such as working conditions and human rights. This suggests that the business conduct of MNCs acting on the Chinese

²⁹⁷ Victor Hugo.

market is not necessarily driven by the Chinese law, nor by any international laws, but rather by the corporate stakeholders, who may be customers located on the other side of the world.

As illustrated in this thesis the market of today puts increased pressure on managers to reflect upon how their companies create and sustain competitive advantage. MNCs that embrace the concept of stakeholder value and proactively address stakeholder issues by taking steps beyond legal compliance and minimum public requirements, instead exceeding the public demands, can better anticipate changes in the business environment. They can reduce the risk of being unpleasantly surprised by emerging societal expectations as well as higher legal standards and regulations. Ultimately, stronger CSR activities can also work as a valuable corporate asset, which allows the leading corporations to discover new sources of competitive advantage.

Most importantly, for corporations to be sustainable they have to find a way of running the business that satisfies both the business interest (financial stakeholders) and the interest of the public (nonfinancial stakeholders). Savitz calls this *“the sustainable sweet spot: the place where the pursuit of profit blends seamlessly with the pursuit of the common good.”*²⁹⁸ He elaborates by stating that every action in business has two components, an impact on profit and an impact on the world. This theory can be represented by a four-celled matrix with two axes, with the northeast corner representing the *sustainable sweet spot*, where stakeholder interest and corporate interest overlaps.²⁹⁹



The southwest corner represents a business that is neither profitable nor beneficial to the stakeholders. Lagerqvist calls this quadrant “delusional business practice” and argues that many corporations’ philanthropic commitments actually end up serving neither social benefits nor profitability. The northwest corner represents a business that is profitable but not sustainable. Neither is the southeast corner sustainable, since it is representing a business that is socially beneficial but not profitable. In conclusion, only the northeast corner of the matrix represents a sustainable approach to CSR which provides a win-win opportunity, in which corporate benefit is gained along with a public good.

²⁹⁸ Savitz A.W. with Weber K., *supra* note 7, p.23.

²⁹⁹ *Ibid.* p.28

As concluded in this thesis the sources of business success are changing; MNCs are therefore challenged to actively reform their business practice towards the northeast quadrant in order to stay competitive on the market. Porter and Kramer claim that this can be done if companies bring to CSR the same analytical tools they bring to the rest of their operations.³⁰⁰ In addition the case studies have indicated that it is crucial to implement CSR into the DNA of the corporate business strategy in order to reach this “sustainable sweet spot.”

As these issues are altering the ground rules of business conduct, it could be suggested that the business conduct on the global market is also a driver of the legal development, which will be explored in this last section of this thesis.

6.1 CSR as part of the New Lex Mercatoria

The formula for best social development used to be proposed that the greatest general well-being could be achieved through the establishment of a free market with private business, governed by a framework of laws.³⁰¹ Given the fact that law has increasingly dropped from the equation, resulting in a lack of political and legal control of MNC, scholars argue that some mechanism of control would need to be re-established. Scholars as well as business leaders are continually pointing towards stronger signs at every enforcement level of enhanced business accountability for human rights and environmental matters.³⁰² However, the question remains; whether MNCs’ socially responsible behaviour is capable of plugging the “governance gaps” left by the insufficient international law framework and the weak, corrupt or under-resourced governments in developing countries that fail to adequately provide various social services. In the words of Ralph G. Steinhardt; *“if law emerges from this buzzing blooming confusion of developments and initiatives in corporate responsibility, it would not be the first time that law gradually crystallized from commercial practices that were grounded in what the entrepreneurial class considered to be in its own long-term self interest.”*³⁰³ What he is referring to is *lex mercatoria*, the law of MNCs, known as *“the most successful example of global law without a state”*.³⁰⁴

³⁰⁰ Porter M.E. & Kramer M.R., *supra* note 142.

³⁰¹ Keinert C., *supra* note 95, p. 23.

³⁰² See e.g.: Chip Pitts J.W. & Sherman J., *Human Rights Corporate Accountability Guide: From Law to Norms to Values*, Corporate Social Responsibility Initiative Working Paper No. 51, Harvard Kennedy School & The Business Leader Initiative on Human Rights (BLIHR), Cambridge, 2008.

³⁰³ Steinhardt, R. G., *Litigating Corporate Responsibility*, Conference Paper, Global Dimensions Seminar, New York, 1 June 2001.

³⁰⁴ Teubner G., ‘Global Bukowina’: Legal Pluralism in the World Society, in: Teubner G. (ed), *Global Law Without a State*, Dartmouth Publishing, Aldershot, 1997. p. 3.

Based on the observation made in the previous chapters of this thesis, this section explores the analogy between CSR initiatives and the ancient *lex mercatoria*, defined as a system of customs and best practice “growing out of the perceived needs of the marketplace that ultimately gave rise to law in a more recognizable and more enforceable form.”³⁰⁵

I argue that MNCs are creating a new commercial CSR-inspired *lex mercatoria* governing the corporate performances in relation to commercial social and environmental practices as well as business ethics and corporate governance. Subsequently, it does not seem too far-fetched to suggest that the corporations’ response to the market expectations might actually result in legal standards.

6.1.1 The Origin of Lex Mercatoria

The concept of *lex mercatoria* can be traced back to the *jus gentium* of Ancient Rome which was understood as a formally autonomous source of law proper to the economic relations between citizens and foreigners.³⁰⁶ However, the conventional storyline begins in the medieval age, where merchants created a system to compensate for the inability of local commercial laws to address problems arising from conducting activities in multiple local settings. With the rise of the nation-state, state-based law governing commercial law displaced *lex mercatoria* which became incorporated into national laws.

As discussed in this thesis, non-state actors have proliferated in the wake of globalization and MNCs have become so powerful that many view corporations as producing their own autonomous legal orders. Consequently, based on the predominance of business norms in driving the international legal regime, commentators argue that a revitalization of *lex mercatoria* is underway.³⁰⁷

Factors supporting the rise of *lex mercatoria* in the global market are; “the changing attitudes of governments towards self-organized institutions of society...the change in attitude of legal systems towards a procedural programming of sociological self-control...the tendency towards a universal business law increased by multinational law firms, auditing companies, and last but not least, by the international arbitration systems and the increasing number of conflicts that cannot be adequately

³⁰⁵ Steinhardt R. G., *supra* note 303.

³⁰⁶ Likosky M. B., *Compound corporations: The public law foundation of lex mercatoria*, Non-State Actors and International Law, Vol. 3, 2003, p. 276-278, citing: Goldman, *Lex Mercatoria: Lecture*, Kluwer Law and Taxation Publishers, 1983, pp. 276-277.

³⁰⁷ *Ibid.*, p. 278.

resolved under national law".³⁰⁸ It can be stated that globalization, associated with widening markets and the liberalization of financial transaction, has resulted in a transformation of legal sources.³⁰⁹

6.1.2 The CSR-inspired Lex Mercatoria

The contemporary CSR drivers discussed in this thesis have resulted in a new multi-faced framework of private law in the international law framework. These include the benefits to reputation, recruitment and retention, risk management and seizing opportunities, along with various initiatives taken by non-state actors, such as soft-law regulations, codes of conduct and emerging international standards.

This new framework, which is more sensitive to the public values of human rights, working conditions, environmental sensitivity etc., applies as a practical matter whether a given corporation subscribes to a particular voluntary initiative or not. In the words of *Joe W. Chip Pitts III*, former Chief Legal Officer of Nokia Inc. and Chairman of Amnesty International USA; *"a variety of pluralistic legal, ethical, and market enforcement mechanisms exists at every level, making it a serious question whether many of the legally imbued so-called 'voluntary' initiatives are truly voluntary, or whether they amount to a form of 'supra-governmental regulation'."*³¹⁰

Globalized rules and principles certainly have significance even though not incorporated into state law or international law. As observed by Braithwaite and Drahos; *"dense webs of influence are needed to pull off an accomplishment as difficult as establishing a global regulatory structure that secures the compliance of relevant actors in business and the state."*³¹¹ It is the construction and operation of these dense webs, or what is being referenced here as the new multi-faceted framework, that emerge as the crucial lynch-pin in making global regulation a reality.

Teubner claims that it is not only the economy but various sectors of world society that are developing a global law of their own, and they do so *"in relative insulation from state, official international politics and international public law"*.³¹² MNCs are arguably the main actors that stand out in this process, as their conduct is playing an increasing role in the development of international law by giving a global echo to the standards they agree to, including social, environmental, ethical as

³⁰⁸ Pariotti E., *International Soft Law, Human Rights and Non-state Actors: Towards the Accountability of Transnational Corporations?*, Human Rights Review, Vol. 10, 2009, citing: Mertens H.-J., *Lex Mercatoria: A self-applying system beyond national law?* in: Teubner G. (ed), *supra* note 304, p. 141.

³⁰⁹ *Ibid.*, p. 139-140.

³¹⁰ Chip Pitts III J.W., *supra* note 166, p. 359.

³¹¹ Braithwaite J. & Drahos P., *Global Business Regulation*, Cambridge University Press, New York, 2000, p. 13.

³¹² Teubner G., *supra* note 304, p. 3.

well as human rights standards capable of being applied by judges or arbitrators as a source of legal rules.³¹³

For example, in labour law, private actors such as enterprises and labour unions are dominant law-makers.³¹⁴ Moreover, items such as the *UN Convention on the International Sale of Goods*, *INCOTERMS*,³¹⁵ various *UNIDROIT principles*³¹⁶ as well as the entrenchment of various convenient arbitral regimes as the preferred mode of resolving commercial disputes indicates how corporations actively contribute to forming international law. Other examples are the pharmaceutical, entertainment, and software companies which had a major role in drafting the Trade Related Intellectual Property Rights Agreement (TRIPS).³¹⁷ These achievements indicate how corporations are actively contributing to the formation of international law, both directly via participating in drafting and negotiations and indirectly via setting global standards of business conduct.

It is claimed that corporations have achieved a “remarkable and growing degree of private law” presaging a more environmentally sensitive and right-based *lex mercatoria* that emerged during the 20th century.³¹⁸ In this process, Calliess and Moritz Renner argues that corporations are acting as “private norm entrepreneurs” by using corporate codes of conduct to signal their reliability towards other economic actors, i.e., their consumers. They underline the importance of this performance, since it cannot be achieved by domestic legal systems as their reach is territorially limited, nor by public international law as MNCs commonly are not regarded as having international legal personality.³¹⁹ Moreover, it may also be suggested that the increasing trend towards private regulation through multi-stakeholders initiatives enhances the legitimacy and acceptance of these regulatory processes.

Although social and environmental responsibility as well as the responsibility to respect human rights is not hard law, its principles have a significant potential legal impact. The findings in this thesis suggest that this hybrid legal and normative system of CSR initiatives guides and drives business behaviour in the absence of a central global command and governance structure. Like Chip Pitts III, I

³¹³ Pariotti E., *supra* note 308, p. 140.

³¹⁴ See: Bercusson B., *Globalizing Labour Law: Transnational Private Regulation and countervailing Actors in European Labour Law*, in: Tueber G, *supra* note 304.

³¹⁵ Incoterms rules are international rules that are accepted by governments, legal authorities and practitioners worldwide for the interpretation of the most commonly used terms in international trade.

³¹⁶ International Institute for the Unification of Private Law, UNIDROIT Principles of International Commercial Contracts, 2004, available at www.unidroit.org/english/principles/contracts/main.htm

³¹⁷ Chip Pitts III J.W., *supra* note 166, p. 349.

³¹⁸ *Ibid.*, p. 348.

³¹⁹ Calliess G.-P. & Renner M. C., *Between Law and Social Norm: The Evolution of Global Governance*, *Ratio Juris*, Vol. 22, Iss. 2, 2009, p. 273.

believe that these initiatives can complement and enhance often limited state enforcement capacity, made more limited by the speed of business today and “regulators’ difficulties of ‘keeping up’.”³²⁰

6.1.3 Plugging the Governance Gaps

John Ruggie states that “the root cause of the business and human rights predicament today lies in the governance gaps created by globalization”,³²¹ referring to the incomplete nature of the existing norms and channels and the incapacity of the various parts of the system of the UDHR and subsequent human rights treaties. It is precisely from this gap that demands for greater corporate responsibility have emerged.

Nevertheless, despite the significant progresses of relating social and environmental responsibilities to MNCs, the initial governance gaps have not closed completely. Thus, just as the medieval *lex mercatoria* used self-regulatory rules and principles based on usages and customs that merchants followed in order to fill in the gaps created by what was at the time an unresponsive civil law, I believe that the emerging new CSR-inspired *lex mercatoria* as described in this section will result in continued movement toward plugging the governance gaps created by the global market.

The increasing amount of judicial proceedings against MNCs involving human rights infringement; various corporate governance reforms requiring enhanced attention to stakeholders and not just shareholders; the emergence of mandatory CSR reporting requirements; and adoptions of soft law standards by governments (e.g. export credit agencies, procurement agencies) and international financial institutions are just some of several trends towards a stronger and more concrete legal framework in the field of CSR. National legislation making reporting requirements of CSR mandatory is the most prominent case of legislation emerging as a result of market- and stakeholder based pressure and actual business practice. Such legislation has already emerged in various countries, where one of the most recent examples from the U.S. is the *Wall Street Reform Bill* addressing the Democratic Republic of Congo (DRC), requiring corporations to disclose and detail the measures they are taking to ensure that their products do not contain “conflicts minerals.”

A common view is that corporations will oppose the development of a legal framework. However, it may also be pointed out that a legal framework brings some advantages for corporations, especially those who already have implemented and embraced the concept of CSR.³²²

³²⁰ Chip Pitts III J.W., *supra* note 166, p.359.

³²¹ Ruggie J., *supra* note 48, p.3.

³²² The International Council of Human Rights Policy, *supra* note 35, p. 18-19.

I suggest that the development of the market driven *lex mercatoria* in regards to corporate governance as well as CSR is likely to transform from soft law to hard law. However, one has to abandon the view of governments and states having the monopoly of creating law and realize that the creation of a legal framework is mainly driven by the private sector, in collaboration with international organizations and the public sector, where the MNCs are significant players.

6.2 Evidence from China

As previously concluded, when it comes to regulating international business today regulation by governmental authorities alone is not a very efficient way to ensure success. This is well illustrated when examining CSR in a Chinese context, where the legal standards are high, but the lack of enforcement is limiting the actual effect of the laws. This final section exemplifies how legal initiatives that do not correlate with the market have very little effect. Instead, it is the global market rules, *lex mercatoria*, that may form the Chinese business environment.

6.2.1 The Legal Framework

The legal requirements in China concerning corporate governance and CSR are in fact relatively high. For example, in March 2004, the Chinese government amended its constitution to include “*the State respects and protects human rights*”.³²³ This written amendment states, at least in principle, that human rights are to be an obligatory consideration for the government and all those who conduct business in China. Moreover, Article 5 of the *2006 Chinese Company Law* requires corporations to “undertake social responsibility” in the course of business, and the new *Labor Contract Law* in 2008 has enhanced legal protection for workers in China.³²⁴ In addition, the new *Arbitration Law*, which came into effect in May 2008, allows workers to bring cases against their employers to the courts free of charge.³²⁵

However, such laws and regulations are only effective if enforced and the fact that a regulatory environment has been introduced does not therefore necessarily result in good corporate governance or CSR practice being introduced.³²⁶

6.2.2 The Harmonious Society

³²³ Amendment 4 to the Constitution of the People's Republic of China

³²⁴ Chinese Company Law, 2006, Article 5; Labor Contract Law of the People's Republic of China.

³²⁵ Article 54, Law of the People's Republic of China on Mediation and Arbitration of Labor Disputes

³²⁶ Welford R., *Corporate Governance and Corporate Social Responsibility: Issues for Asia*, Corporate Social Responsibility and Environmental Management, John Wiley & Sons, Ltd and ERP Environment, Vol. 14, Iss. 1, 2007, p. 48.

The tremendous economic growth in China has largely been as a result of Foreign Direct Investments (FDI) in Chinese manufacturers to supply thousands of Western corporations seeking to source goods and profit from the cheap labour in China. Consequently, according to ILO, labour rights traced back to the Chinese suppliers are at the heart of any debate on CSR in China.³²⁷ However, the rapid growth rate and the shift of power to the east, with the corresponding and predictable impact on global values, norms and the global system itself, has caused some legitimate concerns regarding the environment, natural resources, human health, working conditions, human rights and local communities.³²⁸

Eager to allay international criticism of the Chinese economy built on human rights abuses and sweatshop practices, the government is promoting CSR as the private sector's contribution to the "harmonious society". This policy was instituted as China's new approach towards development five years ago.³²⁹ However, there are differing opinions on why the "harmonious society" policy was introduced and the importance and effectiveness assigned to it by the Chinese Communist Party (CCP). The initiatives were probably based on fears of added export costs and were, in fact, nothing but the Chinese government's way of assigning responsibility to the corporations instead of themselves. The same can be said of the legal standards enforced in China concerning workers' rights and human rights.³³⁰ The ambiguity of the "harmonious society" as well as legal requirements such as "[to] undertake social responsibility" has actually had very little real impact on business behaviour in the Chinese market.

Instead, just as in the case of the global market, it is through the market driven *lex mercatoria* that CSR is now becoming a genuine issue in China.

6.2.3 Competitiveness in the Supply Chain

Welford and Hills argue that CSR activities in a Chinese context are still driven mainly by leading Western brands and those of a few locally, often Hong Kong-based companies, that have a brand and image to protect by avoiding accusations sweatshops production.³³¹ As MNCs are pressured from consumers and labour rights advocates in their home countries to ensure that their supply chains

³²⁷ Welford R. & Hills P., *People's Republic of China*, in: Idowu, S.O. & Filho, W.L. (eds), *supra* note 160, p. 187.

³²⁸ *Ibid.*, p. 183-184.

³²⁹ President Hu Jintao on September 15, 2006, defined a harmonious society as a society "*which gives full play to modern ideas like democracy, rule of the law, fairness, justice, vitality, stability, orderliness and harmonious co-existence between the humankind and nature.*"

³³⁰ Dongfang H., China Labour Bulletin, interviewed in Hong Kong, 7 November 2009.

³³¹ Welford R. & Hills P., *supra* note 327, p. 183.

perform faultlessly, they often make it an obligatory requirement for suppliers to get international certification.

Hence, various sectors within the Chinese economy have now embraced both domestic and international standards to help propel Chinese businesses to greater heights around the world. Private actors' initiatives, such as MNCs codes of conduct and other similar responsible production standards such as SA8000 have been the main instruments for introducing CSR into China. In addition, the new global standard China Social Compliance Standard for the Textile Industry (CSC9000T) has emerged alongside a sizeable body of soft-law legislation which has been issued on the subject matter. The editors of *CSRChina.com* observe that *"while perhaps there was some hesitancy within the Chinese government a few years ago to fully embrace a more updated idea of CSR [...] the situation has now changed."*³³²

It has been claimed that most Chinese firms regard CSR to be largely founded on Anglo-American philosophies and values, and its requirements as an imposed burden by their business partners, therefore addressing the issue in a "mock compliance" manner, such as in many Chinese factories.³³³ However, according to Xiaohui Liang, Chief R&D Officer at the Office for Social Responsibility of China National Textile and Apparel Council (CNTAC), the attitude towards CSR as a *"trade-barrier in disguise"* is long gone.³³⁴ He explains that there has been a lack of incentives to actually implement the necessary measures of CSR since many suppliers perceive messages from buyers to be contradictory. On the one hand, demands are put forward that suppliers should implement legal minimum wages and reduce overtime to the legal maximum. On the other hand, the market logic of competition forces buyers to prioritise low price and short delivery times. However, Liang emphasises that more and more suppliers are now realizing that implementation of CSR standards makes good business sense. He also states that *"CSR has a legal standing now"*, and points to the fact that the debate over implementing CSR practice has changed from *"why"* to *"how."*³³⁵

Another point accepted by several suppliers is the idea that adherence to sound labour practices may also help raising product quality, based on the premises that well-paid and well cared-for workers are more motivated to work and less prone to make fatigue-related mistakes.

³³² ChinaCSR.com, *How Far Can Chinese Companies Take Corporate Social Responsibility?*, 23 February 2009. <http://www.chinacsr.com/en/2009/02/23/4572-how-far-can-chinese-companies-take-corporate-social-responsibility/>

³³³ Gugler P. & Shi J. Y. J., *Corporate Social Responsibility for Developing Country Multinational Corporations: Lost War in Pertaining Global Competitiveness?*, Journal of Business Ethics, Vol. 87, Suppl. 1, 2004. pp. 3-24.

³³⁴ Liang X., *supra* note 97.

³³⁵ Ibid.

As CSR is still new in China, this suggests that the suppliers who learn from their multinational buyers how to conform to a socially and environmentally responsible model of business will gather a first-mover advantage and become the future first-tier of suppliers. Surely, more and more suppliers recognize that increased CSR engagement will offer them competitive advantage and unless they can act in accordance with comprehensive codes of conduct, they are unlikely to get repeat orders. According to many CSR experts in China, labour issues are today as important as price, quality and delivery for these suppliers.³³⁶ Consequently, several Chinese suppliers are now also stating their activities in Social Responsibility Reports.³³⁷

Even though this thesis has mainly focused on foreign MNCs doing business in China, it is also important to note that large Chinese firms are picking up a fast track learning process of CSR. Gugler and Shi argues that China is shifting from being a “defensive” to “proactive” player in CSR engagement in order to maintain Chinese corporate competitiveness in the global market.³³⁸ With Chinese corporations like Haier, Lenovo and Li-Ning making advances into foreign countries, corporations who were once reticent about embracing CSR as a business fundamental are now faced with the same demands as every other MNC on the global market.³³⁹ For instance, Lenovo, the fourth-largest PC maker in the world, has made clear strategies for implementing its CSR and has decided to make social investments in several sectors, such as education, environmental protection, elimination of the digital gap between the developed world and developing economies, and poverty alleviation.³⁴⁰

A UNCTAD survey found the main driving force for Chinese MNCs’ internationalization to be “the need to bypass trade barriers” and “the need to utilize domestic production capacity” because the home market for their products is too small.” So challenged with both the opportunity of grabbing new market shares around the world and the risk that irresponsibility can impair growth, I am convinced that, sooner or later, Chinese MNCs will be forced to commit to global initiatives when they advance to a market with higher social standards that go beyond legal enforcement.³⁴¹ In addition, the practices of cross-listing on key stock exchanges requiring higher degrees of corporate governance practices and favour sustainable practices certainly promotes self-regulation on powerful social norms and thereby helps drive CSR forward in China. When it comes to environment

³³⁶ Welford R. & Hills P, *supra* note 327, p. 188.

³³⁷ See e.g.: Beijing Topnex Co., Ltd, *Contributing to Quality Life for the Mass*, Social Responsibility Report, 2008; Jingsu Hongdou Industrial Co., Ltd., *Serve the Country for Common Prosperity*, Corporate Social Responsibility Report 2008.

³³⁸ Gugler P. & Shi, J.Y.J., *supra* note 333, p. 4.

³³⁹ ChinaCSR.com, *supra* note 332.

³⁴⁰ Lenovo Group Limited, *Built to Last*, 2008/2009 Sustainability Report, p. 8.

³⁴¹ The number of Chinese participants engaged in the Global Compact is over 200.

protection, China itself is investing heavily in renewable energy and fine-tuning the environment owing to the enormous amount of pressure received from the UN, international organizations and the business sector. Companies are also being forced to “shape up” when it comes to environmental practice.

6.2.4 Concluding Discussion

Interestingly, CSR in a Chinese context today is often an exercise in seeking compliance with the actual local law and not moving beyond it. Whether obeying the law can be seen as good CSR practice or not is, of course, questionable and it is certainly on this point where CSR in a Chinese context differs from the western views. The development of CSR and corporate governance issues in China presents some significant differences from the global market. As discussed, first level of compliance on the global framework is legal compliance and thereafter comes the societal expectations. In China however, the government raised the bar for legal compliance above the societal compliance without any enforcement mechanisms. It is not until recently, when the business market itself caught up with the legal requirements, that corporations have actually started to embrace the concept of CSR and sustainability. This shows that CSR legislation that does not correlate with the market is unlikely to be enforced in common business practice. Instead, the most effective way to implement issues such as human rights, working conditions and sustainable development is through the market *lex mercatoria* itself, which is increasingly shaping CSR in China today.

However, one should not forget that the government is a major stakeholder, especially in China. Hence, the fact that the government is also recognizing the new CSR-inspired *lex mercatoria*, which is connecting CSR to the corporations’ global competitiveness, is an important driver for CSR in a Chinese context. I am convinced that as much as the global market cannot ignore China, Chinese corporations cannot ignore the demands of the global competitive market if they want to be a part of it. Since China is dependent on its long-term business relationships with MNCs, this is what will drive CSR in China and will eventually require Chinese corporations to integrate their social and environmental impact in their core business strategy.

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