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DISCUSSION PAPERS

# Corporate strategy and inadequate governance: The pitfalls of CSR

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*Corporate social responsibility programs can boost a company's reputation, strengthen the license to operate and help create market advantages, but there are risks that CSR can undermine good governance in less developed countries where business takes on roles beyond their core competencies.*

When the world's richest man speaks, people listen. In 2002, Bill Gates told the World Economic Forum, "We need a discussion about whether the rich world is giving back what it should to the developing world." One way companies have attempted to "give back" is through global corporate social responsibility (CSR) initiatives. While it is welcome that so many executives are determined to act responsibly, reliance on some CSR strategies can undermine good governance in the developing world. I focus in particular on corporate efforts to provide much needed services including roads, schools, healthcare and other public and quasi-public goods.

Global CSR practices can be defined as "business decision-making linked to ethical values, compliance with legal requirements, and respect for people, communities, and the environment around the world." Almost every multinational and many smaller companies have adopted such voluntary CSR initiatives, which can include codes of conduct, auditing and monitoring strategies, social and eco labels, as well as philanthropy. They are a form of soft law; firms also use these initiatives to communicate with and assuage their critics.

The trend to CSR reflects globalization as well as the retreat of the state. As growing number of firms source and produce globally, many of their stakeholders have insisted that global firms be held accountable for conduct that could undermine economic, social or environmental progress. Moreover, in recent years, the traditional dividing lines between business and government have become fluid. Industrialized and developing countries alike have deregulated or privatized traditional public functions such as the provision of water, education, and postal services. But in many developing countries, governments are unable or unwilling to ensure that all of their citizens have access to such services. Government officials may lack the funds or the "know how" to provide these services in an effective and equitable manner. And citizens often lack the education or ability to influence government and obtain consistent and affordable ac-

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cess to the resources they need to thrive. In such countries, governance is inadequate.

Good governance is easy to describe but hard for all governments to consistently achieve. Good governance is fluid: officials must respond to rapidly changing social, economic, technological and political developments. But good governance is not just about the supply side of laws, policies, and regulations. Governance also includes "the mechanisms, processes and institutions, through which citizens and groups articulate their interests, exercise their legal rights… and mediate their differences." Thus, good governance requires buy-in and involvement from citizenry (the demand side.) But to get that buy-in, policymakers and market actors must ensure that citizens have access to information as well as the ability to influence and contest public policy. Therefore, governments must respect civil and political rights.

Firms often respond to conditions of inadequate governance with CSR strategies. But there are several reasons why these initiatives may not be sustainable. First, CSR strategies are expensive. Firms may abandon their voluntary initiatives when times are tough or when competitors do not have similar strategies in place. Secondly, firms that provide quasi public goods through philanthropy or partnerships with NGOs or foundations may lack the expertise or consistent interest in providing these services. Firms may be distracted from their core mission. Third, corporations can be easily manipulated by activist stakeholder groups that may or may not represent the public. And finally, because CSR strategies are voluntary and relatively new, we know very little about which approaches are most effective in particular circumstances (the UNDP, OECD, UN Global Compact and individual scholars are trying to develop these insights.)

Moreover, although executives may design CSR strategies "for the people," these policies are not by the people. If private firms provide public goods citizens may learn to expect these goods from private firms rather than from government. Moreover, if citizens don't communicate to policymakers what they need, policymakers don't learn how to respond to such feedback. Citizens don't learn how to influence government or the importance of such learning for effective governance. Government officials may not be able to provide governance that responds to changing market and political needs, because there is not an effective feedback loop between the government and the governed. Thus, CSR strategies can create a moral hazard problem.

Anglo-American's experience in South Africa provides a good example of this dilemma. The right to health is written in the South African constitution. But until recently, the government was not wiling or able to provide all of its needy citizens with access to affordable medicines. The largest employer in South Africa, Anglo American, decided to take a proactive role. First, it invested in NGO educational projects designed to promote safe sex. But in so doing, the firm strengthened the NGO sector, an action which some policymakers found threatening. Anglo-American also provided retrovirals to its employees, but decided it could not afford to provide the same medicines to dependents, contractors, or the communities where it operated. While this strategy was both generous and in the firm's strategic interest (it estimated ¼ of its employees were HIV positive), it was also widely perceived as inequitable. But the firm did not only face escalating demands for assistance. According to the consultancy Sustainability, "the government pushed back, ostensibly because of the lack of consultation." The strategy put the government on the defensive (which could be good) but did little to build governance capacity to respond to the needs of the people.

History may provide some insights into an alternative approach where managers built governance capacity. During World War II, U.S. and Canadian policymakers relied on business expertise to gear up production to a wartime economy. Executives from many companies provided skills and know-how; some even served as "dol-

lar-a year men." These executives saw their investment of time and expertise as meeting both the public and business interest. They wanted to help the Allies win the war; and they knew that by working with policymakers they could build future business ties.

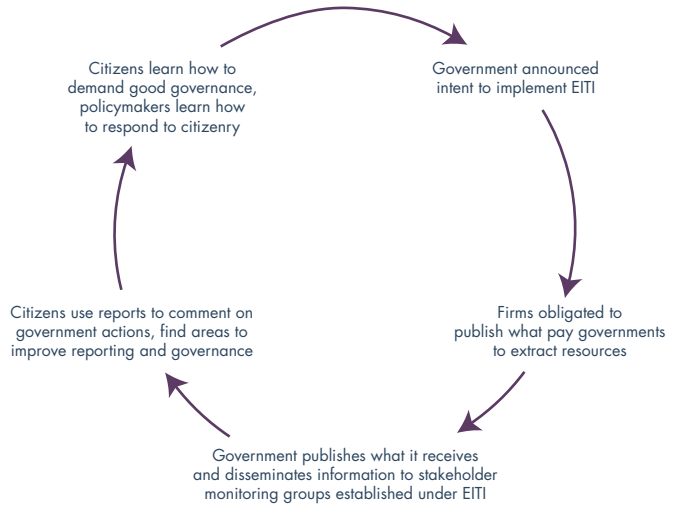
Business investment in capacity building continued after the war. In 1947-1948, many European economies were struggling. After a harsh winter, citizens in many European countries were restive. U.S. and European policymakers feared that Communist parties would be increasingly attractive unless they could stimulate economic recovery. Secretary of State George Marshall proposed that the US fund capacity building overseas. U.S. executives shared the latest management techniques with European executives as well as policymakers. They understood that by helping European competitors recover, they could lose market share. But they also reasoned that renewed competition would keep U.S. managers "on their toes," U.S. companies could again reap economies of scale and scope, and that a healthy European economy was in the business and public interest.

Similarly, managers today can provide technologies, assets and skills to improve governance in the developing world. Such capacity building is an opportunistic investment in the country and its people, and designed to bolster the company's ongoing operations in such nations. Firms will probably only make such investments if they perceive that the benefits of investment will outweigh the costs. To be successful, capacity building efforts must be designed to respond to legitimate public demands (such as the demand for health care). For this reason, executives often partner with other firms and NGOs in providing such capacity. Firms should also take every step to avoid corruption or favoritism that could result from such involvement.

The Extractive Industry Transparency Initiative (EITI) is an interesting example of such a partnership; it has garnered significant support from the Bank. The EITI provides a framework for citizens, policymakers, and business executives to act upon their shared interest in ensuring that that the extraction of natural resources does not stimulate corruption. In corrupt environments, markets are distorted and characterized by inefficiency. Neither corporations nor citizens have the information they need to influence governmental decisions. And policymakers lack incentives to respond to their citizens.

The EITI partnership sets up a feedback loop between officials and their constituents. EITI participating governments are obligated to publish what they earn from resource rents and to require firms operating in the country to publish what they pay to extract resources. EITI also obligates implementing governments to ensure that civil society is actively engaged in the process. Citizens can learn how to monitor and influence government actions. Meanwhile, policymakers may gain greater understanding

**Figure 1: The EITI Process and Governance Capacity Building: Immediate and Long-term Spillover**



of problems in government administration such as different agency approaches to budgeting or regulation. And citizens will learn if government provides good and complete data; if such records are computerized and if they are tested for accuracy Ever so gradually, the habits of good governance learned under EITI could spill over into the polity as a whole.

Governments implement EITI, and thus, it is not a form of CSR. However, many firms may see EITI as a key element of their CSR commitment and strategy. Moreover, the EITI is aimed at improving governance and the ability of the state to be responsive to its citizenry. It is not designed as a business strategy, although extractive firms contribute to the successful implementation of EITI.

Ultimately CSR strategies may not be the best way for firms to "give back." A better approach may be to collaborate with citizens, other firms, and policymakers in building the capacity of government to provide resources citizens need. The World Bank can play a helpful role by providing incentives for firms to invest in building the capacity of governments to govern effectively and responsively.

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