CSR and Public Policy

New Forms of Engagement between Business and Government

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Corporate Social Responsibility Initiative

The Corporate Social Responsibility Initiative at the Harvard Kennedy School of Government is a multi-disciplinary and multi-stakeholder program that seeks to study and enhance the public contributions of private enterprise. It explores the intersection of corporate responsibility, corporate governance and strategy, public policy, and the media. It bridges theory and practice, builds leadership skills, and supports constructive dialogue and collaboration among different sectors. It was founded in 2004 with the support of Walter H. Shorenstein, Chevron Corporation, The Coca-Cola Company, and General Motors.

For Further Information

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The homepage for the Corporate Social Responsibility Initiative can be found at: http://www.hks.harvard.edu/m-rcbg/CSRI/

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ABSTRACT

One of the least researched, yet strategically important issues in the emerging field of corporate social responsibility (CSR) is the relationship between CSR and the public policy frameworks or governance context within which companies are operating – locally, nationally and globally. This interface is likely to come under growing scrutiny in the coming years, both by the supporters and critics of business, and by companies and public policymakers themselves.

As in other aspects of corporate responsibility, compliance with the law and efforts to be accountable and transparent and to 'do no harm' should be the starting point for leading companies. At the same time, as the public problems faced by individual nations and by the international community become increasingly complex and intractable, and pose ever greater risks and opportunities for business, there will be a growing need not only for product and process innovation on the part of companies, but also for institutional and policy innovation on the part of governments, non-governmental organizations, and the private sector.

In 'discharging their responsibilities to their owners', business leaders will increasingly have to concern themselves with the public good – at least those public goods and issues that influence their business risks and opportunities and are likely to affect the success, security and sustainability of the countries and communities in which their companies operate. The ability to identify and prioritize these public goods and issues, and then determine the best strategies for addressing them, either individually or collectively, will be an increasingly important mark of good business leadership in the years ahead – not replacing, but complementing the ability to remain competitive, productive and profitable.

The following paper looks at the challenge for companies operating in situations where there are governance gaps and institutional failures, ranging from repressive and corrupt regimes, to weak public administration, to lack of political will. It illustrates some of the public-private alliances and other institutional innovations that are starting to emerge as a response to these gaps and recommends five actions for companies to consider.

CSR and Public Policy: New forms of engagement between business and government

One of the least researched, yet strategically important issues in the emerging field of corporate social responsibility (CSR) is the relationship between CSR and the public policy frameworks or governance context within which companies are operating - locally, nationally and globally.

CSR can be defined as the way a company manages its overall impacts on and contributions to society through the following three spheres of corporate influence: [1]

(i) **Core business operations and investments –** including the company's governance mechanisms and its activities and relationships in the workplace, the marketplace, and along its value chain, be it local or global. The main contribution that any company can make to society is through carrying out its core business activities in a profitable, productive, ethical and responsible manner. The key goal should be to minimize and account for any negative impacts that may arise from these activities, and to increase and leverage positive impacts and contributions.

(ii) **Strategic philanthropy and community investment** – aimed at mobilizing not only money, but also the company's people, products and premises to help support and strengthen local communities and non-profit partners, preferably in a manner that is aligned with the company's core areas of competence and interest.

(iii) **Public policy dialogue, advocacy and institution building** – efforts by companies, either on an individual or collective basis, to account for their interactions with government, and where relevant, to participate in public policy dialogues and advocacy platforms and to help governments build public capacity, strengthen institutions and deliver public goods.

Although specific impacts and contributions in these three areas will vary depending on the company, industry sector and location in question, all three spheres of influence are relevant for the majority of companies, especially large corporations. While much attention has been focused on the first two areas outlined above, relatively little attention has been paid to the third area by either proponents or critics of CSR.

This is the case even in terms of exploring the relationship between corporate responsibility and traditional business lobbying, political campaign finance, payment of taxes and government relations, let alone new approaches to influencing or addressing public issues such as public-private partnerships, charters and covenants between governments and business groups, multi-stakeholder policy consultation structures, and new governance and accountability mechanisms. [2]

In *The Economist's* critique of CSR in January 2005, author Clive Crook concluded, "Managers, acting in their professional capacity, ought not to concern themselves with the public good: they are not competent to do it, they lack the democratic credentials for it, and their day jobs should leave them no time even to think about it. If they merely concentrate on discharging their responsibilities to the owners of their firms, acting ethically as they do so, they will usually serve the public good in any case. The proper guardians of the public interest are governments, which are accountable to all citizens. It is the job of elected politicians to set goals for regulators, to deal with externalities, to mediate among different interests, to attend to the demands for social justice, to provide public goods and collect the taxes to pay for them, to establish collective priorities where that is necessary and appropriate, and to organize resources accordingly. The proper business of business is business. No apology required." [3]

This would be fine if governments fulfilled all these functions effectively, efficiently and legitimately. Yet, they often fail to do so, especially in times of crisis or when public problems are particularly complex, multi-dimensional, long-term or systemic in nature. This is the case even in stable and democratically elected administrations, let alone in the more fragile governance environments that exist in many transition and developing economies.

As FORTUNE magazine stated in a cover article a few months after Hurricane Katrina devastated America's Gulf Coast, "Government Broke Down. Business Stepped Up. …Hurricane Katrina brought out the worst in Washington and the best in business." [4] The magazine went on to argue, "…that isn't to suggest that corporations can or should supplant government", but the experience of Katrina and similar complex emergencies in recent years illustrates the growing challenge of negotiating boundaries of responsibility between different levels of government, and between government and major corporations. In some cases these companies have built sophisticated risk management, logistics and operational capabilities that match or even exceed government capabilities and capacity.

Focusing on a different, but equally complex issue, Harvard Professor John Ruggie, the UN Secretary-General's Special Representative on Business and Human Rights stated in his interim report to the United Nations Human Rights Council, "The role of States in relation to human rights is not only primary but also critical. The debate about business and human rights would be far less pressing if all Governments faithfully executed their own laws and fulfilled their international obligations." [5] But governments in many countries fail to do this. As a result, the media, activist and even shareholder spotlight has focused increasingly on the role of corporations – ranging from mining and oil to apparel, pharmaceutical, agri-business and information technology companies - in upholding human rights, or at a minimum avoiding complicity in human rights and labor abuses.

The governance challenge is arguably even greater when it comes to tackling trans-boundary issues, those that UN Secretary-General Kofi Annan has described as 'problems without passports'. These include global climate change, health epidemics, immigration, regional conflict, money-laundering and other socio-economic, environmental or political challenges that have existing or potential impacts across national borders and that create business risks or opportunities for a number of industries and companies. In such cases, there is growing recognition that the private sector must engage proactively in the public policy agenda and explore new types of interaction, and in some cases partnership with the public sector at local, national and even global levels.

As McKinsey & Company noted about the results of a 2006 *McKinsey Quarterly* survey, "Although lobbying – often behind closed doors – is as old as business itself, high-level and concerted corporate activism in the social and political arena has been conspicuous by its absence. That deficiency, executives tell us, is the result of short-term financial pressures, a lack of familiarity with the issues, and the sense that specialists in the public-affairs and legal departments handle this sort of thing. Such thinking, we believe, is dangerous and wrong headed. Business leaders must become involved in sociopolitical debate not only because their companies have so much to add but also because they have a strategic interest in doing so." [6]

Björn Stigson, President of the World Business Council for Sustainable Development, commented in a 2006 speech on climate change, "Business must address two separate sustainable development agendas. The first is a *business agenda*, centered on the 'business case for sustainable development'. Even those CEOs who do not believe in sustainable development are doing many things associated with it because they make perfect business sense – besides helping to create a more sustainable world. …The other is a *public policy agenda*, dealing with the framework conditions for business based on government rules and regulations. This agenda is coming our way in business whether we like it or not, and we have to relate to it and manage the different agenda items." [7]

Or as IFPMA (The International Federation of Pharmaceutical Manufacturers and Associations) stated in a recent publication on global health, "Improving the health of the poorer populations in underdeveloped countries presents society with a complex challenge that requires a far larger mobilization of resources, capacities and skills than either the public sector or any single industry can achieve on its own. Public-private partnerships have become a distinctive feature of the healthcare landscape." [8]

In all of these very different examples – responding to complex emergencies, upholding human rights, addressing climate change, and tackling global health challenges - there is little argument that the primary responsibility for action should belong to governments. In today's world, however, resources and influence are usually too dispersed for any one sector to have all the necessary answers, capabilities or legitimacy to implement solutions on their own.

Even when governments are responsive and accountable for serving the needs of their citizens, there is growing debate and experimentation on where and how the private sector might be more effective and efficient in the delivery of public goods, and where and how it can play an appropriate role in the shaping of public policy.

It is particularly difficult for the business community to stand on the sidelines as disinterested observers when there are serious governance gaps or institutional failures. In such situations, especially where the governance context directly undermines or threatens companies' abilities to 'discharge their responsibilities to their owners', business leaders need to respond. At the very least, they need to be able to assess the risks of inaction to the long-term sustainability of their business models.

Companies also need to understand and increasingly account for the impact of their business activities, and their payment of taxes, their lobbying, and their support for political campaigns, on the public policy and governance context in the different locations where they operate. In selective cases, where they deem there is a strategic business risk or opportunity created by this context, they need to have a strategy for active engagement with relevant government entities and for public accountability. Such engagement may occur on an individual or collective basis, with the latter involving industry-wide action or some type of multi-stakeholder coalition.

The role of the private sector in influencing the quality of governance – either national or global - is clearly sensitive. Even when companies act through representative trade and industry associations, many question the mandate and legitimacy of business to influence national governance, let alone to shape global governance frameworks, norms and standards. There is no doubt, however, that companies and business associations do exert often considerable influence over political and governance processes - both transparently and behind closed doors, both for the common good and for vested self-interest, and both positively and negatively - and with all manner of variations between these extremes. The challenge for responsible companies is to ensure that they engage with governments in an accountable manner.

The most effective, appropriate and legitimate response by business will vary depending in part on the industry sector, but also on the type of governance and institutional frameworks that exist in the country or situation in question. As already outlined, the most challenging situations for responsible companies are those where there are serious governance gaps or institutional failures. At the risk of over-simplifying an extremely complex set of conditions and possible scenarios, there are three main types of governance gap that have particularly important implications for CSR and the way companies can respond: [9]

(i) Bad Governance

This relates to governments that are repressive, unaccountable to their citizens and/or corrupt. At a minimum, they put their own interests above those of their citizens and in many cases actively undermine the human rights, economic opportunities and aspirations of the people they are governing. They are often, but not always, undemocratic. Wealth is usually highly concentrated, rent seeking is common, and allocation of productive resources is characterized by cronyism, inequity and lack of transparency. Corruption is usually widespread and endemic.

Many companies avoid investing in such regimes, but where strategic natural resources are located in these countries, or where a situation seriously deteriorates, Zimbabwe being a good example in recent years, companies must decide whether to invest/remain or disinvest. If they invest or remain, they are under increasing pressure to publicly account for the impacts of their own activities and to participate in new types of multi-stakeholder governance and accountability mechanisms to minimize any negative impacts. They need to grapple with the challenge that 'normal' business activities that may be benign or low-impact in locations where there is good governance and strong public institutions could have highly negative 'knock-on' effects in a context of bad governance. If they chose to disinvest, then they must decide how best to protect and support their local employees and consider the impact of their departure on local communities.

An emerging development that is likely to challenge western multinationals operating in some of the most difficult parts of Africa, Asia, Latin America and the Middle East, from both a competitive and corporate responsibility perspective, is the dramatic increase in Chinese and other southern multinationals starting to make major investments in these countries. These new players don't face the same civic activism, reputation threats and legal challenges in their home countries as their western counterparts when it comes to accusations of human rights and environmental abuses. Finding ways to create a 'level playing field' in terms of standards and to share good practices will be difficult but increasingly important. The Financial Times has commented, "There is a risk that the blooming Chinese relationship [with Africa] will undermine efforts by some African leaders and the desires of western partners to promote more responsible government, transparency and sharing of revenues. …China's rise as an economic power is a great chance for the continent. But Africa needs to use it wisely."[10]

Examples of new types of accountability mechanisms, accreditation schemes, and standards and guidelines that have been developed collectively by groups of companies, often in partnership with governments and other actors, aimed at improving the quality of governance and minimizing the negative impacts of private investment in such situations include the following:

Initiatives focused on improving both public and corporate governance

- **The Extractive Industry Transparency Initiative (EITI)** – Established in September 2002, EITI aims to improve the transparency of revenues generated by extractive projects and to stimulate wider dialogue within developing countries about public expenditure priorities. Partners include donor and developing country governments, the World Bank, oil, gas and mining companies and civil society organizations. Increasing transparency will empower citizens and institutions to hold governments to account and make mismanagement or diversion of funds away from development purposes more difficult. Such an initiative has relevance for other industries where large amounts of resources are exchanged between the public and private sectors.

- **Integrity Pacts** – These are country-based mechanisms or tools piloted by Transparency International aimed at preventing corruption in public procurement. They are based on an agreement between a government institution and all bidders for a public sector contract outlining a set of operational, bidding and disclosure standards that all parties agree to adhere to in the bidding process, along with sanctions for non-compliance. Although still limited in coverage, Integrity Pacts have been demonstrated to work in a number of legal and political settings.

Initiatives focused on improving corporate practices

- **The Equator Principles:** Created in 2003 by the International Finance Corporation and an initial group of ten banks from different countries with the aim of providing a social and environmental screening tool for major project finance deals, the participants in the Equator Principles now account for over 80% of relevant deals in developing countries and include financial institutions from over 20 countries.

- **Commodity supply chain standards and certification schemes:** These include initiatives such as The Kimberley Process for diamonds; The Forest Stewardship Council; the Marine Stewardship Council; the World Cocoa Foundation; and the Coffee Partnership.

- **Manufacturing supply chain standards:** Initiatives in this area include the Fair Labor Association; the Ethical Trading Initiative; SA8000; the International Council of Toy Industries' ICTI Care Process; The Electronic Industry Code of Conduct.

- **The Business Principles for Countering Bribery** – Launched in 2002, these principles were developed by Transparency International in partnership with Social Accountability and a steering committee drawn from companies, trade unions, academia and other non-governmental organizations. They offer a practical tool and framework for companies in different sectors to implement anti-bribery programs.

- **Wolfsberg Group -** Initiated in 2000, with input from Transparency International, this is a network of twelve global banks, which aims to develop industry standards and related products for Know Your Customer, Anti-Money Laundering, and Counter Terrorist Financing policies.

(ii) Weak governance

A second type of governance gap or failure relates to governments that lack the necessary institutional or administrative capacity and financial, human or infrastructural resources to effectively serve the needs and aspirations of their citizens. Often this is the result of more responsible leaders succeeding one or more generations of bad governance and needing to overcome years of underinvestment in public services and degradation of institutional and physical infrastructure – and in some cases facing the challenge of rebuilding a failed state after periods of conflict and political turmoil. In such situations, the challenge is to actively support these governments in building or strengthening the institutions needed to better serve their citizens.

Although institution building is primarily a function of governments and donors, the private sector can play a helpful role, especially in the area of building economic and financial institutions, but also helping to strengthen education, health and even justice systems. Examples where companies have played such a role include the following:

- **Strengthening the criminal justice system in South Africa:** South Africa's National Business Initiative (NBI), which consists of over 150 domestic and foreign companies, has been working in partnership with the South African government to undertake a national project involving the sharing of technology, financial support, managerial expertise and planning skills, to help the country's criminal justice system become more modern, efficient and integrated.

- **The Netherlands Financial Sector Development Cooperation:** In July 2004, the Dutch government's Ministries of Foreign Affairs, Economic Affairs, and Finance, entered into a cooperative agreement with ABN Amro, ING, Fortis, Rabobank, and the Netherlands Development Finance Company (FMO), to combine their expertise to stimulate the financial sector in developing countries, emerging markets and transition economies. The cooperation fits with the Dutch government's aim to involve the business community more in the execution of Dutch development assistance, and the government and banks will each bear half of the costs of the initiative.

- **Strengthening health and education institutions in Africa, the Middle East and Latin America:** In a number of countries companies are working with host governments, donors and NGOs to support efforts aimed at improving the delivery capacity and quality of public health and education systems. ExxonMobil for example is supporting the *Africa Health Initiative*, focused on building systems capacity to tackle malaria in a number of African countries; Abbott Laboratories is working with the government of Tanzania, Axios Foundation and Muhimbili Hospital on the *Tanzania Care* program to improve capacity of the country's main referral hospital; Merck is working with the Bill and Melinda Gates Foundation and Botswana Government on the *African Comprehensive HIV/AIDS Partnership* (ACHAP); in South Africa, Nigeria and Guatemala, Chevron is working with a variety of government, business and NGO partners to scale-up national efforts to address road safety via the *Arrive Alive* initiative; Pfizer's *Infectious Diseases Institute* in Uganda is starting to train health professionals from around Africa; the National Business Initiative in South Africa is helping to improve administrative capacity in hundreds of public schools through its *Educational Quality Improvement Programme*; and in Brazil the American Chamber of Commerce is working with some 3,000 Brazilian and foreign companies and the Brazilian government to support a similar project, *Instituto Qualidade no Ensino*, which is reaching about 5,000 schools.

(iii) Indifferent governance or lack of political will

This type of governance gap relates to governments in both developed and developing countries that may be democratically elected and relatively well-resourced, but are overly influenced by special interest groups and/or lack the political will when it comes to tackling certain major economic, environmental or social challenges. Examples might include: failure to remove market distortions to pro-poor growth such as agricultural and other subsidies; failure to prioritize economic, education and health infrastructure in national budgets over non-productive public interventions or military spending; and failure to prioritize what the business community considers to be strategic environmental, social and economic risks or responsibilities in areas such as climate change and international development. Examples of advocacy or new models of partnership initiated by European and American business leaders in these two areas include the following:

- **Corporate and investor advocacy on climate change:** Initiatives such as the *US Climate Action Partnership (USCAP);* the *Climate Group*, the *Investor Network on Climate Risk* and the *Energy and Climate Programme* of the World Business Council for Sustainable Development, are playing an increasingly important role in putting climate change more firmly on the public policy agenda in the United States and elsewhere.

- **Corporate advocacy for international development and poverty reduction:** In the United States, the *Initiative for Global Development* has mobilized over 200 American business and civic leaders to publicly call on the government to, 'make the elimination of extreme global policy a priority'. In the UK, *Business Action for Africa*, has brought together over 50 companies and business networks to share good practices, and mobilize public awareness, political support and private resources for African development. Within developing countries themselves, more business groups are starting to engage proactively with their governments in the development of national growth and poverty reduction strategies.

In summary, good governance is one of the essential foundations on which sustained economic growth and poverty reduction are based. As part of the emerging corporate social responsibility agenda, companies and business associations are playing a more proactive and influential role in shaping governance structures and public policies, not only as they relate directly to economic growth and private sector development, but also to support the achievement of broader economic, social and environmental goals.

There is no doubt, however, that the major responsibility for avoiding bad governance, strengthening weak governance, and aligning political will with public interests rests with governments themselves – at the local, national and global level. It is important that companies and business associations are clear in terms of what they can and cannot do when it comes to addressing governance gaps and institutional failures, and that they manage the expectations of their stakeholders in this regard. It is also important to ensure that their engagement on public policy issues is accountable, transparent, and consistent with their business strategy and CSR activities and statements.

Companies that aim to be leaders in the field of corporate responsibility need to review their policies and practices in the following areas:

1) Ensure greater internal dialogue and coherence between CSR departments and government relations and public affairs teams. This may include the establishment of an internal cross-functional senior management team to address key public policy and CSR issues in a more integrated manner.

2) Integrate CSR and public policy issues at the board level, for example through establishment of a board sub-committee that has responsibility for ensuring a more holistic governance structure and overview of these issues.

3) Identify and publicly communicate the company's positions on key public policy issues that represent specific risks and/or opportunities to the company and/or its industry sector. Such communication can range from public policy sections on company websites and in sustainability reports, to CEO speeches and statesmanship.

4) Establish external, independent stakeholder advisory groups or host stakeholder forums to serve as a 'sounding board' - and in some cases an additional accountability or assurance mechanism - for the company on particularly sensitive public policy issues or concerns.

5) Create new types of public-private partnership and leadership alliances, either collective industry-wide initiatives or multi-stakeholder partnerships, to tackle

complex and systemic challenges that no one company or industry sector can address on its own.

The interface between CSR and local, national and global governance and public policy agendas is likely to come under growing scrutiny in the coming years, both by the supporters and critics of business, and by companies and policymakers themselves. As in other aspects of corporate responsibility, compliance with the law and efforts to be accountable and transparent and to 'do no harm' should be the starting point for leading companies. At the same time, as the public problems faced by individual nations and by the international community become increasingly complex and intractable, and pose ever greater risks and opportunities for business, there will be a growing need not only for product and process innovation on the part of companies, but also for institutional and policy innovation on the part of governments, companies and non-governmental organizations.

In 'discharging their responsibilities to their owners', business leaders will have no choice but to concern themselves with the public good – at least those public goods and issues that directly influence their business risks and opportunities and are likely to affect the success, security and sustainability of the countries and communities in which their companies operate. The ability to identify and prioritize these public goods and issues, and then determine the best strategies for addressing them, either individually or collectively, will be an increasingly important mark of good business leadership in the years ahead.

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