Department for International Development

The Department for International Development (DFID) is the UK Government department responsible for promoting sustainable development and reducing poverty. The central focus of the Government's policy, based on the 1997 and 2000 White Papers on International Development, is a commitment to the internationally agreed Millennium Development Goals, to be achieved by 2015. These seek to:

- Eradicate extreme poverty and hunger
- Achieve universal primary education
- Promote gender equality and empower women
- Reduce child mortality
- Improve maternal health
- Combat HIV/AIDS, malaria and other diseases
- Ensure environmental sustainability
- Develop a global partnership for development

DFID's assistance is concentrated in the poorest countries of sub-Saharan Africa and Asia, but also contributes to poverty reduction and sustainable development in middle-income countries, including those in Latin America and Eastern Europe.

DFID works in partnership with governments committed to the Millennium Development Goals, with civil society, the private sector and the research community. It also works with multilateral institutions, including the World Bank, United Nations agencies, and the European Commission.
DFID has headquarters in London and East Kilbride, offices in many developing countries, and staff based in British embassies and high commissions around the world.

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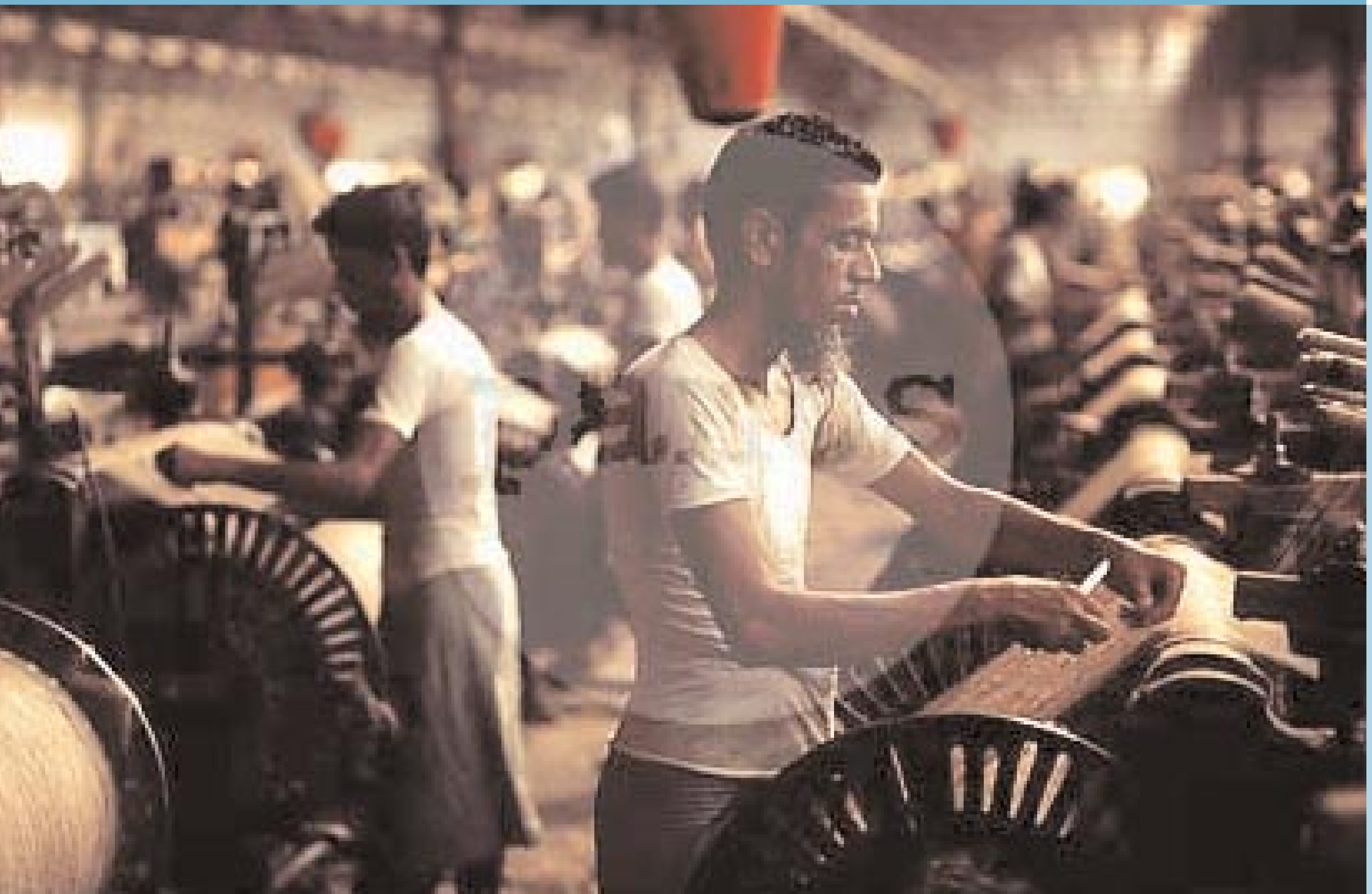
DFID Department for International Development

DFID and corporate social responsibility

DFID and Corporate Social Responsibility: An Issues Paper

"Foreign investors can contribute to economic growth through capital, technology transfer, access to specialised skills, and through their ability to integrate production across several countries. Those businesses that are committed to socially responsible practices can have an even greater impact. They can reinforce the poverty reduction strategies of the country in which they are operating, contribute to environmental sustainability and promote core labour standards and human rights."

Valerie Amos, Secretary of State for International Development



Introduction

The private sector is sometimes seen as the enemy of the poor. However, it plays an important role in the economic growth that is essential to reducing world poverty. As well as driving economic growth, the private sector can have a direct effect on poverty through its own policies and practices. More and more businesses and governments recognise its critical role in international development.

The 1990s started to change the way we looked at business and development. The Rio Earth Summit in 1992 helped to promote the concept of 'sustainable development' where economic progress should not come at the cost of using up irreplaceable natural resources and polluting the planet. 'Eco-efficiency' started to become a guiding principle for some businesses and governments alike. During the late 1990s, campaigns against the private sector, plus actions by the voluntary sector and shareholders, increased public interest in the behaviour of businesses. But at the beginning of the 21st century, many people do not trust corporations. The recent negative publicity in the US over how corporations are run has led more people to question of the role of business in society. At the same time, people are more aware that the private sector must play its part in reducing poverty.

The past decade has seen fundamental changes in the way we work with the private sector. In 1997 we ended the 'Aid and Trade Provision' scheme that helped UK businesses by providing credits and low-interest loans. Since April 2001, UK aid has been 'untied'. This means that recipient governments or agencies do not have to buy exports from the UK to qualify for our development assistance. We estimate that this has increased the impact of UK aid by 10% -20%. We are looking at new ways of working with the private sector. Promoting 'corporate social responsibility' can open up the wider discussion about the contribution international businesses make to sustainable development.

Guide to sections

This paper outlines our approach to corporate social responsibility. It is in four sections.

What is Corporate Social Responsibility and what drives it?

What is Corporate Social Responsibility?

Different organisations have different definitions of corporate social responsibility, although there is much common ground. Definitions generally focus on how companies manage their core business to add social, environmental and economic value in order to produce a positive sustainable impact for both society and for the business. Terms such as 'socially responsible business' and 'corporate citizenship' are used to mean the same thing. We will use the term corporate social responsibility throughout this paper. Our wider analysis of how the private sector – domestic and foreign – can contribute to development is set out in Chapter 4 of the White Paper on International Development 'Making Globalisation Work for the Poor'.

There is no blueprint for corporate social responsibility, but there are common themes amongst responsible companies:

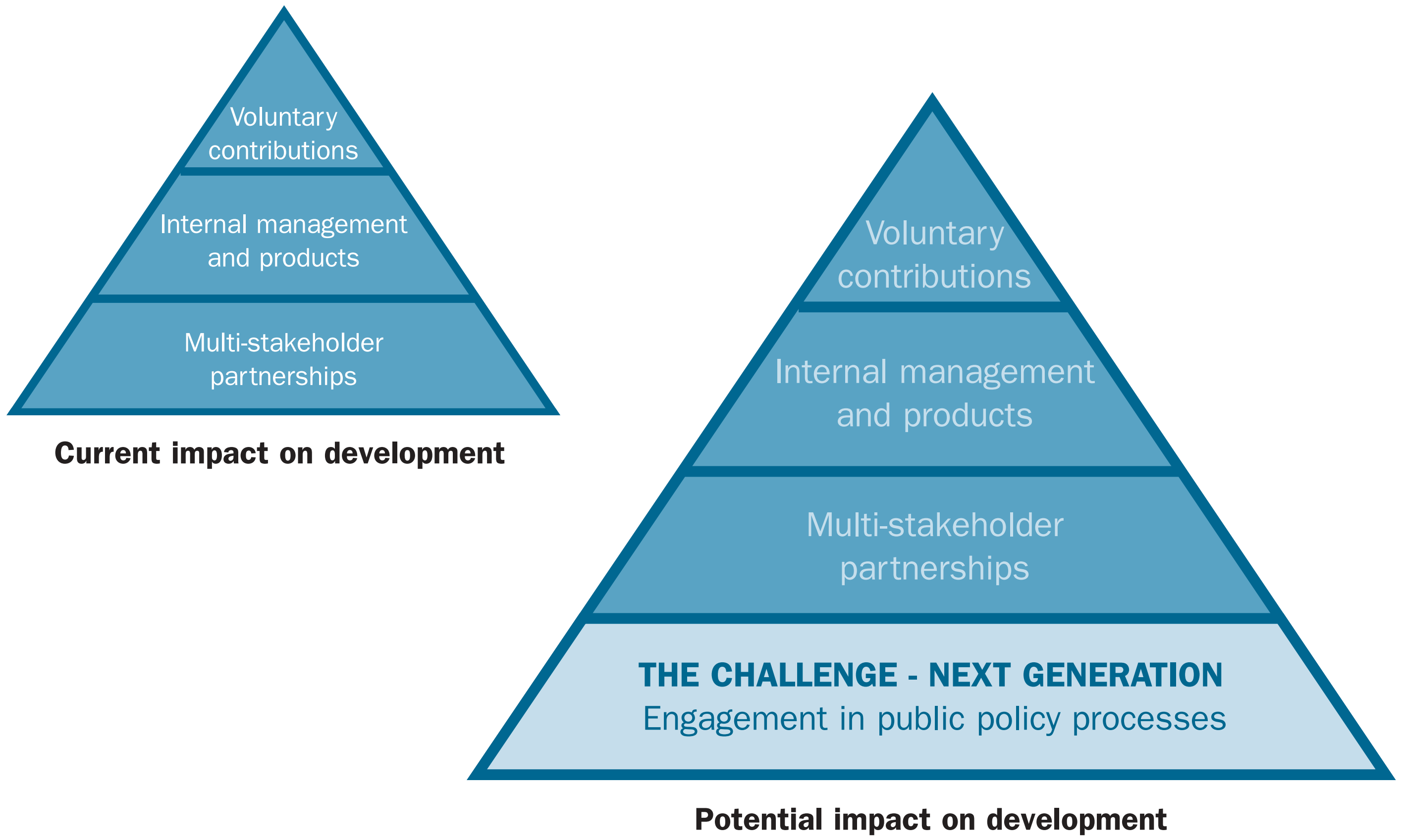
- The Board is committed to and promotes corporate social responsibility.
- Local laws and tax rules are followed.
- Stakeholders' opinions are taken into account.
- There are high labour standards and measures to protect the environment.
- Their economic, social and environmental performance and impact, is monitored and reported to the public.
- There is a high standard of employee training and steps aimed at raising awareness of the company's responsibility.

Here we describe three situations: investing directly in developing countries, buying goods and services from developing countries, and selling goods and services to developing countries.

Investing directly in developing countries: We encourage businesses that invest directly in developing countries at a minimum, to comply with the various international, national and industrial regulations and codes of conduct. These range from the Organisation for Economic Co-operation and Development (OECD) Guidelines for Multinational Enterprises at the international level (see box 5), to tax and bribery laws in individual countries, to industry-wide codes such as the Extractive Industries Transparency Initiative (see box 1). If there are obstacles to businesses behaving responsibly in this way (eg. corruption, bureaucracy, lack of infrastructure, and lack of a healthy and skilled workforce), we would like businesses to use their influence with governments to help demolish these barriers. This is distinct from conventional corporate philanthropy, which might give a company visible, easy gains, but is not likely to provide long-term local benefits. Businesses, civil society, governments, and development agencies should work together to improve infrastructure and services. By working together, they can each use their core competencies to help overcome these obstacles.

Figure 1 illustrates this process. It shows how businesses contribute to developmental impact through their philanthropic activities at the top of the triangle, through their core operations (production, employment, knowledge, taxes, etc.), and through their multi-stakeholder partnerships. These are sometimes referred to as the three generations of corporate social responsibility. We argue that the lower down the activity is in the triangle, the greater its long-term impact on development. In the right-hand triangle, we show how not only is there a greater potential impact when companies undertake a 'fourth generation' activity - to engage with governments in the wider public policy issues - but also improved public policy can in turn magnify the contribution of the other business impacts to development.

Figure 1: **The impact of business on development** (adapted from Unilever, 2001)



Companies working in areas where there is conflict can take this approach. Economic and social development, good governance, human rights, and accessible justice are fundamental to preventing armed conflict. Businesses have a major interest in advancing these objectives. The ways in which businesses can help to prevent war are complex. However, they can often help to solve problems that sometimes lead to conflict, such as unemployment, by creating jobs and managing skills and technology transfer. They can also follow agreed guidelines on the behaviour of international firms in conflict zones. These include the OECD Guidelines for Multinational Enterprises and the United Nations Global Compact (see box 5). The UK Government is working to strengthen such international agreements and encourage more companies to keep to them. We are researching the economic causes and consequences of conflict and promoting international action such as the Extractive Industries Transparency Initiative (see box 1) to engage companies in the public policy process and to start to cut the links between the exploitation of mineral and natural resources and violent conflict.

Box 1: **The Extractive Industries Transparency Initiative (EITI)**

The Extractive Industries Transparency Initiative (EITI), announced by Tony Blair at the World Summit on Sustainable Development, brings businesses, governments, international agencies, and non-governmental organisations (NGOs) together to promote transparency over payments in the extractives industry. Oil, gas and mining industries have been important engines in driving growth in countries such as Botswana, which has used the wealth from its diamonds to lift itself into the middle-income bracket and its citizens out of poverty. However, in many countries, natural wealth has led to conflict and poverty. Of the world's 20 most mineral-dependent states, 11 are heavily-indebted poor countries and five have had civil wars since 1990.

The key challenge is to make sure that natural resources and the wealth from them are governed well. Adopting open and accountable systems for making and recording payments and incomes in this sector would be an important step in overcoming this challenge.

Governments of developing countries would find it easier to attract quality investment from abroad and borrow at a lower cost. Investors and international financial institutions may be more willing to offer financial and technical help. Citizens could hold their leaders accountable for money received and governments could use the information to help make sure companies keep to tax regulations. Companies also stand to gain. They could benefit from a more level playing field, a more predictable business environment and reduced risk of political instability and armed conflict. Instead of being associated with government corruption, they could improve their reputations by making their legitimate payments publicly known. The UK Government is committed to working with others to take this initiative forward.

Buying goods and services from developing countries: For businesses buying goods and services from developing countries, the situation is different. More responsible businesses are committed to meeting labour and environmental standards throughout their supply chain, but they also recognise that if these standards are applied too crudely, they might rule out producers in poor countries. For this reason, companies supplying goods and services from developing countries have started to make their trade more 'ethical' (see box 2).

Box 2: **Ethical Trade and Fair Trade**

Ethical Trade and Fair Trade are two approaches to managing the supply chain.

Ethical Trade refers to practices throughout the supply chain that promote and protect core labour and environmental standards and human rights. Many major companies are developing their own strategies and codes of conduct on ethical trade, and their supply chains are independently monitored. Leaders in the field, such as members of the Ethical Trading Initiative (see section three), encourage independent monitors to visit their suppliers, identify conditions that do not meet the code, and then plan improvements in agreement with suppliers. The members of the Ethical Trading Initiative have a combined turnover of more than £100 billion a year.

Fair Trade is a distinct, niche market for specially labelled products that meet international standards agreed by the Fairtrade Labelling Organisation. These standards aim to give disadvantaged producers in developing countries better trading terms and guarantee them a minimum price above that offered by mainstream markets. Fair Trade arrangements also provide a 'premium' to producers to be used for projects aimed at developing the community.

At the moment, only a narrow range of products (including coffee, tea, chocolate and bananas) may carry the Fair Trade label and the size of the UK's Fair Trade market, despite recent growth, remains small (£63 million in 2002). Fair Trade has played an important role in raising awareness of, and interest in, ethical trading claims and helped to highlight the growing demand for businesses to demonstrate their commitment to corporate social responsibility.

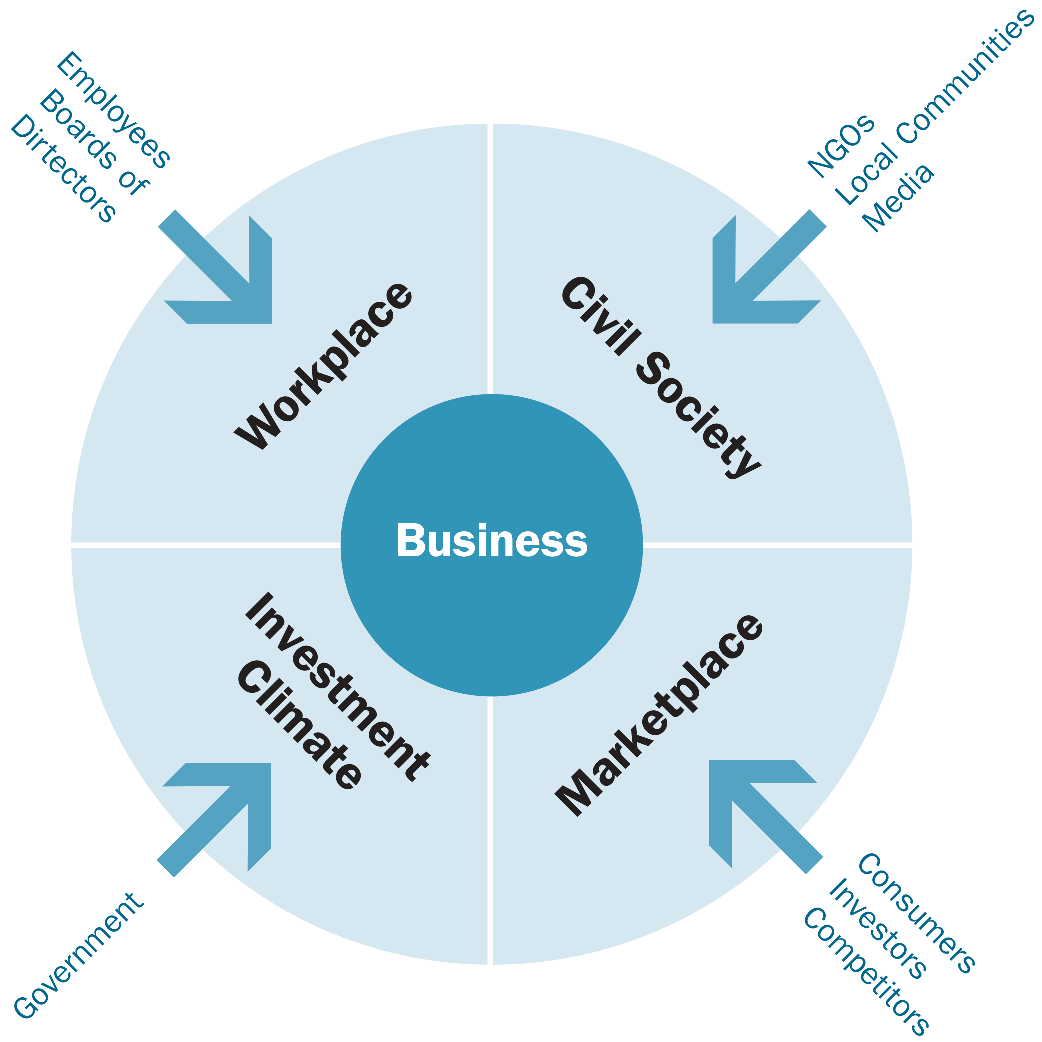
Selling goods and services to developing countries: Finally, there are companies who sell goods and services to developing countries. Two-thirds of the world's population live in developing countries. 90% of the two billion people who will be born between now and 2020 will be born in developing countries. So the poor clearly represent a huge market for goods and services. Traditionally, businesses do not consider it worthwhile to market services to the poor because of their low ability to pay. However, evidence shows that responsible businesses that extend their activities to developing countries can increase the size of their markets as well as helping to reduce poverty.

For example, when a company in India began making soap powder affordable by using simple technology and low-cost manufacturing, they created a new and profitable business. This forced a large multinational firm to launch a rival low-cost product and to change its view that there was little profit from serving the poor. The focus on distributing the product to rural areas also helped strengthen the distribution chain to these areas and helped them to become part of the market economy.

What is driving corporate social responsibility?

More and more companies recognise that corporate responsibility is not only morally right, but that it also makes good business sense. There are four forces driving corporate social responsibility: the consumers, the investment climate, civil society and the workplace.

Figure 2: **Drivers of corporate social responsibility**



In theory, a dynamic market process is at work. The initial pressure for businesses to adopt corporate social responsibility comes mainly from consumers and society. These pressures then bring corporate social responsibility into the mainstream of a company's activity. The business benefits through higher productivity and quality, and improved relationships with suppliers. The financial markets reward the company. As the company reaps the rewards, this puts pressure on their competitors to do likewise (see box 3). Leading companies then go further and their competitors are forced to follow.

However, this does not always happen. A lack of accurate information or open competition, or distortions from subsidised sectors, can lead to a breakdown in the market-led process. In developing economies, there is not usually the right environment for competitive business, and it is difficult to enforce regulation governing business practices. Foreign capital does not always bring benefits to the poor. For instance, the so-called 'resource curse' of oil has brought more misery than shared wealth to Nigeria and Angola. Huge foreign investment in Russia and Brazil has had little impact on the poor of those countries.

Governments and development agencies can do a lot to make sure conditions are right not only for investment, but also for making investments more responsible. Businesses can also act responsibly in different situations where foreign capital has distorted political processes. Governments and development agencies can:

- **Regulate** against persistent poor performance or towards increased openness;
- **Facilitate** processes, information and cooperation to bring about changes to help the poor;
- **Form partnerships** with businesses and civil society, where each partner uses its specific skills or knowledge to tackle problems; and
- **Endorse** best practice and transparency.

Box 3: **Investors – driving corporate social responsibility**

Institutional investors can have a major influence on multinational companies. For this reason, 'socially responsible investment' (where investment decisions are based on a company's social and environment policies and performance) is one of the most powerful ways of embedding corporate social responsibility into businesses. Assets held under socially responsible investment in the UK amounted to some £225 billion in 2001, making it the fastest growing type of investment, although its share of all investments remains low. There are three broad approaches to socially responsible investment:

- ethical investing where investors screen out companies engaged in activities they have ethical objections to (such as the tobacco and pornography industries);
- positive screening where investors try to invest in companies with the best environmental, social or ethical performance in their type of industry; and
- investors using their rights as shareholders to encourage companies to improve their performance, but without screening.

We welcome the recent rise in popularity of the third approach. In comparison to screening, the third approach allows investors to influence the behaviour of a larger number of industries and companies. It may also prove more attractive to investors with diversified portfolios and it avoids inappropriate screening that could harm the poor. However, none of the existing socially responsible investment funds promote poverty reduction. Many investors believe that if poverty reduction criteria were offered alongside existing socially responsible investment criteria, there would be a market for it.

Section Two

The links between corporate social responsibility and poverty reduction

The roles of businesses and government should not be confused. Businesses can help harness the natural and human resources of a country in order to generate wealth, but governments must make sure that wealth is shared out in a fair way. Companies must pay local taxes, so governments can receive the income they need to deliver services to their people.

Businesses can help to reduce poverty:
- by investing, producing, and paying wages and taxes, they can contribute to growth;
- by respecting labour standards and encouraging local sourcing, they can contribute to pro-poor growth; and
- by creating jobs, providing skills and training, and producing products that meet the needs of the poor, their operations can have a direct impact on the poor.

However, there are some genuine concerns that corporate social responsibility can disadvantage the poor. The following risks need special attention:
- Socially responsible practices **should not replace local laws,** let alone prevent businesses complying with them. Ultimately it is effective institutional, regulatory and legal frameworks, including appropriate tax systems, which will deliver the greatest benefit to most poor people.
- **Prescriptive corporate codes of conduct,** or sudden action which does not involve suppliers **may not be appropriate for local conditions.** For example, banning child labour without taking any action to increase levels of income of their families and educational opportunities for the children could drive children into worse conditions in the informal or illegal sectors.
- In the worst cases, **inappropriate codes of conduct become a form of protectionism** that prevents goods from the South being sold in the North. Exporters in developing countries can find the proliferation of regulations and standards hard to comply with. They often fear that ‘process standards’ on the way products are made (such as the standards on labour, the working environment or animal welfare) will lock their products out of developing country markets.
- Many non-government organisations, consumers and investors have put pressure on multinational enterprises to withdraw from countries with poor human rights records. For example, as part of its ethical investment policy, one US pension company pulled their investments out of a number of South East Asian countries because of their poor track record on labour standards. **Instead of withdrawing investments, principled engagement can help poor people** and so help to bring about change.
- The **costs associated with following ethical codes of conduct vary.** If a company buying goods from overseas pays the cost of monitoring working conditions, they may favour larger suppliers, who are easier to monitor, and exclude small-scale producers. Setting up joint monitoring systems, sometimes with suppliers, local non-government organisations and trade unions, can reduce this danger.

Section Three

The Government’s role

Legislation and voluntary initiatives

There has been much debate about the role of legislation in driving forward corporate social responsibility. To play their full part in eliminating world poverty, international businesses will have to behave more responsibly than they have done in the past. This will require a mixture of voluntary and mandatory measures. But it will also need businesses to do more than just keep to the laws, regulations and codes of conduct. That is why the UK Government is working to make sure that regulations encourage corporate social responsibility and do not stifle it. International legally-binding frameworks for multinational companies may divert attention and energy away from encouraging corporate social responsibility and towards legal processes. Current laws (see box 4) emphasise making company information available, especially information on corporate policy and practices. The laws are designed to complement voluntary initiatives to encourage corporate social responsibility.

We also need to work more with businesses and non-government organisations to turn existing initiatives into effective action, and to promote transparency. Partnerships between businesses, non-government organisations, governments, and trade unions, can be effective in most sectors (our own experience points to good lessons in the retail, extractives and water sectors). We also need to encourage countries to sign up to existing international agreements, particularly, the OECD (Organisation for Economic Co-operation and Development) Guidelines for Multinational Enterprises and the ILO (International Labour Organisation) Core Conventions on labour standards (see box 5).

Box 4: **UK Laws relating to corporate social responsibility**

2000 Amendment to the Pensions Act: In July 2000, the UK passed a law requiring occupational pension funds to disclose the extent to which they take account of social, environmental or ethical issues in their investment decisions. A number of other countries have followed the example set by the UK.

www.legislation.hmso.gov.uk

The 2002 White Paper on Company Law: Drawing on the recommendations of the Company Law Review, the 2002 White Paper on Company Law asks whether all UK–based companies with a significant turnover should have to reveal, where material, their policies and performance relating to environmental and social issues.

www.dti.gov.uk

The Organisation for Economic Co-operation and Development (OECD) Convention on bribery of foreign public officials: In accordance with this convention, the UK has passed a law that makes it illegal for a UK citizen or company to bribe someone overseas. This new law should not disadvantage British companies, as all 10 major exporters in the OECD now have similar laws. The law will also give British companies a stronger defence against attempts to extort bribes from them.

www.oecd.org

Box 5: **International Agreements**

The OECD Guidelines for Multinational Enterprises: The UK Government has signed up to these Guidelines which set out recommendations for good corporate behaviour. The recommendations chiefly apply to the global operations of enterprises based in the 30 member countries. The Guidelines include recommendations on employment, industrial relations, human rights, health and safety, bribery and the environment.

www.oecd.org

The Core Conventions of the International Labour Organisation (ILO): These core conventions cover areas such as freedom of association, abolition of forced labour, equality and child labour. In the 1998 Declaration on Fundamental Principles and Rights at Work, all states that are members of the ILO agreed that they would respect the standards in the conventions, even if they were not yet able to ratify them. Many multinational companies have developed codes of conduct that draw on the declaration and core conventions.

www.ilo.org

The UN Global Compact: The Global Compact is made up of organisations that have signed up to a set of universal principles based on human rights, labour standards and the environment. It is not a regulatory instrument or code of conduct. It disseminates good practice based on universal principles.

www.unglobalcompact.org

How do we promote corporate social responsibility?

We support initiatives that promote corporate social responsibility practice in ways that reduce poverty and support growth. Some of these initiatives are set out below. We also work across Whitehall and with other development agencies to ensure more coherent and poverty-reducing international action on corporate social responsibility.

The Ethical Trading Initiative (ETI): This alliance of UK retail companies, non-government organisations and trade unions works to improve labour conditions in country supply chains of its corporate members delivering goods to consumers in Britain. We helped to set up the ETI in 1998 and have supported and worked closely with it since then. The combined annual turnover of corporate members amounts to over £100 billion and is expected to rise significantly as more large UK companies sign up to join. The employment standards adopted by ETI members are international standards that come from the Core Conventions of the International Labour Organisation. ETI members visit their suppliers, identify conditions that do not meet the ETI Base Code, and then plan improvements in agreement with their suppliers. Members also take part in projects that aim to test out techniques of implementation and monitoring of the Base Code. Examples of these projects include the wine industry in South Africa and horticulture in Zimbabwe.

www.ethicaltrade.org

Extractive Industries Transparency Initiative: See box 1. At the World Summit on Sustainable Development, in Johannesburg 2002, Tony Blair called upon natural resource rich governments, extractive companies, international agencies and non-government organisations to work together to promote transparency of payments in the extractives industry. The Extractive Industries Transparency Initiative aims for openness in the payments by companies to governments and government-linked entities, as well as transparency in revenues by host country governments.

www.dfid.gov.uk

Business Partners for Development (BPD): Between 1998 and 2002, BPD (led by the World Bank) has studied, supported and promoted examples of businesses, civil society and governments working together to develop communities around the world. The BPD programme showed that these ‘tri-sector partnerships’ can benefit the long-term interests of businesses while meeting the social goals of civil society and the government by helping to create stable social and financial environments.

www.bpdweb.org

Developing country government capacity for corporate social responsibility: This project is funded partly by us and managed by the World Bank. The purpose of the project is to build the capacity of governments in developing country to set up frameworks to encourage corporate social responsibility and to develop voluntary codes and standards related to sustainability. The project aims to build on the lessons learned and tools developed through Business Partners for Development.

www.worldbank.org

Poverty elimination, competitiveness and corporate responsibility: We are supporting work by AccountAbility to carry out research into on the links between poverty elimination, competitiveness and corporate responsibility. This project will also look at the public policy implications of corporate responsibility, and help build international capacity to address these issues.

www.accountability.org.uk

Just Pensions: Just Pensions was set up after the UK Pensions Act amendment in June 2000, under which all occupational pension funds must state the extent to which they take account of social, environmental and ethical issues in their investment decisions. Just Pensions is a learning and advocacy institution aimed at promoting the links between these socially-responsible investment decisions and international development and to encourage trustees to use their influence to persuade fund managers to invest in socially responsible enterprises, which benefit the poor. We are funding a three-year programme focusing on engagement and advocacy, research and dissemination, trustee training, European engagement and public-policy change.

www.justpensions.org

Pro-poor Investment Reporting: We have funded research carried by Emerging Market Economics, on how to measure and report the contribution businesses make to reducing poverty. We are also funding further work to develop sector-by-sector reporting guidelines on poverty impact.

www.emergingmarkets.co.uk

Business Links Challenge Fund (BLCF): The BLCF awards grants to enterprises that help develop sustainable business links with companies in developing countries.

www.challengefunds.org

Financial Deepening Challenge Fund (FDCF): The FDCF awards grants to private sector financial institutions that are committed to increasing access to financial services for the poor and businesses that employ the poor.

www.challengefunds.org

Fair Trade: We have supported Fair Trade initiatives for a number of years, through direct support to the Fair Trade movement, development education in the UK, and its overseas programmes.

www.fairtrade.org.uk

Projects in Developing Countries

We support several projects in developing countries that deal with corporate social responsibility issues unique to that area, and we pass on any lessons learnt to the wider business audience.

- **NEPAD Business Group in Africa:** We provide funding for a joint project between the Commonwealth Business Council and New Partnership for African Development (NEPAD) to encourage the private sector to work with the NEPAD programme of action, and stimulate the increased domestic and foreign investment required for NEPAD to succeed.

  www.nepad.org

- **Kenyan Business Partnerships Programme (BPP):** BPP focuses on improving productive opportunities and living conditions for the poor by supporting the development of corporate social responsibility and promoting ethical trading. This programme, funded by us and run by the Kenya Federation of Employers, encourages businesses to incorporate corporate social responsibility principles into their core business processes and to carry out corporate social responsibility audits.

  www.dfid.gov.uk

- **Chinese State-Owned Enterprise Restructuring and Enterprise Development Project:** This project aims to develop and facilitate the replication of effective approaches to socially responsible state-owned enterprise restructuring and enterprise development as a contribution to poverty reduction in China. The project builds up the understanding and capacity to operationalise corporate social responsibility in the Chinese context.

  www.dfid.gov.uk

- **International Alert's Business and Conflict Project in Azerbaijan:** We provide funding for International Alert's work in Azerbaijan to promote peace through the practices, principles and policies of extractive multinationals in partnership with international agencies, governments and civil society.

  www.international-alert.org

Section Four

Further information

Who to contact

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visit the DFID website at **www.dfid.gov.uk**

The UK Government's website at www.societyandbusiness.gov.uk is dedicated to corporate social responsibility. It contains the Government Annual Report on corporate social responsibility.