

Corporate Responsibility

PRIVATE INITIATIVES
AND PUBLIC GOALS

GOVERNANCE



Corporate Responsibility

PRIVATE INITIATIVES AND PUBLIC GOALS



ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

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Foreword

This report contains the information and analysis developed for a project on private initiatives for corporate responsibility that was commissioned by the Committee for International Investment and Multinational Enterprises. Chapter 3 of this publication – which describes the contents of 256 corporate codes of conduct – was also commissioned by the Trade Committee.

The report has benefited from contributions by Kathryn Gordon and Maiko Miyake. Barbara Fliess made important contributions to Chapter 3. Fabienne Fortanier worked extensively on Chapter 6.

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Preface

Corporate responsibility involves the search for an effective “fit” between businesses and the societies in which they operate. The notion of “fit” recognises the mutual dependence of business and society – a business sector cannot prosper if the society in which it operates is failing and a failing business sector inevitably detracts from general wellbeing. “Corporate responsibility” refers to the actions taken by businesses to nurture and enhance this symbiotic relationship. Of course, societies can also act to nurture this relationship by providing such services as law enforcement, appropriate regulation, investment in the many public goods used by business and by financing these activities via a well designed, disciplined tax system. If the actions of both business sectors and societies are successful, then the “fit” between the two helps to foster an atmosphere of mutual trust and predictability that facilitates the conduct of business and enhances economic, social and environmental welfare.

The core element of corporate responsibility concerns business activity itself – the function of business in society is to yield adequate returns to owners of capital by identifying and developing promising investment opportunities and, in the process, to provide jobs and to produce goods and services that consumers want to buy. Economic history attests to the power of business sectors operating in effective environments of private and public governance to raise general welfare and living standards.

However, corporate responsibility goes beyond the core function of conducting business. Businesses are expected to obey the various laws which are applicable to them and, as a practical matter, often have to respond to societal expectations that are not written down as formal law. Since many enterprises now straddle numerous legal, regulatory, cultural and business environments, the challenge of legal and ethical compliance has become more complex. But many businesses have attempted to meet this challenge. Working with trade unions, non-governmental organisations and governments, the business community has developed principles and management methods for addressing a range of issues about which it would have been incapable of organising any systematic response even as recently as two decades ago. This publication provides an overview of private initiatives for corporate responsibility.

An Analysis of Private Initiatives for Corporate Responsibility

Executive Summary

Voluntary initiatives in the area of corporate responsibility have been among the major trends in international business in recent years. Business surveys show that most large OECD-based multinational enterprises have participated in this trend in one way or another. These initiatives involve, first, the issuance of codes of corporate conduct setting forth commitments in such areas as labour relations, environmental management, human rights, consumer protection, disclosure and fighting corruption. These codes are often backed up by management systems that help firms respect their commitments in their day-to-day operations. More recent developments include work on management, reporting and auditing standards and the emergence of supporting institutions (e.g. professional societies, consulting and auditing services).

This paper analyses the results of an OECD fact-finding project on business approaches to corporate responsibility. In so doing, it places corporate responsibility in its broader governance setting, recognising that voluntary initiatives have a crucial, but necessarily only partial, role to play in the effective control of business conduct.

The paper also looks at the contribution that voluntary initiatives have made to the accumulation of two types of intangible capital that are needed to make legal, regulatory or less formal systems of behavioural control effective. The first of these is consensus – the widespread agreement or consent of the people and organisations covered by the controls. Consensus promotes what has come to be known in enforcement circles as “voluntary compliance”, that is adherence to behavioural norms that is not due to formal enforcement. The second is the managerial expertise that allows firms to translate general principles into an operational response.

The key findings are as follows:

- *Global phenomenon.* Voluntary initiatives are a global phenomenon, but there are significant intra-regional variations in practice.
- *Some initiatives are more voluntary than others.* Although the initiatives are often referred to as “voluntary”, some firms are under strong pressures to adopt them. Such pressures stem from legal and regulatory arrangements, from employees, from the need to protect brand or reputation capital and from civil society. For other firms, however, such pressures can be weak (e.g. for those with low public visibility).
- *Divergences of commitment and management practice.* There appear to be wide divergences of commitment even in relatively narrowly defined issue areas (e.g. labour standards in branded apparel, environmental and human rights commitments in extractive industries, fighting bribery). This is not necessarily a problem, since there can be no “one-size-fits-all” approach to commitment in business conduct. On the other hand, it may point to a need to continue the public debate on what exactly constitutes appropriate behaviour for the different ethical challenges that confront international business. Similarly, management practices in support of commitments vary significantly. Some firms have adopted advanced practices while others have yet to translate their codes into management controls.

- *First steps toward an eventual consensus on global norms for business conduct.* The corporate responsibility movement has provided an international channel through which various actors – businesses, business associations, governments, trade unions, intergovernmental organisations and NGOs – can debate various standards of business conduct and management practice. The amount of dialogue and mutual influence among these actors has been significant.
- *Accumulation of managerial expertise in ethical and legal compliance.* Voluntary initiatives in corporate responsibility have promoted the accumulation of the management expertise needed to translate legal compliance and ethical norms into the day-to-day operations of companies. The institutional supports for this expertise – management standards, professional societies, specialised consulting and auditing services – help lower the costs of legal and ethical compliance as well as making it more effective. Non-financial auditing and reporting standards are a more recent phenomenon and they are still relatively weak.
- *The costs of voluntary initiatives for corporate responsibility.* The fact-finding project contains little information on the costs of these initiatives in specific business settings because little is available. It is expected that, as experience with the initiatives grows, businesses will add to their knowledge of both costs and benefits. Uncertainty also gives rise to the possibility that corporate responsibility initiatives will have “unintended consequences”. In particular, this means that well-intended initiatives occasionally have adverse, unforeseen effects. The risk of unintended consequences underscores the need to proceed carefully and with adequate knowledge of local circumstances.
- *The benefits for individual companies and for society.* The benefits of these initiatives for firms are potentially numerous. They include improved legal compliance, management of litigation risks, brand and reputation enhancement and smoother relations with shareholders and with society. Some initiatives have also allowed industries to deflect calls for formal regulation. Finally, companies use the initiatives to improve employee morale and to promote a “culture of integrity” within the firm. Societies gain inasmuch as these initiatives reflect business sector attempts to translate external pressures for corporate responsibility (law, regulation, public opinion) and internal pressures (coming from employees) into concrete business practice.
- *The effectiveness of voluntary initiatives.* It is clear that an informal system based on only word of mouth or direct hierarchical control would not be sufficient to allow large, complex companies to respect their legal and ethical commitments. These companies need to communicate effectively with thousands of employees and to use diverse compliance tools, effectively deployed in a coherent management system. Private initiatives are the expression of managerial expertise that allows companies to blend profit pressures with non-financial pressures into coherent business activity and response. However, in the non-financial dimension, these initiatives have no more credibility or force than the social, legal and regulatory pressures that shape them. If private initiatives are successful, this attests not only to the competence of the business community, but also to the abilities of societies to formulate, communicate and channel reasonable pressures for appropriate business conduct. Thus, the effectiveness of these initiatives is closely linked to the effectiveness of the broader systems of private and public governance from which they emerge – private initiatives cannot work well if other parts of the system work poorly.
- *A role for the OECD Guidelines for Multinational Enterprises.* As the only multilaterally endorsed comprehensive code of conduct, the Guidelines have an important role to play in this ongoing process. The Guidelines institutions could be used to strengthen and encourage the emergence of consensus and to contribute to the accumulation and dissemination of expertise.

Introduction

Voluntary initiatives in the area of corporate responsibility are among the major trends in international business in recent years. The initiatives include the issuance of codes of conduct, the implementation of associated management systems and, more infrequently, the adoption of special reporting practices.

There is a considerable disagreement about how meaningful these initiatives are. Some view them as the first steps toward global convergence of business practices, while others see them primarily as public relations ploys.

Recent practice in regulatory and management control emphasises the need to create the intangible assets that facilitate compliance with appropriate norms for business behaviour.

As globalisation has broadened and deepened the ties linking the world's regions, the concern that the benefits of globalisation for business should be matched by requirements for responsible behaviour has been repeatedly expressed in public discussions. Although there is little agreement about the exact content and form of such requirements, a number of public and private responses have emerged. Recent public initiatives include the adoption of the ILO Convention 182 on the worst forms of child labour and the successful revision of the *OECD Guidelines for Multinational Enterprises*. Private responses to these concerns have emerged in the form of voluntary initiatives to define appropriate norms for business conduct. These corporate responsibility initiatives involve the issuance of codes of conduct, which set forth commitments and behavioural guidelines in such areas as labour relations, environment, consumer protection and fighting bribery. The codes are often backed up by accompanying management systems that help companies respect their legal and ethical commitments in their day-to-day operations. Prototypes for non-financial disclosure and reporting standards – which help firms communicate their commitments, practices and performance to the outside world – have emerged more recently. These initiatives draw on management principles and practices that have developed only over the past 25 years or so.

Despite the intense activity in this area, there is little agreement about exactly what these initiatives mean. Some believe that they constitute a first step in building reasonable behavioural standards from the ground up and that voluntary, decentralised approaches offer the flexibility needed to adapt to regional and sectoral circumstances and to acquire necessary knowledge and experience. Others view these efforts as little more than public relations ploys and would favour replacing them with binding rules of the game involving sanctions and government-directed enforcement mechanisms¹. Only these arrangements, they feel, will give the standards enough “teeth” to influence corporate behaviour in a meaningful way.

The challenge of building up global norms largely “from scratch” places a premium on understanding the basic building blocks that support effective systems for controlling business conduct. Recent thinking emphasises the importance of intangible assets that support such systems of regulation or “softer” forms of social control of business. It says that many of the essential ingredients of any system of regulation, law or informal control of business – those that help determine whether or not the system is effective – are invisible to the eye. They cannot be read about in law statutes, written down explicitly in contracts or in international agreements or discerned by looking at a particular enforcement apparatus.

This paper focuses on two such intangible assets – consensus or agreement with the norms and the management expertise needed to comply with them.

This paper analyses the results of a fact-finding mission on corporate responsibility that are reported in subsequent chapters of this publication.

The fact-finding results suggest that these voluntary initiatives form a global trend, but that there are significant intra-regional variations in practice.

Although these initiatives are referred to as “voluntary”, firms are under varying degrees of external pressure to undertake them. OECD governments have been very active in shaping the initiatives through regulatory and legal enforcement. Protection of brand and reputation capital is also an important consideration.

This paper focuses on two such intangible assets. The first is consensus – or widespread agreement with and acceptance of behavioural norms among the people and organisations covered by them. The belief that compliance with behavioural norms results solely from monitoring and threats of punishment is not supported by OECD experience. On the contrary, compliance in democratic societies tends to be more voluntary than enforced. The second intangible asset is expertise – the “human capital” that, it is argued here, has become an essential building block for successful systems of control of business conduct, regardless of whether these controls are private or public. The challenge for building global norms is to accumulate these intangible assets – consensus and expertise – on an international scale. One of the main findings of this paper is that voluntary initiatives are making significant contributions to the global accumulation of both, but that much remains to be done.

The present paper analyses the results of an OECD fact-finding project on private initiatives in the area of corporate responsibility that was authorised by the Committee on International Investment and Multinational Enterprise (CIME)². This Chapter begins by reviewing and assessing the record of private initiatives to date – in general terms, what has been accomplished and what may be accomplished in the coming years. The next section examines the question of costs and benefits. The third section draws out implications of the above for policy makers.

The Record to Date

Voluntary efforts to develop appropriate and meaningful standards of conduct have been a recent prominent development in international business. The fact-finding effort suggests that this trend is global in scale, but that it also shows large intra-regional variations. The OECD inventory contains codes from the majority of member countries (Chapter 3 of this publication). The study of environmental management practices (Chapter 6) shows that they are common among European and Japanese firms, while the study of non-member Asian companies also suggested significant, but variable, involvement.

The fact-finding mission underscores the nuances that are necessary when referring to these initiatives as “voluntary”. Webster’s dictionary defines “voluntary” as “acting or done with no external compulsion or persuasion.” The inventory of how public policy influences these initiatives highlights the fact that, often, there are powerful regulatory or legal pressures acting on firms undertaking these initiatives³. Chapter 5 notes that private initiatives have been incorporated into public regulatory and law enforcement strategy. This has occurred in such diverse areas as environment (in the European Union, among others), occupational health and safety (the United States), combating money laundering (Switzerland), food safety (in the United States), competition policy (in Australia and Canada) and, in the United States, any corporate criminal activity that falls under the Federal Sentencing Guidelines. Likewise, for companies with significant brand or reputation capital, threats of

NGO campaigns (of the type that have been waged against various brand-based retailers and against some extractive industry firms) confront them with potentially large capital losses⁴. Thus, firms face varying intensities of pressure to engage in these “voluntary” practices – they may be intense on some, but relatively weak for firms with low public visibility, no brand capital and facing few regulatory or legal incentives.

The codes address a wide range of issues from the sustainable development agenda and the issue areas most commonly discussed are labour relations and environment.

The codes in the OECD inventory cover a broad range of issues and address each of the economic, social and environmental “pillars” of the sustainable development agenda. They address many issues that are central to the debate on globalisation – environmental management, human rights, labour standards, anti-corruption, consumer protection, information disclosure, competition and science and technology. The inventory shows that environment and labour relations are the most common issue areas in the codes followed by consumer protection and anti-corruption. Also covered are a number of “niche” issues that attract only occasional mention (animal rights, research ethics, building local partnerships etc.).

The commitments made in the codes exhibit significant divergences in their scope and in the concepts used. Even in narrowly defined issue areas, the codes do not define a de facto standard of conduct.

The inventory shows divergences in the scope and nature of commitments contained in the codes, even in rather narrowly defined issue areas (Chapter 3). For example, the bribery codes are about evenly divided among those that discuss only private to private bribery, only bribery of public officials and those discussing both. Anti bribery concepts are also diverse in such basic areas as gifts and entertainment and the use of agents or third parties. Likewise, the only issue area that is addressed in all supplier codes in the branded apparel industry is child labour (although the specifics of their commitments vary widely⁵). Similar divergences are found among company codes in extractive industries. The divergences could reflect underlying differences in the companies’ business environments – there can be no “one size fits all” approach to commitment because firms operate in different sectors and in different countries. They could reflect “cherry picking” of issues by companies (companies might commit in areas where it is not costly and ignore areas where it is). They could reflect fundamental differences of view about the nature of companies’ ethical obligations. Thus, the codes, probably for a combination of the reasons listed above, do not generally constitute a *de facto* standard of business conduct in the areas they cover.

These divergences are not necessarily a problem. The codes movement provides an institutional channel for debate among various representatives of civil society.

This should not be interpreted as a weakness or criticism of these private initiatives – private business alone is not responsible for the creation of such standards. Indeed, the companies involved in this movement – by seeking to enhance the transparency of their non-financial commitments – may be making important contributions to the eventual formation of such standards. In effect, the code movement provides a communications channel for airing and debating ideas about norms for business conduct. The amount of dialogue and mutual influence that takes place in the codes movement is considerable and has been facilitated in recent years by advances in communication technology. Examples of the types of dialog facilitated by the codes movement are described in Box 1.

Box 1. Consensus-building and Voluntary Initiatives – examples from the Codes Inventory

Dialogue among the business, labour and NGO communities: Some of the codes represent co-operative efforts among firms, NGOs and labour unions. Thus, in the course of writing and promoting them, dialog among representatives of civil society took place. Examples of this kind of code include SA 8000 on core labour standards and CERES on the environment. Likewise, the codes that are part of collective agreements were negotiated between business and trade unions.

Dialogue within the business community: Some of the most influential codes in the inventory have been issued by business associations and represent the fruit of extensive consultation and pooling of expertise. Business association codes account for 37% of the OECD codes inventory. Prominent examples of this kind of code include Responsible Care in the chemicals industry, the Business Charter for Sustainable Development on environmental management and the British Code of Advertising and Sales Promotion.

Comparing and evaluating codes: Specialised NGOs have produced databases and publications providing assessments of the content of corporate codes and of their efforts to implement these codes. Prominent examples of NGOs providing this kind of service are Ethical Investment Research Service (EIRIS) and Council on Economic Priorities. These services not only inform civil society and institutional investors, but allow firms to see how their practices compare with those of other firms.

Government contributions: Various OECD governments have added their voices to the debate by issuing model codes. The revised OECD *Guidelines*, as the only multilaterally endorsed comprehensive code of conduct for multinational enterprise, contribute in important ways to dialogue and growth of consensus.

This activity provides inputs into the progressive formation of consensus on norms for business conduct.

All of this activity provides inputs into the progressive formation of broader agreement or consensus on norms for business conduct. Economic thinking (for example, among development practitioners) and recent regulatory and law enforcement practice – via its focus on so-called “voluntary compliance” – recognise the economic value of consensus as one of the basic building blocks that supports economic development and effective implementation of appropriate norms for business conduct.

Consensus – A Basic Building Block for the Effective Control of Business Conduct⁶

We can learn from experience that management of ethical behaviour is not limited to monitoring and inspection of corruption or wrongdoing, but it is about seeking a consensus regarding good conduct and providing a direction for action and policy decisions.

*Jung-Suk Yoo,
Strengthening Professional Ethics in the 21st Century*

Informal conventions and norms are important intangible inputs for any economy. They complement written law and contract.

Informal conventions and norms⁷ about what constitutes appropriate behaviour are a pervasive feature of any economic and social system – they are “intangible assets” that facilitate exchange and the effective functioning of organisations (see Coleman 1990; Williamson 1996). They have facilitated commerce throughout economic history and are a feature of all transaction frameworks, from barter economies to the sophisticated markets and organisations of advanced industrial societies. The first anthropological field study was motivated by the observation that primitive societies are quite orderly despite the absence of written rules and formal enforcement⁸. Some (e.g. North 1990) argue that advanced economies – notwithstanding their tendency to formalise rules in law and transactions in contracts – rely heavily on informal norms and conventions. This is because it is rarely possible to account for all contingencies when writing out formal rules or

Informal norms are part of social capital. Much of this social capital is rooted in national institutions and values. For the time being, there is little global social capital.

Recent enforcement practice in law and regulation has tended to move away from an exclusive focus on deterrence...

... because it has been found that formal deterrence often accounts for only a small fraction of law-abiding behaviour. Much compliance with law appears to stem from the fact that it is supported by social norms – individuals believe in the law and they may be under social pressure to comply with it.

contracts. Informal norms tend to come into play on the many occasions when economic actors must respond to events that have not been described *ex ante* in law, regulation or contract.

These informal norms are essential inputs into the transactions process – the economics literature uses the term “social capital⁹” to refer to, among other things, these unwritten, but widely held beliefs and norms (Coleman 1990). The reason the term “capital” is used is that these norms – or agreed ways of doing things – have economic value. They allow transactions – trades, production, hiring of productive factors – to take place that might not otherwise have been feasible or they lower the costs of certain transactions (e.g. legal or monitoring costs). Generally, these norms are seen as complementary to formal legal arrangements – they may facilitate contract enforcement (by allowing contracts to be drawn up with less detailed treatment of contingencies and by lowering the amount that must be spent on third party enforcement). However, since social capital is rooted in culture and other institutional, economic and societal characteristics, it tends to be specific to nations or regions – “global social capital” is, at least for now, fairly underdeveloped.

Consensus about individual or business behaviour – that is widespread agreement on how things ought to be done – is also increasingly viewed as an essential element of law enforcement – one that lowers enforcement costs and increases its effectiveness (see Ayres and Braithwaite 1992). Law enforcement is often thought of as a process in which a government invests resources in monitoring and deterrence, thereby creating an incentive system that shapes decisions to comply with law or to engage in criminal behaviour. In return for their investment, societies receive a certain amount of compliance. A simple “deterrence” approach to law enforcement relies on the following assumptions: 1. Legal statutes can unambiguously define misbehaviour; 2. All actors are fully informed expected utility maximisers (that is, they are *homo economicus* observed in an enforcement context); 3. Legal punishment (fines, imprisonment) provides the primary (indeed the only) incentive for compliance; 4. Enforcement agencies optimally detect and punish misbehaviour, given available resources (Scholz 1997). Thus, the operative assumptions are that “good and evil” or “legal and illegal” can be easily identified and codified and external (government) enforcers can be relied upon to uphold the “good”, while the actors covered by the laws are naturally inclined to do “bad” if it is in their economic interest.

The “deterrence” model undoubtedly provides useful insights, but enforcement studies show that it does not come close to providing a full explanation of real-world compliance. Indeed, one of the central questions in regulatory enforcement is why compliance tends to be so high when the amount spent on deterrence is often so low. For example, Slemrod (1998) reports on studies of compliance with income tax laws in the United States. These show that people pay far more in income taxes than can be explained by a rational calculation that balances the financial advantages of not

One of the challenges for the development of global norms for business conduct is to amass the social capital on a global scale. Without this, the norms are likely to be ineffective and any supporting laws might be prohibitively costly to enforce.

Newer regulatory and legal enforcement strategies draw on the inherent willingness and ability of the business community to comply. The managerial expertise that businesses bring to bear on compliance problems is an important consideration in this strategy.

complying against its expected costs based on the probability of getting caught and the likely amounts of penalties paid if one is caught. In fact, people appear to pay their income taxes for a number of reasons, many of which have nothing to do with tax enforcement – they may believe it is the right thing to do (personal conviction) or their friends and family may pressure them to do so (peer pressure). These findings and others¹⁰ have given rise to increased interest in law and regulatory enforcement circles in the concept of “voluntary compliance”; that is, compliance that occurs because of personal belief or social pressure, rather than being due to the enforcement apparatus. In this sense, voluntary initiatives and formal law and regulation draw on the same sets of social capital (or consensus on appropriate behaviour) and, hence, are complementary.

Thus, there is a growing recognition that a critical mass of understanding, agreement and consent underpins any effective system for controlling business behaviour. In effect, it lowers enforcement costs by eliminating the need to have a policeman on every corner and an inspector in every factory. Without this agreement and implied consent, many laws would be prohibitively costly to enforce using methods that are acceptable to democratic societies. But, as noted above, most social capital is grounded in regional cultures and societies – there is as yet little global social capital. The corporate codes movement provides one avenue through which a broad-based understanding of and consensus about norms for various aspects of international business conduct can be built. Indeed, this gradual movement toward of consensus – though still highly incomplete – is one of the major contributions made by these voluntary initiatives to date.

Expertise – Human Capital and the Social Control of Organisations

The recognition of the importance of voluntary compliance tends to blur the distinction between the voluntary initiatives examined here and more binding systems of law and regulation. This blurring has become more pronounced as a result of recent enforcement trends. As discussed in Chapter 5, regulatory and law enforcement practitioners have become disillusioned with purely adversarial approaches to enforcement based on the command and control model of regulation. There is a growing recognition that managerial expertise is often a key ingredient for successful compliance with law and regulation. Newer enforcement techniques try to promote voluntary compliance in the corporate sector, but also to draw on the sector's compliance expertise and to integrate this private expertise into public enforcement strategy. Many of the voluntary initiatives examined here are the reflection and expression of growing compliance expertise within the business community (and of an associated regulatory expertise in the enforcement community).

The fact-finding project documented the emergence of a new class of professional manager specialising in legal and ethical compliance. Various institutions have emerged to support and spread this expertise (e.g. management standards, specialised consulting services, professional societies).

The accumulation of expertise also reflects the recognition that corporate conduct (or misconduct) is a complex phenomenon. Some misconduct, for example, might not be calculated wrongdoing. It might reflect lack of due care in managing human cognitive constraints, problems in managerial or technical controls in dealing with risky or dangerous. Defining and evaluating reasonable practices in such circumstances requires considerable expertise.

This complexity creates a need for voluntary initiatives, since law and regulation could never spell out good practice in sufficient detail. Many of the codes in the OECD inventory are expressions of company's efforts to use due care in keeping risks to an acceptable level.

Chapters 4, 5 and 6 note the emergence of a new class of professional managers specialising in legal and ethical compliance. These managers now have rapidly growing professional societies and the majority of major business schools now offer courses in compliance. NGOs have also accumulated expertise in these areas. Activities have been undertaken in business associations and in the International Organisation for Standardisation that allow businesses to pool expertise and to share the costs of developing new management and reporting systems (Chapter 5 shows that OECD governments contributed to these initiatives). Numerous private companies – mainly specialised consulting companies or large audit firms – provide packages of “risk management” services (legal, management control, monitoring, record keeping and reporting and public relations). Work on standardisation of non-financial reporting practices is underway in several institutional settings (e.g. the Global Reporting Initiative).

This accumulation of expertise reflects the high stakes underpinning compliance in many areas and the growing recognition that corporate conduct (or misconduct) is a complex phenomenon. That is, there are many possible types and motivations for misconduct and enforcement techniques that work for one type of misconduct do not work for others. For example one view of corporate misconduct (that differs from the calculated misconduct of the deterrence model) links it to basic human cognitive constraints – often called “bounded rationality”. This view emphasises the fact that misconduct can arise from error, ignorance or innate human limitations when faced with situations that are risky or uncertain. In addition to accounting for the risks and uncertainties inherent in most human activities, this approach recognises that corporate actors – workers, managers, executives – have only limited amounts of the information, knowledge and resources needed to control outcomes. In such circumstances, misconduct can occur even when the perpetrators face major financial penalties in the event of say, an accident, and when they all share a strong personal conviction that misconduct should be avoided. Safety management (ie. occupational safety or public safety) is an example. Major problems may be infrequent (so that vigilance can be worn down by routine) and safety dispositions may form a system, making it difficult for any single actor to identify emerging problems. Under this view, there is often significant uncertainty or ambiguity as to what constitutes misconduct or in recognising it in a real world setting. Financial and penal sanctions will often be of limited usefulness in such situations and must in any case be complemented with other methods (Scholz 1997).

Under this approach, rules systems help define society's risk tolerance and what constitutes due care for companies in managing these risks. Rules writing and compliance in this setting are quite different than under the deterrence model described above. First of all, explicit rules – in the form of codified laws – may be impossible to write because of the large number of contingencies that would have to be built in to them. This creates a role for the private initiatives examined here – that is, these initiatives help to define and clarify the implications of societal risk tolerances for the firm's

operations. Many of the codes and management systems examined in the fact-finding report deal with risk management issues (see, for example, the Responsible Care code and many of the “environment, health and safety” and “consumer protection” codes).

Costs and Benefits of Private Initiatives

...there is one and only one social responsibility of business— to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition, without deception or fraud.

Milton Friedman, *Capitalism and Freedom*, page 133. 1962

This section explores the costs and benefits of these initiatives for companies and for the societies in which they operate.

The codes in the OECD inventory often define and describe an ethical posture for business that goes beyond legal requirements (Chapter 3) and beyond the Milton Friedman's narrow view of business ethics (see quote above). As noted, some companies back these up with management and reporting systems. One might well ask why companies would bother to do this and what benefits, if any, accrue to the societies affected by these initiatives. These initiatives are presumably costly for the companies that undertake them and may give rise to broader opportunity costs (economic activity that might otherwise have been undertaken if it weren't for the initiative).

Little quantitative information is available on the initiatives' costs and benefits in particular business settings. This section provides general assessments.

This section looks at the benefits and costs of private initiatives in general, non-quantitative terms. The fact-finding results contain few quantitative assessments of benefits and costs in any given business or sectoral setting. The section also considers the uncertainty surrounding both benefits and costs as well as the risk that these initiatives may give rise to unintended consequences.

The Benefits for Firms

The benefits of such initiatives are potentially numerous. They lower risks of costly criminal prosecutions, litigation and damage to reputation...

The benefits of these initiatives for firms are potentially numerous. Many of the initiatives are designed to improve compliance with law and regulation and to manage litigation risks by helping companies show that they have exercised due care in trying to live up to their legal and ethical responsibilities. By taking such actions, companies hope to avoid costly litigation or legal defence, criminal or civil sanctions and damage to reputation.

... they help firms manage relations with shareholders and with other actors in the societies in which they operate.

The initiatives are also a communications tool used in managing relations with various elements of societies in which the business operates – companies use them to explain their positions and actions to civil society and customers, thereby helping to enhance company image and reputation. For publicly traded companies, the initiatives help smooth relations with shareholders especially in view of the growing tendency for questions relating to business ethics issues to be brought up during shareholder meetings¹¹.

In some instances, they have been used to deflect momentum for government regulation.

Other initiatives are at least partly motivated by a desire to deflect or pre-empt efforts for government regulation. The UK advertising standards initiative, a highly regarded private system for promoting truth in advertising, was designed to eliminate the need for government regulation and is regarded as being quite effective (OECD 1997). Responsible Care, an influential private initiative¹² for

Companies claim that these initiatives improve employee morale and form the cornerstone of broader efforts to create a “culture of integrity”.

promoting safety in the chemicals industry, was designed in part to deflect growing political momentum to tighten government regulation (OECD 1997).

Companies also say that these initiatives help them to improve morale and motivation among existing employees and to compete more effectively in labour markets. In a very general sense, these initiatives are a fundamental component of broader efforts to promote a “culture of integrity” within companies. This elusive aspect of corporate culture – integrity – is essential ingredient of management control in many business organisations. As a result of technological change and other structural pressures, companies now tend to be flat and, hence, to have fewer hierarchical checks and balances. Furthermore, “knowledge workers” often have *de facto* control of key proprietary intangible assets. Thus, organisational and technological change has tended to enhance the power of many employees – enlarging their scope for autonomous action and their control of key resources – and, as always, power can be both used and abused. In some sense, then, these initiatives are the most general measure used by companies to limit the likelihood of wrongdoing by company employees seeking to gain personal advantage.

The Benefits to Society

The primary role of business in society is to conduct business.

The main role of the business sector in society is to provide adequate returns to suppliers of capital and, in the process, create jobs and produce goods and services that consumers want to buy. Companies often highlight this basic principle of business ethics in their codes (see Box 2). But all the codes in the inventory contain commitments that go beyond this principle.

Box 2. The Business of Business is Business – Direct Quotes on this Theme from Individual Company Codes of Conduct

Our first priority is to be a profitable business and that means investing for growth and balancing short term and long term interests.

From the Chairman's message in the code of a major consumer products company.

[Company name] is committed to increasing its value to customers, employees and shareholders by profitably providing beneficial products and services to world-wide markets.

From the code of a North American chemicals manufacturer

The objectives of [Company group names] are to engage efficiently, responsibly and profitably in the oil, gas, chemical and other selected businesses and to participate in the search for and development of other sources of energy. [Company group names] seek a high standard of performance and aim to maintain a long-term position in their respective competitive environments.

From the code of a major petrochemicals company

[Company name] is a growing worldwide company dedicated to excellence through quality – creating value for customers, employees and shareholders through innovation, technology and operational expertise.

From the code of a leading metals company.

What justifies departures from this principle? Many of the codes define the company's position in relation to various types of market failure. The codes can be seen as the business sector's response to legal and social pressures to redress the effects of market failure.

The codes also address ethical issues (e.g. racism) that are, in some sense, imported from the societies in which they operate.

Thus, the potential benefits for society include the alleviation of market failure and a more focused co-operation from business in redressing broader ethical problems.

Critics of voluntary initiatives view them mainly as public relations ploys and insist that they be accompanied by external verification and by sanctions. However, external verification is not a straightforward process – it requires institutional supports such as auditing and reporting standards.

One way to justify departures from complete reliance on the disciplines provided by product and factor markets is to invoke the idea of “market failure”. Many of the codes explicitly address issues of market failure¹³. In this sense, the potential benefits for society of private initiatives are closely linked to those obtained from regulation, corporate criminal law and other policies that influence how companies conduct their business (such as taxes and subsidies). All of these – formal law and regulation, private initiatives – are (in principle) designed to improve situations where the market does not work well on its own. This could be due to the presence of market power (e.g. natural monopolies, network effects) or to other forms of market failure (e.g. externalities, missing markets, information asymmetries, public goods, co-ordination failures). In a very general sense, then, the benefits of these private initiatives, if they succeed in their objectives, are similar to (and complementary with) those one would hope to get from (well-designed) law and regulation – that is, the redressing of market failures.

The codes also make it clear that many of the ethical challenges faced by businesses are, in some sense, “imported” from the societies in which they operate. For example, 61% of the labour codes deal with discrimination (e.g. racial, religious) in the work place (Chapter 3). In this way, companies try to prevent prevailing biases and prejudices from impacting on workplace or customer relations¹⁴. Many anti-bribery codes note that some countries’ tolerance of corruption means that employees routinely face demands for bribes. While it is difficult to assign tangible benefits to this type of ethical consideration for business, it is clear that businesses themselves do not feel they can extricate themselves from the broader ethical challenges facing the societies in which they operate.

To summarise, the potential benefits to society of these initiatives are similar to the benefits societies hope to get from regulation and corporate criminal law, with which these initiatives are often highly synergistic and supportive. The codes are the reflection in management practice of various legal, regulatory and social pressures that motivate the company to prevent abuses of market power and to redress other sorts of market failure. The codes and associated management systems also have the potential to help the businesses contribute to redressing broader ethical problems.

The Effectiveness of Voluntary Initiatives: Do they Change Company Behaviour?

Of course, if these initiatives are mere “window dressing”, then they produce no social benefits. The question then arises as to what, if anything, makes these initiatives meaningful in terms of changing business behaviour. Some claim that, if the codes are not subject to formal deterrence (external verification and related “punishments”), then they are not credible; they call for external monitoring and enforcement, binding laws, trade sanctions and so forth. While there might be some circumstances in which such measures do have a role to play, proponents of this view seem to downplay the difficulty of external verification and of designing effective systems of

deterrence¹⁵ (Chapter 4) and may underestimate the importance of “voluntary compliance”, already discussed above. They may also underestimate the complexity and difficulty of ensuring that individual employees actually “internalise” the incentives created by public monitoring and sanctions.

The general management problem is to get individual employees to act in response to the incentives created by various external pressures. The voluntary initiatives studied here are an attempt to translate legal, regulatory, social pressures into coherent managerial and operational responses.

The issue of how various incentives are internalised by the individuals and groups that make up a company is central to the field of management control, a well-established business discipline that is closely linked with the voluntary initiatives studied here. In corporate finance, the counterpart of this question is: to what degree are individual incentives within the firm aligned with shareholder interests¹⁶? More generally, to what degree do the various social, technical and financial processes shaping individual behaviour within the firm form a harmonious whole permitting coherent action by the enterprise? In modern, complex corporations, formal control systems are used to align individual employee interests with shareholder interests and to balance these with other, possibly competing, considerations (e.g. the need to comply with the law). The voluntary initiatives examined in the fact-finding mission are the business sector's response in terms of management controls to the non-financial pressures it faces.

A crucial question is: Do these initiatives actually succeed in changing business behaviour? The answer to the question is yes – these initiatives are a crucial ingredient for effective ethical and legal compliance in large, complex corporations.

The businesses in the OECD codes inventory and other data sets are often very large (sometimes exceeding 100 thousand employees) operating in dozens of countries, sometimes having hundreds of business partners, and engaging in the design, production and marketing of numerous products and services. These are not small businesses where communication can occur by word of mouth and where the owner can directly place his/her stamp on company practices. The fact-finding mission focused mainly on large, complex, professionally managed companies. In this type of company, formal compliance systems are essential. If no steps are taken to enlist the support and harmonise the actions of hundreds or thousands of employees and business partners, then there will be no managerial control in support of ethical or legal compliance (other than the spontaneous compliance that might emerge from actions by individual employees motivated by their own personal values).

However, the business community's main role is to provide the managerial expertise needed to reflect social, legal and regulatory pressures into business practice. It is up to society as a whole (of which business is a part) to decide what those pressures should be.

Thus, private initiatives reflect managerial expertise that allows companies to blend short- and long- term profit pressures, as well as non-financial pressures, into coherent corporate activity and response. However, in the non-financial dimension, these initiatives have no more credibility or force than the social, legal and regulatory pressures that shape them. If these private initiatives are successful, it is a testimonial not only to the competence and expertise of the business community, but also to the ability of societies to formulate, communicate and channel reasonable pressures for appropriate business conduct. In this sense, the success of voluntary initiatives is inextricably linked to the external pressures – law and softer ways of influencing behaviour – that the business faces.

Therefore, the question of whether or not these initiatives are effective cannot be answered by looking only at what businesses do. If they are effective it is because societies manage to formulate and channel reasonable pressures for appropriate business conduct.

Thus, it is difficult to separate the effectiveness of these initiatives from that of the social and political, legal and regulatory context in which they develop – that is, from the suitability and effectiveness of both private and public governance. For example, private initiatives in support of legal and regulatory compliance will be undermined if they are associated with regulatory or legal systems that are inefficient, poorly designed or corrupt. Likewise, if the basic institutions of democratic societies are not in place, then the pressures coming from the media, from representatives of civil society or from the political arena will be absent. If trade unions and other institutions for promoting transparency in labour relations are suppressed, then measures designed to raise workplace standards will be hobbled. Private initiatives for corporate responsibility have an important and distinctive contribution to make as part of a broader system of private and public governance. However, they cannot work well if other parts of the system work poorly.

Voluntary Initiatives in a Broader Governance Context

Should our regulatory institutions be designed for knaves or should they be designed to foster civic virtue? Our answer has been that they should be designed to protect us against knaves while leaving space for the nurturing of civic virtue.

Ian Ayres and John Braithwaite, Responsive Regulation, Page 53.

The costs and benefits of private initiatives depend on finding a judicious combination of private and public action.

Both the costs and the benefits of private initiatives depend on whether or not societies manage to combine public and private action in effective mixes. No system for controlling business conduct – binding or voluntary – is perfect and each has its distinctive strengths and weaknesses. Private initiatives are not alone in suffering from credibility problems – that is, from the belief that the initiative will not have the impact it is supposed to have. Indeed, the credibility (or lack of credibility) of many types of public policy – fiscal, monetary and regulatory – is frequently called into question and OECD experience with regulation shows there have been serious and pervasive problems [see OECD 1999, OECD 2000 and Gonenc et al. (2000)]. These include inflexibility, regulatory inflation¹⁷, capture of the regulatory process by interest groups, ineffectiveness and unintended consequences. Poorly designed and implemented regulation has imposed large costs on individual companies and on OECD societies.

Although the two approaches both offer distinctive strengths and weaknesses, the tendency now is to look at them as largely complementary efforts.

Box 3 describes the differences between binding laws and voluntary “standards” and highlights the strengths and weakness of the two approaches. But, as already noted, emerging regulatory practice within the OECD tends to treat public regulation and private initiatives as complementary, rather than competing, approaches. Judiciously used, private initiatives help to lower the costs of regulation and to enhance its effectiveness. The difficulty for both public and private actors is determining the appropriate form of private and public co-operation. Important questions include: To what extent should public enforcement rely on private compliance efforts? What should be done if a company is found to be operating in bad faith? Which firms should be inspected and what should the inspection consist of? Should the public enforcement authority try to impose a standardised compliance system or should it let firms develop their own systems? All of these questions must be

Box 3. A Comparison of Binding Laws with Voluntary Initiatives

Uniformity and Consistency

Formal codified and enforced law tends to have the advantage of relative consistency and uniformity of standard (see, for example, Webb and Morrison 1996). In contrast, actors in voluntary systems sometimes (but not always) have trouble defining and achieving uniform standards. Chapter 3 shows that the codes in the OECD inventory do not constitute a de facto standard of conduct, while Chapter 6 shows that there is not yet any international standard of environmental management practice.

Flexibility and Responsiveness to Changing Circumstances

The positive side of the non-uniformity problem posed by voluntary corporate control systems is their flexibility or their ability to adapt to the circumstances of individual firms or to the particular requirements of a sector or location (Ayres and Braithwaite, 1992). Voluntary efforts often have the advantage of flexibility and adaptability to changes in structural conditions over time. This tends to lower what economists call the dead-weight costs (i.e. the value of lost output) of the codes (relative to those associated with more rigid rules).

In contrast, the public authorities charged with writing or enforcing law may far be removed from the processes that society is attempting to control. Often, they do not have the information needed to design high quality laws or to enforce them effectively (that is, with due concern for individual circumstances). In addition, both the legislative process and the enforcement apparatus may be subject to considerable inertia. As a result, the system of rules and enforcement can quickly get out of alignment with the underlying structural conditions, especially in fast moving sectors. A study of regulatory systems in the OECD (OECD 1997) characterises them as containing “enormous inventories of rules and formalities that have survived without any serious examination for years or even decades.”

Effectiveness and Cost of Monitoring and Enforcement

There is no clear “winner” in the comparison between binding and voluntary systems in this area – monitoring by civil society or by private specialised agents tends to support and complement public monitoring. Furthermore, all external monitoring, both public and private, suffers in varying degrees from the same basic problems – how effective are external monitors likely to be in discerning misconduct that may be cleverly disguised or inherently difficult to perceive? How independent are the external monitors from various parties that are being monitored?

Imperfect monitoring and enforcement gives rise to the so-called “free rider” problem (Purchase 1996). The free rider benefits without paying or can impose costs on others without compensation. For example, a firm might use the label of a private quality control association without actually adhering to the norms established by the association – thus, it benefits from the scheme without fully bearing its costs. The free rider problem – that firms say they are observing high standards, but do not – is one of the main reasons for public doubts about the credibility of private initiatives. However, most government policies, including regulation, also have credibility problems – indeed, policy credibility is one of the most basic issues addressed in public policy analysis. In the labelling scheme just described, the free riding problem stems from imperfect monitoring (are firms really respecting the quality standards?). Clearly, public labelling schemes can pose the same monitoring problems as private schemes.

As noted in Chapter 4, firms and NGOs are aware of these enforcement problems and have been busy trying to address them by building private monitoring and enforcement capacity. Efforts include establishing norms for record keeping, developing specialised training programmes, refining the use of whistle-blowing facilities and developing external monitoring services, including formal audits.

Capture by Vested Interest Groups

Although regulatory economics often looks at regulation as if it were governed by the benevolent objective of serving public needs, practical experience shows that this is often not the case (see Gonenc et al. for a discussion of OECD experience with regulation). One weakness of systems that are designed and/or enforced by governments is their susceptibility to capture by interests groups (for example, Peltzman (1976) and Stigler (1971)). The scope for such capture is increased when information asymmetries make it difficult for civil society to hold regulators accountable (Laffont and Tirole, 1993). Despite attempts to increase the transparency and public accountability of regulatory processes, the quality of the written law and enforcement may still suffer as the regulatory apparatus is captured by the more politically well-connected actors and made to serve their interests. Private initiatives may also be subject to influence by vested interests as well. For example, the private firms that audit corporate performance in labour and the environment have occasionally acted like vested interests in private international standards-setting fora such as ISO. However, the voluntary movement is less susceptible to vested interests because its decision-making apparatus tends to be less centralised than in government-led binding systems.

answered on a sector- and issue-specific basis. Again, this is an area where regulatory and compliance expertise is being accumulated.

Cost Uncertainty and Unintended Consequences

There is little quantitative information on the costs and benefits of these initiatives. It is expected that information will accumulate as experience grows in different business sectors and different regions.

These initiatives can have unintended, adverse consequences. Problems with the initial phases of a campaign to eliminate child labour in the Pakistani soccer ball industry provide a case of point...

... and subsequent attempts to achieve the gradual elimination of child labour in the industry may have undermined the economic position of women in the region.

This underscores the need to proceed carefully with these initiatives and with due recognition of the difficulty of predicting outcomes that involve complex interactions of social, economic and environmental factors.

There is often considerable uncertainty as to the size and nature of the cost and benefits of these initiatives, but they are being clarified as experience grows. For example, even in one of the better understood areas (environmental management systems), it is unclear whether initiatives in this area are a cost (reducing the value of companies) or an investment (increasing it). One web site for ISO 14001 managers implies that the net present value of its members' "investment" in ISO 14001 implementation was positive (The ISO 14001 Information Guide, 1999)¹⁸. Thus, for that group of companies, ISO 14001 was not a cost item on average at all; rather it yielded a net financial benefit.

These initiatives also occasionally have "unintended consequences". The background associated with one of the business association codes in the OECD inventory shows how problems can inadvertently arise from well-meaning initiatives. The code emerged as a result of what is now an infamous case of unintended consequences of NGO activity – in this case, in response to the revelation that children were involved in the production of soccer balls in Pakistan. As a result of NGO activity, soccer balls suppliers in Pakistan were instructed to stop employing children immediately, which they did. However, since many of the children had been brought in from surrounding areas to work in factory-type situations, they ended up on the streets without caretakers or family supervision.

In a further development of this same episode, soccer ball retailers worked extensively with the ILO and with NGOs to restructure conditions of production in the Pakistani soccer ball industry. Their aim has been the progressive elimination of child labour. This restructuring increased the market share of formal, factory-like production sites ("stitching centres"), while decreasing the market share of "cottage" or home-based production (where it is more difficult to control participation of children). But this shift also undermined the economic autonomy of adult women in the region, who are less involved in factory work than in home-based production (see UK Cabinet Office, 2000 page 161). This was another largely unintended consequence.

This example underscores the need to proceed carefully with corporate responsibility initiatives and to have adequate knowledge of local conditions. It also points to the difficulty of predicting outcomes for initiatives that involve complex interactions of social, economic and environmental factors. Another issue raised by these examples is the degree to which there is transparency and accountability in the NGO community. These organisations use their (sometimes considerable¹⁹) resources to persuade other actors to do things that generate patterns of gains and losses in various parts of the globe (e.g. people may be thrown out of work or their businesses may be destroyed). Clearly, NGO actions have occasionally resulted in consequences that range from highly undesirable to, at the very least, questionable. Many of the NGOs

themselves agree that with their “influence” comes responsibility and, hence, a need to make themselves accountable for their actions (see the web-site of “Action Contre la Faim²⁰”, for example).

Implications for International Economic Policy

The main political message emerging from this analysis of voluntary initiatives is a positive one. Viewed as whole, these initiatives have contributed to the basic building blocks – consensus and expertise – that will eventually permit global convergence of norms for business conduct.

But the job of creating global norms for business behaviour is not likely to be finished any time soon.

OECD governments have already done many things to shape these private initiatives.

The voluntary initiatives analysed here should be accorded an important role in the dialog between OECD governments and their constituencies about globalisation. Unfortunately, the message stemming from the initiatives is not one that lends itself to media-friendly presentations nor does it hold the promise of easy or quick solutions. Nevertheless, it is an important and positive one – these private initiatives contribute to the basic building blocks of a system that will eventually permit meaningful convergence of economic, social and environmental standards among the countries of the world. The fact-finding mission has shown that progress varies by issue area and within and across regions, but that it has nevertheless been significant and global. These efforts represent a serious endeavour – involving enterprises on at least four continents – to address numerous problems of business ethics. The business community – working with other civil society actors and with governments – has developed principles and management methods for addressing a range of issues about which it would have been incapable of organising any systematic response even as recently as two decades ago.

Of course, progress is ongoing and the job of achieving appropriate norms of conduct for international business is not likely to be finished any time soon. The fact-finding report found significant variation of practice and commitment that cannot be easily attributed to differing business circumstances. Business communities in some countries are heavily involved in developing and implementing these initiatives and not involved at all in others. The fact-finding data set consists mainly of large, publicly-traded companies – data on what other types of companies are doing in this area are scarce, but what is available suggests that adoption of such practices may be less common among small, closely held companies. Basic institutional supports (e.g. non-financial auditing and reporting standards) still need to be developed, disseminated and tested in a variety of business situations.

What should governments be doing to enhance the effectiveness of these initiatives? The fact-finding report suggests that OECD governments have already done a lot – many of these initiatives are closely linked to national policy environments from which they have emerged. The relevant policies adopted to date have tended to avoid direct control, working instead through indirect influence (tax expenditures on the NGO sector, incentives under regulatory and law enforcement arrangements, etc.). So far the indirect approach appears to have been successful in encouraging the business community and governments to co-operate in making both more effective. These policies have also encouraged the acquisition of compliance expertise in the business community. Governments have also added

The indirect policy stance currently adopted by many OECD governments is likely to continue to be a promising one in most issue areas. It promotes and contributes to debate and allows experience and knowledge to be accumulated.

Any global system of norms that will eventually emerge is likely to involve combinations of public and private action.

In any global system that eventually emerges, there will certainly be a role for formal deterrence of some sort. But systems for monitoring and deterring misconduct on a global scale will require accumulation of global expertise.

their voices to the debate about behavioural norms through such instruments as the OECD *Guidelines for Multinational Enterprises*.

In many issue areas, the indirect approach is likely to be a more effective policy stance for governments than more direct types of intervention. This contrasts with the view of some that governments need to add “teeth” to voluntary initiatives in order to make them effective. The indirect approach encourages businesses and societies to continue feeling their way forward. It allows open dialogue to take place and experience and knowledge to be accumulated while avoiding dangers of direct intervention (capture by vested interests, inability to respond to changing circumstances, etc.). The follow-up process of the OECD *Guidelines for Multinational Enterprises* has the potential to play an important role in reinforcing the indirect strategy already adopted by governments by contributing to dialogue and to the dissemination of knowledge and experience.

In any case, the expertise and slow movement toward consensus that voluntary initiatives are helping to promote will be useful in future international policy endeavours, regardless of the form these happen to take. Any global system of norms will undoubtedly feature important elements of co-operation between the business communities and governments. This will be true internationally for the same reasons it has been true domestically – in many cases, adversarial approaches do not work well and are more costly than co-operation. Building a workable set of behavioural norms for international business promises to be a long and arduous process that will, for the most part, have to emerge from the policy communities with the necessary issue-specific expertise and political accountability. The challenge for the investment and trade policy-makers will be to work constructively as part of this painstaking process. In particular, this will mean working with the issue-specific policy communities while promoting the basic values of the investment and trade communities – transparency, investment protection and non-discrimination.

Of course, the critics of voluntary initiatives are not entirely wrong. It would be naïve to think that a meaningful system of global norms could exist without any formal deterrence. The fact-finding piece has shown that many “voluntary” initiatives are underpinned by significant threats of monetary damage (legal costs, fines, loss of reputation capital) or other sanctions. However, the analytical paper has shown that the design of deterrence is not straightforward – regulatory and compliance expertise is required to make deterrence work and the methods deployed depend very much on the compliance issue (e.g. bribery is different than control of supply chain). Thus, while there is certainly a role for deterrence, effective global methods in most areas will probably emerge slowly out of national pools of expertise and from gradual convergence of national practices. The OECD Bribery Convention – which obliges signatory governments to enact laws and criminal sanctions against bribery of foreign public officials – is one example where the international policy community has been able to promote convergence of legal

Credit for the success of some private initiatives does not belong only to the business community. It also reflects the success of broader social, economic and political processes. The OECD's peer review and outreach activities can help societies improve public governance, which will also contribute to the effectiveness of private initiatives.

norms for enterprises in their global operations. Note that enforcement of this initiative is based on deterrence and compliance expertise located in adhering countries.

Another important role for OECD governments – indeed all governments – is to initiate a process of continual improvement in public policy and to maintain peer pressure on one another in this same area. This paper has shown that any credit that might be due for the success these voluntary initiatives does not belong only to the businesses that undertake them. It is also due to the effectiveness of broader social, economic and political processes. These allow pressures – financial, social, legal, regulatory, political – to be focused onto the business community. Open and democratic societies increase the likelihood that governments will fulfil their roles (providing public services) and will avoid putting businesses in the position of having to address problems that stem mainly from failures of government (e.g. corruption in public services, public spending that favours wasteful expenditures on political elites to the detriment of spending on basic public services). This is area in which the OECD's peer review and outreach activities have important contributions to make.

Notes

1. An example of this kind of position can be found in the NGO statement made at the adoption of the revised OECD Guidelines for Multinational Enterprises. The statement says: "Governments have accepted the argument put forcefully by business during the review that the Guidelines should not be "mandatory in fact or effect". The undersigned NGOs believe that this concession is fundamentally out of step with the experience and expectations of many communities around the world... As a result, NGOs will continue to call for a binding international instrument to regulate the conduct of multinational corporations." (page 23). (OECD 2000)
2. The Working Party of the Trade Committee also authorised work in this area. Annex I of the six annex series was produced in co-operation with Trade.
3. For a more complete inventory, see OECD- PUMA (1999).
4. There are many examples of such campaigns against firms operating in such diverse sectors as apparel, toys, food and extractive industries. In the apparel industry, the campaigns have focused on retailers with brands and have largely ignored the non-branded segment of the market.
5. Some make extensive commitments to protect any children that might be found to be employed by the companies suppliers; some mention specific ages or age ranges while others do not; some commit to the elimination of child labour but note that this may force children into less desirable occupations.
6. The material in sections II.1 and II.2 draws on work already published in German by the Austria's Federal Ministry of Economics and Labour in *Osterreichs Aussenwirtschaft*, 1999-2000; see Chapter 3.6 "Rules for the Global Economy: Voluntary versus Binding Approaches" by Kathryn Gordon.
7. An "informal norm or convention" is used here to refer to a standard or guide for behaviour that is not codified in law or private texts – sometimes they are only tacitly understood by the people that adhere to them. At times, such informal standards may underpin or precede attempts at codification.
8. The field study in question was done by Bronislaw Malinowski in the Trobriand Islands and was published in 1926 as *Crime and Custom in Savage Society*.
9. A general definition of social capital is given in Nahapiet and Ghoshal (1998). Social capital is "the sum of the actual and potential resources embedded within, available through and derived from the network of relationships possessed by an individual or social unit (including families, business organisations or whole societies)."
10. In the area of environmental regulation, for example, Arora and Gangopadhyay (1995) state, "Compliance with environmental standards under a schema of low surveillance and minimum fines, is in itself an interesting phenomenon. Most firms choose to comply despite seemingly lax enforcement". Page. 290. Compliance studies in occupational health and safety suggest that compliance is not closely related to the level of penalties but was influenced by detailed inspections run jointly by labour and management representatives (Gunningham and Rees 1996).
11. For examples of why this is necessary see Global Proxy Watch March 31st for a discussion of a major French extractive industry firm's shareholder meeting in which questions on environmental management were posed. In the same issue, there is a discussion of the re-shuffling of the board of directors of a major US-based public employees retirement fund. The reshuffle is described as signalling a greater interest in socially and environmentally responsible investing. Davis (2000).
12. Although the Responsible Care Initiative started in Canada, it has since been copied elsewhere. The codes inventory contains 5 Responsible Care codes issued by firms from the United States, Mexico, Finland and Germany. The environmental database contains seventeen Responsible Care references issued by European companies.
13. Examples of code language that addresses markets failures are: 1) Information asymmetry - "Provide relevant information on the hazards of chemicals to its customers (from Responsible Care); "[companies] agree not to engage in conduct that is misleading or deceptive or that is likely to mislead or deceive. "from an association code on food standards. Environmental externalities: "In the Group we are committed to: pursue the goal of no harm to people; to protect the environment; " from an extractive industries code; Competitive practices: "Violations include agreements among competitors to fix or control prices; to boycott specified suppliers or

customers; to allocate products, territories or markets; or to limit the production or sale of products.” from the code of a multinational chemical company.

14. For example, the codes of an advanced materials manufacturing company states: “We at [company name] are committed to a policy of equal employment opportunity without regard to race, religion, national origin, sex, age, disability or any other classification protected by federal state or local laws. We practice and promote this policy in all locations.”
15. As shown in Chapter 4, it is difficult to use (non-financial) external verification as a tool for some compliance problems (e.g. bribery) because it is unlikely that an external monitor – public or private – would be able to detect most instances of bribery, especially the more sophisticated forms of corrupt practice. The position described in the main text also seems to ignore the important role that verification or auditing standards play in enhancing the effectiveness and credibility of verification and the fact that, for non-financial verification, these are only in the early phases of development. Likewise the components of an effective system of deterrence depends very much on the issue at hand (Ayres and Braithwaite 1992). For example, anti-corruption, occupational safety and transport safety pose different deterrence problems and require issue specific expertise.
16. This is the central question of the branch of finance and organisation theory called “agency theory”. See for example, Jensen and Meckling (1976). Alexander and Cohen (1999) apply this model to problems of corporate crime and find that corporate crime tends to penalise shareholders. The sample is 109 US publicly traded companies convicted of US Federal crimes between 1984 and 1990.
17. Regulatory inflation refers to the continual growth of attempts at regulation arising from the lack of constraints on the growth of rules and regulation. Attempts at producing “regulatory budgets” have so far been unsuccessful.
18. The service states that annual savings due to ISO implementation were more than \$200,000 per year with an average project length of 12 months. The ISO 14001 implementation costs were, on average, between \$25,000 and \$128, 000, depending on the size of the firm. At any reasonable cost of capital, these figures imply that the net present value of ISO 14001 implementation was highly positive, on average, for these organisations.
19. For example, the international secretariat of a well-known human rights group has a budget of nearly 17,000,000 GBP. This is in addition to the national budgets of the same group.
20. www.acf-fr.org

Overview of a Fact-finding Mission on Private Initiatives

Introduction

Public concerns have been expressed about the economic, social and environmental impacts of the activities of multinational enterprises.

Globalisation has brought with it new management challenges stemming from the need to comply with the laws and regulations of numerous jurisdictions and to respond appropriately to various societal expectations.

Firms have been responding to these concerns and challenges with managerial innovations, including codes of conduct and associated management systems.

The practice of issuing codes is a relatively recent development.

In the ongoing public debate on globalisation, concerns have been expressed about the economic, social and environmental impacts of deepening international trade and investment ties and about the activities of the multinational enterprises. These concerns focus on a variety of issues including labour relations, human rights, environment, corruption, control of technology and consumer protection. The high profile of this debate means that most multinational enterprises now pay close attention to public perceptions of their activities in the societies in which they operate.

Globalisation has also brought with it additional management challenges for firms in an area that has come to be called “legal compliance”. Multinational enterprises are often present in dozens of jurisdictions covering many legal and regulatory areas. These companies need to keep themselves informed about the regulations affecting them and must take steps to ensure that they comply with law and regulation. Compliance can be quite complex, especially when the enterprise’s operations straddle a variety of regions and business cultures. Thus, compliance with law and regulation is often not a straightforward task, especially for multinational enterprises.

Firms have attempted to respond to public concerns and to the growing challenge of “legal compliance” in a globalising business environment. New management techniques have emerged. Some twenty years ago, firms began issuing policy statements – or codes of conduct – that set forth their commitments in various areas of business ethics and legal compliance. A second step was the development of management systems designed to help them comply with these commitments and the emergence of standardised management systems. A new management discipline has emerged involving professionals that specialise in regulatory, legal and ethical compliance. More recently, steps have been taken to formulate standards providing guidance for business reporting on non-financial performance.

These private initiatives are a prominent recent development in international business. Business surveys show that most major companies issue codes of conduct (see, for example, KPMG (1999) and Control Risks Group (1999)). The compliance tools now used routinely in international businesses hardly existed three decades

Firms have not developed these management innovations on their own. Business associations, NGOs and governments have also played important roles.

This paper reports on the results of this fact-finding mission.

The issuers of the codes in the inventory differ by nationality, purpose and sector of operation.

ago. The practice of issuing codes on business conduct dates roughly to twenty-five years ago. The first major corporate code of conduct appears to be the 1977 issuance of guidelines on conducting business in South Africa by a major automobile manufacturer. Many other companies later adopted these “Sullivan Principles” or began to issue corporate codes dealing with broader areas of business ethics.

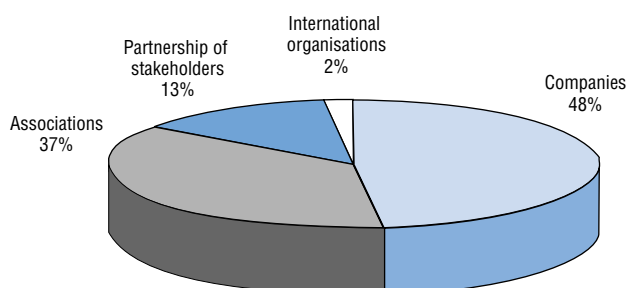
Companies have not acted alone in making these innovations. Business associations have undertaken many initiatives to help their members and NGOs have played important and varied roles. OECD governments also have influenced the shape of these initiatives in various ways. In particular, many have incorporated them into their regulatory and law enforcement strategies, giving rise to hybrid systems involving both public and private action.

The present paper summarises the results of the fact-finding mission. More detailed papers describing the components of the fact-finding mission may be found in a subsequent chapter of this publication. Chapter 3 reports on an analysis of 246 codes of conduct. The others are based on additional analysis performed on the codes inventory (Chapter 4) and on databases covering companies’ environmental management practices (Chapter 6) and the ways OECD governments have influenced voluntary initiatives in the areas of corporate responsibility (Chapter 5). The results of the fact-finding mission are summarised in the Box 4.

Commitments and Codes of Conduct: Actors, Issues and Audiences¹

Codes of conduct are voluntary expressions of commitment that set forth standards and principles for business conduct. A wide variety of actors – corporations, business associations, NGOs, trade unions and international organisations – issue such codes. Companies issued 48% of the codes in the inventory, business associations accounted for 37%, “partnerships of stakeholders” (mainly NGOs, but also trade unions) issued 13% and inter-national organisations, 2% (Figure 1). The companies issuing the codes are based in 23

Figure 1. **Composition of codes by type of issuer**



Box 4. **Principal Findings**

Scope and Detail of Commitments Made in Codes

Viewed as a whole, the 246 codes in the inventory cover the three components of the sustainable development agenda – the codes contain a detailed set of commitments relevant to the economic, social and environmental welfare of the societies in which they operate. The commitments cover a vast array of issues including core labour standards, environmental stewardship, human rights, disclosure, corporate governance, public safety, protection of privacy and consumer protection. Labour relations and environmental stewardship are the most common broad issue areas covered in the codes.

Uniformity of Approach to Commitment

Although the code inventory shows the firms are making commitments in an array of issues, it also suggests that there is little uniformity in their approach to commitment, even in relatively narrowly defined issue areas. The bribery codes show major differences of approach to basic features of commitment – parties to bribery (public officials, private operatives or both?), gift-giving and entertainment (e.g. reasonable, accepted by local culture?) and political activity. Likewise, the codes dealing with labour relations among suppliers to the branded apparel industry (i.e. codes issued by garment retailers with a well-known brand) all mention the prohibition of child labour, but their treatment of other basic human rights within the workplace is variable (e.g. some mention freedom of association and others do not).

Implementation of Codes of Conduct

An examination of the 118 codes issued by individual business shows that many of them discuss implementation of commitments. Many different compliance or implementation tools are in evidence in the codes – commitment by top executives, creation of a compliance office, training, employee signatures, internal audits, external audits, threats of punitive action, whistle-blowing facilities and record keeping. The codes in different issue areas differ in the frequency with which they discuss implementation. The bribery codes are twice as likely to discuss implementation as the environmental codes. The analysis also suggests that companies use different mixes of tools to deal with different implementation problems. In bribery, the most common tools are financial records, internal monitoring, and whistle blowing. In codes addressed to suppliers (usually focusing on labour issues), the most common tools were threat of punitive action (termination of the supply contract) and internal and external monitoring.

Advanced Management and Reporting Practices – European, Japanese and Asian Companies

A data set covering the environmental practices of over 400 publicly traded European companies operating in high environmental impact sectors was analysed in order to determine how common various advanced environmental management and reporting practices are. A matched sample of 100 non-member Asian firms was also developed and analysed. The analysis of the European companies suggests that over 50% of the sample has a formal environmental management system and that EMS are extremely common in some countries (especially in northern, continental Europe) and not common at all in others (Ireland and Greece). Reporting of environmental performance was the least common environmental practice – about 60% of the Swedish high-impact companies publish a stand-alone report, whereas none of the Irish or Greek companies in the sample do. About 20% of the non-member Asian high environmental impact companies have a formal management system and about 10% of them issue a stand-alone environmental report. Results for Japanese companies suggest that Japanese companies have very high rates of adoption of environmental commitment, management and reporting practices and that they have a strong preference for standardised management systems such as ISO 14001.

The Important and Varied Roles of Governments

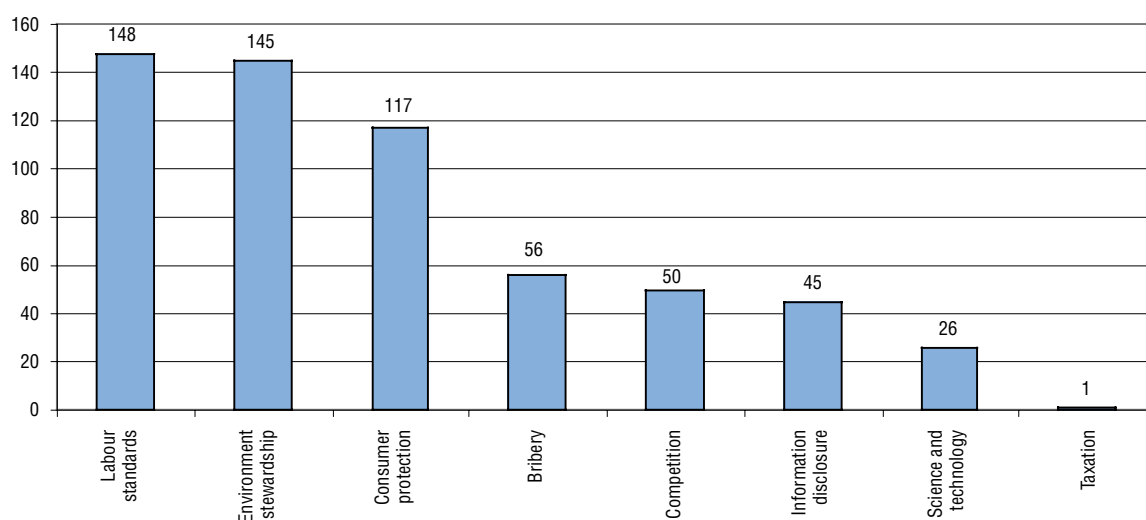
The corporate responsibility initiatives studied here are private and voluntary, but have nevertheless been influenced by numerous government policies. Perhaps the most important of these is the incorporation of private compliance initiatives into public enforcement strategies for law and regulation (e.g. in environment, occupational safety, competition law). This is sometimes done in ways that create powerful incentives to undertake such initiatives. Some governments have influenced corporate responsibility initiatives indirectly by providing tax expenditures (and occasionally direct subsidies) to the NGO sector, which has played diverse roles in these initiatives. Governments have also engaged in moral suasion to encourage companies to participate in particular initiatives and have contributed expertise and promoted the accumulation of human capital in this area.

All aspects of the sustainable development agenda – decent work, environment, anti-corruption, human rights, technology etc – are covered in this inventory of codes.

member countries and cover all economic sectors (primary production, industry and services).

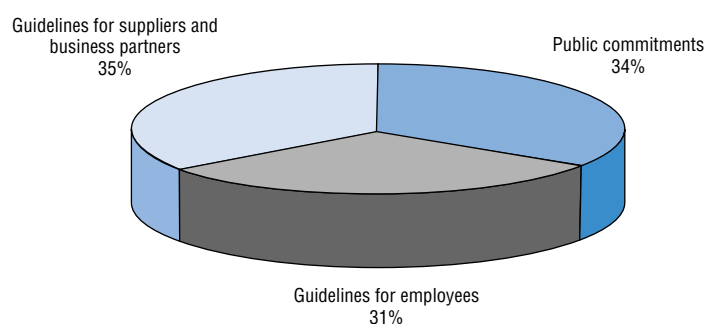
Viewed as a whole, the codes cover a broad range of issues and address each of the economic, social and environmental “pillars” of the sustainable development agenda. The codes address such issues as environmental management, human rights, labour standards, anti-corruption, consumer protection and information disclosure, competition and science and technology (Figure 2). The most common issue areas addressed in the inventory are labour standards and environmental stewardship. Tables 1 and 2 show the

Figure 2. **Issues addressed in codes of corporate conduct**
(number of codes mentioning issue; out of 246 codes)



Source: OECD

Figure 3. **Type of Codes**



Source: OECD

Table 1. Commitments in the Environmental Codes

	Percentage of environmental codes mentioning attribute*
Comply with laws	67.6
Openness to community concerns	40.0
Environmentally friendly products and services	37.9
Employee training, awareness and dialogue	35.9
Transparency to Public	35.9
Contractors, suppliers & partners	35.2
Continual improvement	33.8
Global application	33.8
Water, waste & effluent management	33.1
Conservation of Materials & Recycling	33.1
Public/customer awareness	33.1
Internal Reporting & Performance audits	28.3
Research	26.2
Accountability of Management	24.8
Energy Conservation	24.8
Prior assessment	23.4
Hazardous waste disposal/management	23.4
Sustainable development	23.4
Exceed legal requirements	20.7
Measurable objectives	17.9
Emergency Preparedness	17.2
Contribute to sound legislation	16.6
Design, construction and decommissioning sites/facilities	15.2
Bio-diversity	11.7
Transfer of technology	9.7

* These are calculated as: $100 \times [\text{the number of codes mentioning attribute}] \div [\text{the number of codes citing environmental stewardship}]$

Source: OECD

Table 2. Commitment in the Labour Codes

	Percentage of labour codes mentioning attribute*
Reasonable working environment	75.7
Compliance with laws	65.5
No discrimination or harassment	60.8
Compensation	45.3
No child labour	43.2
Obligations on contractors/suppliers	41.2
No forced labour	38.5
Provision of training	32.4
Working hours	31.8
Freedom of association	29.7
Specific mention of "human rights"	25.0
Monitoring	24.3
Right to information	13.5
ILO codes mentioned	10.1
Promotion	8.8
Reasonable advance notice	3.4
No excessive casual labour	3.4
Flexible workplace relations	0.7

* These are calculated as: $100 \times [\text{the number of codes mentioning attribute}] \div [\text{the number of codes citing labour}]$

Source: OECD

Compliance with law is one of the most common commitments made in the code.

The approach to commitment made in narrowly defined areas is highly variable. Examples are the variability in the language and concepts used in the bribery codes...

... and in codes dealing with labour management among foreign suppliers to the branded apparel industry.

Firms use a variety of tools to implement their commitments and to comply with laws.

This section looks at how the codes treat a range of compliance tools – executive commitment and other hierarchical controls, whistle-blowing facilities, compliance officers and external verification.

frequency of mention of more specific commitments in the areas of, respectively, environment and labour.

Compliance with law is a prominent concern in the codes (Tables 1 and 2) and nearly all commitments to it apply to both home and host countries. However, none of the 246 codes in the inventory could be read as a pure “legal compliance” text. All codes citing legal compliance also cite broader commitments in the areas they cover.

A look at the commitments made in narrowly defined issues in relation to a particular activity (e.g. out-sourcing) shows that the codes vary in their approach to particular types of commitment. For example, the codes dealing with combating corruption use a wide variety of concepts and terms. The codes that discuss “parties to bribery” (that is, who might be involved in corrupt transactions) are about evenly divided among three categories: those that discuss only bribery of public officials, those that deal only with private-to-private bribery, and those that deal with both public and private operatives. Some discuss remuneration of agents, while others do not. Likewise, the treatment of gift giving, entertainment and political activity is very different among the bribery codes (see Chapter 3, Table 7). Thus, the codes do not generally constitute a de facto standard of commitments in the areas they cover.

Similar diversity is found in the labour commitments made in branded apparel industry codes. The only issue about which these codes agree is the need to eliminate child labour (though, even here, there are major differences in concepts and terms). Other key human rights issues for the work place (e.g. forced labour and reasonable working conditions) are also addressed in the majority of the codes. However, other issues (e.g. freedom of association) are dealt with by less than half of the branded apparel industry codes (see Chapter 3, Figure 16).

Implementing the Codes – A Portfolio of Tools ²

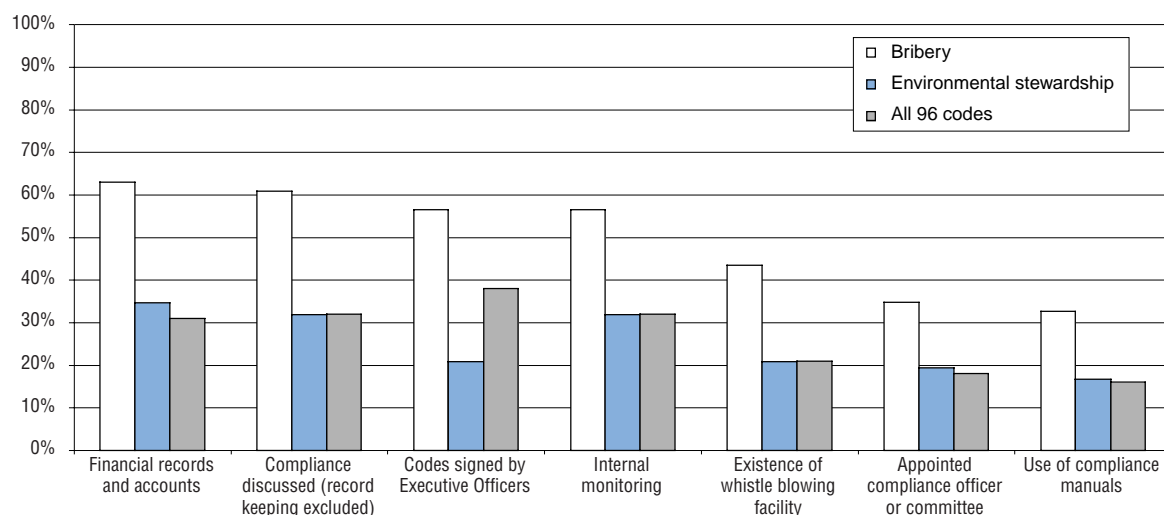
Business activity in the area of legal and ethical compliance programmes has not been limited to the formulation of commitments. Managerial know-how on implementing commitments has been accumulating, within the business community, in the NGO sector and in governments. An examination of the 118 individual company codes in the OECD inventory indicates that firms use a portfolio of management tools in order to implement their commitments and to comply with law.

This section looks at the tools that companies use to translate code commitments into day-to-day business practice. The compliance tools examined here include: internal monitoring, reports to Boards of Directors, use of compliance manuals, whistle-blowing facilities, signatures of Directors, training, periodic compliance reviews by managers, employee signatures, disciplinary action and active communication and external verification. Financial reporting and record keeping (normally done as part of firms’ broader financial control functions) are also counted as an implementation measure when they are explicitly referred to as such.

The paper looks at two types of code: those addressed to employees of the company issuing the codes and those addressed to subcontractors and suppliers.

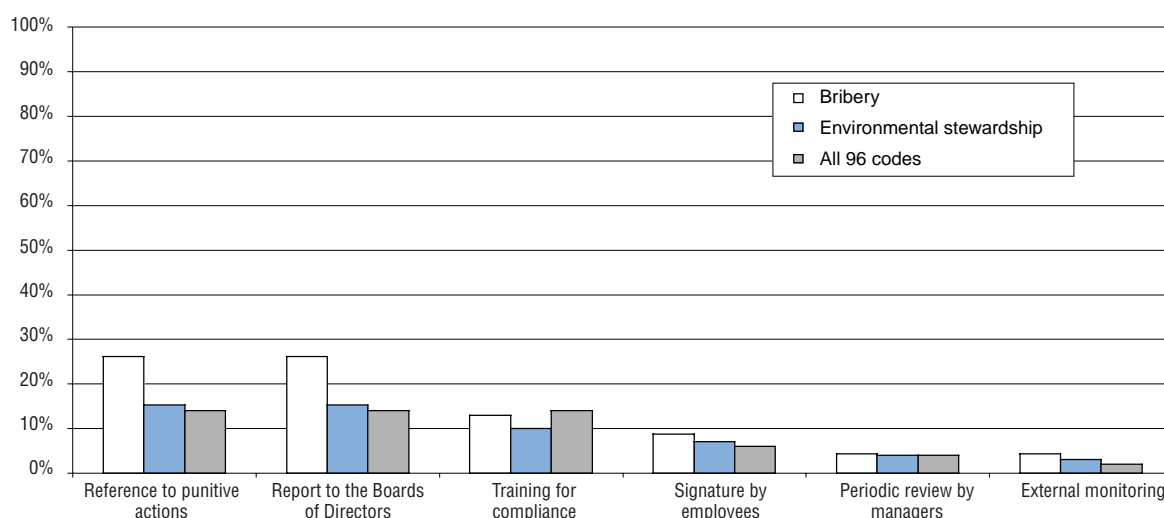
The analysis presented here divides the inventory of company codes into two sets – those in which the company makes commitments in relation to its own activities and those where the company states what it expects of its business partners (mainly suppliers). Among the 118 company codes, 96 express commitments about the company's own behaviour and 22 codes provide guidance to suppliers. The results of this analysis are presented in Figures 4a

Figure 4a. Implementation in the 96 codes of conduct addressed to employees
(Percentage of codes mentioning a particular implementation measure)



Source: OECD

Figure 4b. Implementation in the 96 codes of conduct addressed to employees
(Percentage of codes mentioning a particular implementation measure)



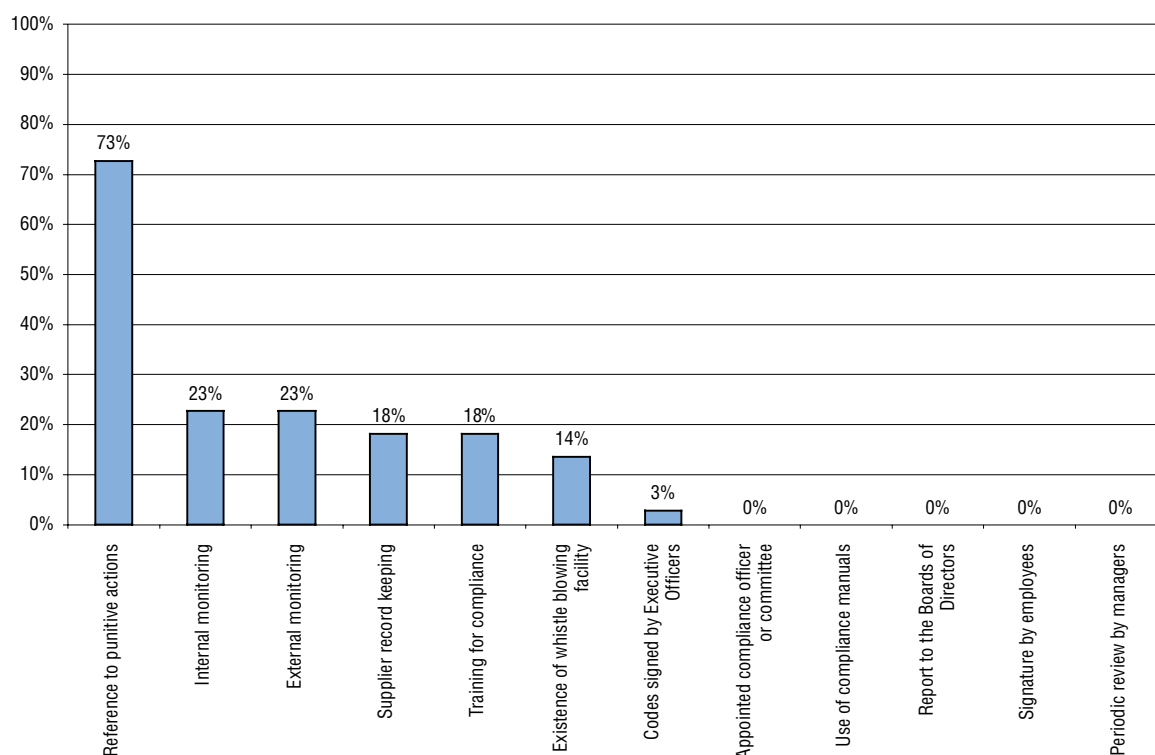
Source: OECD

The company codes mention a variety of compliance tools. They use different compliance strategies for different commitments.

and b (for the company codes) and Figure 5 (for supplier codes). Figures 4a and 4b show the frequency of mention of compliance tools in the total sample and in codes making two types of commitment: fighting bribery (44 codes) and environmental stewardship (72 codes).³

Figures 4a and 4b suggest that companies use a variety of management techniques in order to respect their commitments and that these techniques vary by type of commitment. As shown in Figure 4a, 32% of all company codes discuss implementation in one way or another. Combating bribery is the most “implementation intensive” issue – anti bribery codes are more than twice as likely to discuss implementation as the average code. The bribery codes also show a distinctive pattern of deployment of the compliance tools examined. They are much more likely than non-bribery codes to mention financial records and accounts as an implementation measure and they are more likely to mention a range of more specific internal measures (e.g. internal monitoring, whistle-blowing, etc.). External monitoring is the least used implementation technique examined – only 2% of the company codes mention it.

Figure 5. **Implementation measures in 22 codes of conduct addressed to suppliers**
(Percentage of codes mentioning a particular implementation measure)



The supplier codes emphasise a different cluster of compliance tools. The use of threats – e.g. terminating the business relationship – is common in these codes.

The supplier codes are ten times more likely to mention external monitoring than the company codes.

In summary, there is no “one-size-fits-all” approach to implementation.

Implementing a legal and ethical compliance programme can be a formidable task. This section looks at companies’ environmental practices.

The data sets used here include a database covering over 1600 European companies and 100 non-member Asian companies. A different data set on Japanese companies’ environmental practices is also presented.

The 22 supplier codes in Figure 5 show a very different pattern of implementation. These codes’ primary focus is labour standards in connection with retailers’ outsourcing activities in production sites not owned by the company. The most common measure is threat or “reference to punitive action” (mentioned in 73% of the codes). This means that the code threatens some adverse economic consequence (usually termination of contract) if the code is not complied with.

The supplier codes are more likely to mention external monitoring by parties not involved in the supplier’s day-to-day operations. Such monitoring is mentioned in 23% of the supplier codes. This is monitoring by an organisation that is “independent” of both the issuing firm and the supplier (e.g. for profit auditing companies or NGOs). Generally, the codes do not state that such monitoring will be done, rather they reserve the right to do so.

In summary, this analysis shows that firms do not use a “one-size-fits-all” approach to implementation and that they tailor implementation measures to the type of commitment. A wide portfolio of management tools is used and expertise in the use of these tools is needed to implement ethical and legal compliance programmes in different business contexts.

Management Systems and Reporting – Focus on the Environment⁴

Implementing a corporate compliance programme can be a formidable task requiring considerable managerial know-how. Normally all aspects of the firm’s operations will be affected – structure of responsibilities, hiring, record keeping, incentive systems, external communications, training, production, legal services, emergency preparedness, etc. This section looks at how common such practices among European, Japanese and non-member Asian companies. It sheds light on the frequency of adoption of various environmental management and reporting practices and compares practices across countries and sectors of activities.

This discussion of European companies presents aggregations of data from an existing database on environmental management and reporting practices (the environment module of the EIRIS⁵ database, which uses only publicly available information) covering over 1600 publicly traded companies in Europe. This discussion focuses on the firms in this database (numbering over 400) that operate in “high environmental impact” (HEI) sectors such as chemicals, air transport and forestry. The Secretariat has duplicated the EIRIS methodology and created another database on a matched set of non-OECD Asian companies in high environmental impact sectors. The Secretariat has also aggregated survey data on corporate environmental practices in Japan compiled by the Asahi Foundation. All three databases cover firms’ environmental commitments, environmental management practices and environmental reporting.

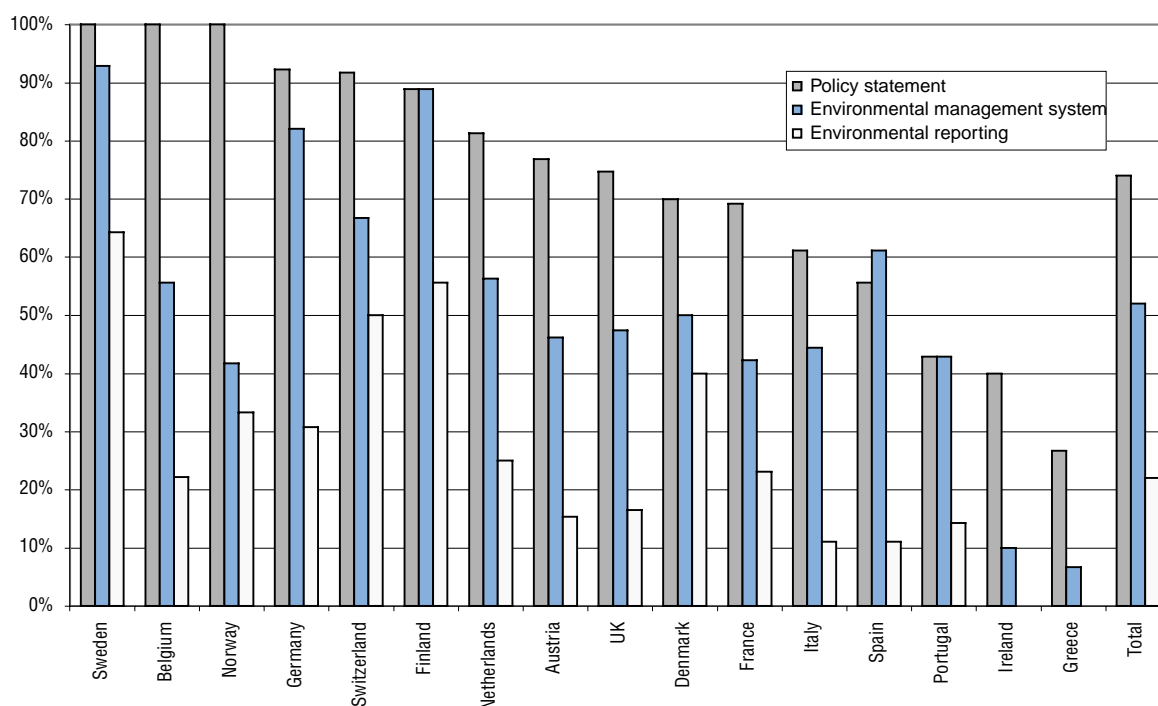
The analysis suggests that 75% of the high impact firms in the sample publish environmental statements.

Firms sometimes use formal environmental management systems. Use of such systems is extremely high in northern Europe, but low in some other parts of Europe.

The statistical results for the HEI firms in Europe are shown by country and by environmental practice (statement of environmental commitment; formal environmental management system; reporting). Seventy-five per cent of the HEI firms in the EIRIS sample publish a formal “environmental policy statement” (i.e. a type of detailed code of conduct setting forth the company’s commitments for its environmental performance). The equivalent figure for all firms (high and low impact) is 42%. All HEI companies from Sweden, Belgium and Norway issue policy statements, whereas less than 30% of the Greek HEI companies do (Figure 6).

Companies sometimes use a formal environmental management system to help achieve their environmental commitments. Fifty-two % of the HEI firms have such a system (Figure 6). The data point to wide differences among countries in the rate of implementation of such systems. Countries whose HEI companies have high rates of EMS implementation are Sweden (93% of HEI companies), Finland (89%), and Germany (82%). Countries whose high environmental impact companies have relatively low rates of adoption include Greece (7%) and Ireland (10%).

Figure 6. **The environmental practices of European companies: policy, management systems and reporting**
(percentage of firms adopting practice and operating in high environmental impact sectors)



Standard environmental management systems are available. Many European companies use such standards, but a third of them use tailor-made systems.

Environmental reporting is the least common environmental practice.

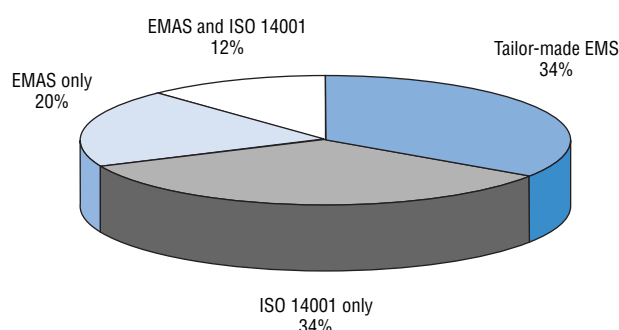
The EIRIS methodology has been duplicated for a sample of 100 publicly traded non-member Asian companies. The results show quite advanced environmental management practices in some cases.

An important development in this area in recent years is the marked progress made in standardisation of environmental management systems (EMS). Two main EMS standards are available – ISO 14001 and European Union's Eco-Management and Audit Scheme (EMAS). The purpose of management standards is to lower the cost of implementation for companies (since they can take a management system “off the shelf”) and to increase the credibility to external stakeholders of firms' efforts to achieve appropriate environmental standards (since their environmental practices are then recognised as being standard). The disadvantage of a standard is that it may not be well suited to a firm's individual management problems or style. The data show that the majority of European firms using an EMS use an EMS standard (ISO or EMAS), while 34% use only tailor-made systems (Figure 7).

Environmental reporting is the least common among the three main practices studied. Forty-one per cent of the HEI firms publish a stand-alone report on their environmental performance. Figure 6 suggests that significant differences exist between countries in the area of environmental reporting by HEI companies. Countries whose HEI companies are likely to publish stand-alone reports include Sweden (64%), Finland (56%) and Switzerland (50%). In Ireland and Greece, none of the HEI firms produce stand-alone reports.

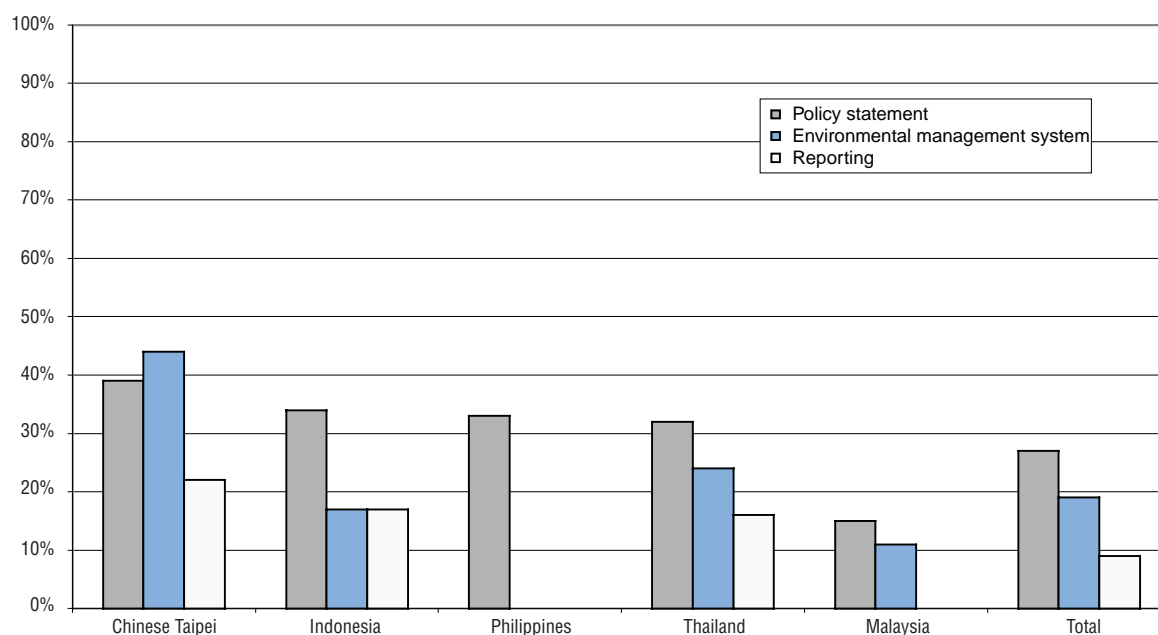
OECD-based companies are not the only firms involved in the adoption of advanced environmental management practices. The Secretariat duplicated the EIRIS methodology for a matched sample of 100 high environmental impact companies based in five non-member Asia companies (Indonesia, Malaysia, Philippines, Chinese Taipei and Thailand). Note that, as with the EIRIS database, the nationality of a company depends on the stock exchange where its shares are quoted (in both cases, foreign ownership is often high). The results show reasonably high rates of adoption of such practices, especially in Chinese Taipei and Thailand for EMS adoption (Figure 8). These numbers place the rate of corporate adoption of

Figure 7. **Standardised EMAS and ISO 14001 versus Tailor-made EMSs in Europe**
(as a percentage of all companies with EMSs)



Source: EIRIS and OECD

Figure 8. **Environmental management practices of non-member Asian companies**
(percentage of firms adopting practice and operating in high environmental impact sectors)



Source: OECD

A survey-based data source suggests that Japanese companies have high rates of adoption of advanced environmental management and reporting practices.

formal EMSs in those two countries at only slightly lower than in the United Kingdom and France. An interesting difference between the Asian and European samples is the much higher reliance of Asian firms on standardised environmental management systems. All of the firms with an EMS in the Asian sample are certified for ISO 14001 (that is, none of the Asian firms use a tailor-made system).

The Secretariat has also looked at the environmental practices of Japanese companies by aggregating survey data compiled by Asahi Foundation. The methodology underpinning this data is quite different than that of the two studies reported above (see Annex to Chapter 6) and so comparisons should be made with caution. However, the data suggests that Japanese companies have very high rates of adoption of advanced environmental management practices: 78% of the companies publish a statement of environmental policy, 58% have one or more units certified for ISO 14001 and 54% publish information on their environmental performance. One striking feature of the Japanese data is that it shows less difference between companies operating in high- versus low- environmental impact sectors than is typical of European companies.

Governments' Roles in Influencing These Initiatives

OECD governments have played important and varied roles in influencing these private initiatives.

Although the business initiatives discussed here are essentially private, they are influenced in various ways by the broader environment – cultural, social, legal and political – from which they emerge (Punch 1996). Public policy shapes this environment and is part of the institutional framework that influences firms' voluntary initiatives. A survey of corporate environmental programmes in Asia, Europe and North America attests to this diversity of influences. Companies in all three regions named domestic legislation as the most important influence on their environmental management practices. This was followed by “legal actions”, environmental accidents and host country legislation (survey cited in Kolk (2000)). Chapter 5 of this publication discusses the ways OECD governments shape these initiatives. The policy areas covered are regulatory enforcement, criminal law enforcement, tax policy and policies affecting intangible capital (especially higher education).

One of the most important ways that governments have promoted voluntary initiatives is by explicitly incorporating them into their regulatory enforcement strategies.

One of the ways that governments have promoted the adoption of corporate voluntary initiatives is by explicitly incorporating them into their regulatory strategy (OECD 1997). This strategy recognises that firms and their employees are often best placed to identify non-compliance with regulation. Under this approach, incentives are created to encourage firms to participate and to become, in effect, the first line of enforcement of public policy. Examples include the European Union's environmental enforcement strategy (involving EMAS) and the United States' co-operative programme in occupational health and safety. Other examples have been noted in food safety and truth in advertising (see OECD 1997) and in reduction of toxic chemical releases (Arora and Gangopadhyay (1995)).

They also use them in their enforcement of corporate criminal law.

A closely related development can be found in enforcement of corporate criminal law. Several OECD members have explicitly incorporated consideration of companies' compliance and risk management practices into their approaches to punishing and correcting illegal corporate activity. Some countries refer to corporate compliance practices in their sentencing guidelines for corporate crime. A company that can show it exercised due care in avoiding criminal misconduct by its employees may receive less severe punishment than a company that cannot show it took reasonable measures to discourage misconduct. Examples are found in Australia (especially competition law), Canada (competition law) and the United States (Federal Sentencing Guidelines). These programmes create powerful incentives for firms to implement formal compliance practices and management systems of the type discussed in this paper.

Some governments also offer advantageous tax treatment to the NGOs that have played important roles in promoting these initiatives.

Compliance with criminal law and regulation is not the only factor influencing corporate initiatives – they also respond to public concerns about the economic, social and environmental impacts of business activities. In recent years, NGOs have assumed an increasingly high profile role in the public debate on the activities of multinational corporations. NGO activity in monitoring and shaping

Governments have also contributed to the development of intangible capital – mainly expertise and standards – that are crucial to these private initiatives.

business conduct has been diverse. It has included monitoring of the activities of some multinational enterprises and conducting public campaigns against those activities that are deemed to be inappropriate. They have also issued model codes of conduct (often in co-operation with the business community) and have provided expert advice in the field on managerial and strategic issues in the area of corporate responsibility. Some OECD governments have indirectly promoted these activities by offering favourable tax treatment to NGOs fund-raising efforts.

Governments also have contributed to the accumulation of intangible capital that is important in this area. They have contributed to the development of management and reporting standards (e.g. they contributed expertise when the ISO 14000 series of environmental standards was being developed). They have promoted the accumulation of human capital through their systems of higher education which now offer special course work and degree programmes in various field of corporate ethics and compliance. They have contributed to broader thinking in this area by promoting specific initiatives (e.g. the Apparel Industry Partnership in the United States and the Ethical Trading Initiative in the United Kingdom) and by creating information services designed to promote “best practice” (e.g. in the European Union, Australia and Canada).

Notes

1. This section discusses in more detail in the paper in the first annex.
2. Further detail on results and methodology may be found in Annex of this paper.
3. Notice that there is some overlap between the set of bribery codes and the set of environmental codes; that is, some codes mention both issues.
4. A more detailed discussion of the studies of European companies, non-member Asian and Japanese companies, which uses a different methodology than those of the European and non-member Asian studies, is provided in Chapter 6.
5. EIRIS, the Ethical Investment Research Institute, provides data used by ethical investors to evaluate individual company performance in a variety of ethical areas. EIRIS is based in the United Kingdom and covers European firms. The OECD Secretariat performed the aggregation of EIRIS's firm-level data into sectoral and national groupings.

Chapter 3

Codes of Corporate Conduct: Expanded Review of their Contents¹

Executive Summary

Based on a slight extension of the inventory of 233 codes of corporate conduct collected for an earlier study (TD/TC/WP(98)74/FINAL), this paper takes a more in-depth look at the contents of the codes with respect to issue coverage and code implementation procedures.

The main findings of this investigation of 246 voluntary codes of conduct are:

The codes examined differ considerably in terms of their content and degree of detail. This reflects the underlying diversity of the organisations issuing the codes, which differ in terms of size, sector and regional affiliation. All the firms subscribing to the codes covered in this study are based in the OECD (most of the 29 member OECD countries are covered in the inventory). The firms operate in a variety of sectors including high technology, mass retailing, heavy manufacturing, light manufacturing, primary production and financial services. Some codes in the inventory are issued by business associations and others by NGOs.

The codes address a variety of issues, many appearing to arise from concerns of the general public. Environmental management and labour standards dominate other issues in code texts, but consumer protection and bribery and corruption also receive extensive attention. In addition, many codes contain extensive text on fairly narrow questions of internal control and protection of shareholder value. These issues are particularly important for financial intermediaries, conglomerates and very large manufacturers. Another objective that appears in some of the codes is the desire to manage risk of liability or to ensure compliance with the law in such areas as competition and environment.

The statements made by some of the codes suggest that economic motivations related to the desire of organisations to compete successfully in the market place can also play a role in an organisation's decision to develop a code of conduct. Relatively often mentioned considerations are the protection or enhancement of an organisation's reputation and stronger customer loyalty.

Codes addressing labour and environmental issues differ considerably in how they approach these two issues. While some codes mention labour and environment only in passing, many of them are devoted exclusively to one of these two issues. Especially in these "single issue" codes, the overall level of commitment is often quite high, although the specifics of the commitment vary. In the environmental codes, commitments often include being open to community concerns, engaging in a process of continual improvement, training employees and encouraging dialog within the firm. The same situation holds for the labour codes – the codes that deal with the issue at length tend to show a high level of commitment. Among the codes mentioning labour, the most common commitments are: creating a reasonable working environment; refusal to discriminate or harass; compliance with law; avoidance of child labour; and conditions of worker compensation. Many of these codes have been influenced by external reference standards (other codes and international agreements and recommendations).

The codes from the apparel and extractive industries show that industry factors can be very important in shaping the codes. The content of the apparel codes, all of which cover labour issues, is quite different from the “average” content of the labour codes in the overall inventory. All of the apparel codes deal with child labour and the majority deal with bonded labour, working environment and compensation. Codes from the extractive industry typically deal with a diverse array of issues and are much more likely to deal with environment and labour than the “average” code in the inventory.

The codes surveyed show the diversity of approach which organisations take to including information about the process of implementation in their codes. The codes are quite selective in the elements of implementation which they describe and the detail of information provided. Certain elements, such as policy to inform stakeholders of the code and monitoring, are mentioned more frequently than others.

The methodology adopted by this study has unavoidable limitations and the findings can only be seen as indicative of how firms manage certain aspects of their policies of corporate responsibility. The codes of conduct methodology looks only at what may be the “tip of the iceberg” in firms’ efforts to meet a given standard for business conduct. Codes of conduct, in order to be fully understood, must be placed in their broader managerial, sectoral and social context. Data other than those derived from the code texts are necessary to further such understanding.

Introduction

This paper is part of ongoing collaborative work by CIME and the Trade Committee on codes of corporate conduct. Drawing on a jointly drafted outline for such work and comments made by Member countries, this paper follows up on a mandate for extended factual analysis aimed at clarifying the content, purposes and effects of codes.

An initial examination of code texts was undertaken in TD/TC/WP(98)74/FINAL, which presents an inventory of 233 codes collected from OECD countries. The present report deepens the examination by addressing the following two questions:

- What objectives do codes set for themselves and how do these relate to public concerns? The paper looks in some detail at how these issues are addressed – for example, within the general issue of environmental management, what, more specifically, do firms say they want to do? It also takes a closer look at the codes in the apparel and extractive industries in order to see if they deal with public concerns that appear to be of particular relevance to these sectors. In particular, it looks at the codes’ treatment of child labour and other workplace issues in the apparel industry and at protection of indigenous peoples and site restoration in extractive industries.
- What do the code texts reveal about the activities that are being undertaken by organisations in order to put the commitments or principles set forth into effect?

Methodology and Limitations

The codes inventory used in Chapters 3 and 4 defines codes of corporate conducts as “commitments voluntarily made by companies, associations or other entities, which put forth standards and principles for the conduct of business activities in the marketplace”. This definition includes self-obligations and negotiated instruments. It excludes codes of corporate governance.

Each code was scored as to whether it mentioned nine issue areas: environmental stewardship, labour standards, science and technology, competition, information disclosure, taxation, bribery and corruption, and consumer protection. These areas were selected because they are important for the ways that companies affect the welfare of the societies in which they operate. The content analysis of the codes was deepened by breaking individual issues areas, such as environmental protection and labour practices, further down into various sub-areas.

The initial inventory was also slightly expanded. Codes of firms in the apparel and extractive industries were collected to make possible a more focused analysis of codes in these two sectors. The additional firms were identified through competitor analysis of the firms whose codes had already been inventoried. The Secretariat also conducted several interviews with Japanese and American firms concerning codes of corporate conduct as a complement to the textual analysis. The codes that were collected during these interviews have been included in the inventory. Telephone interviews were conducted with nine French branded apparel firms, none of whom had issued codes.

To explore what code texts reveal about the implementation of codes, the texts of the 246 codes were examined for relevant statements, which then were aggregated using broadly defined areas of activity. Specific statements taken from codes serve to illustrate the variance in the degree of detail and content of provisions on implementation.

The methodological limitations of this study should be born in mind. Because of the way the codes were collected, the set of codes is neither a random nor a representative sample of the codes issued by companies, associations or other stakeholders in various countries. The types of codes included in the inventory vary widely, from codes designed to influence employees' conduct to sourcing principles. For some organisations, several codes are included (and counted separately) in the inventory; in other cases, the inventory contains only one of several codes which a firm has issued.

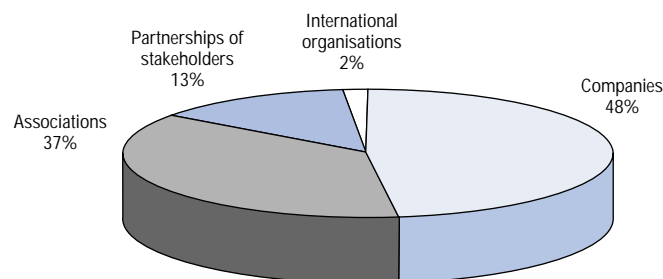
There is no way to ensure that the material which the OECD received from respondents is comparable. Some companies and other organisations issue short statements of values and then publish separately instructions manuals and training material for their employees that reveal more about corporate commitments and in particular the processes and procedures underpinning code implementation. This material has not always been sent to OECD. Other issuers include detailed instructions and other information about implementation procedures in the code text itself. Scoring was based on the entire set of information received and therefore may not be fully comparable across code issuers. Thus, some of the measured variation may stem from the inventory containing fuller information for some code issuers than for others.

Finally, the overall code analysis aggregates over a number of important sectoral and geographical factors. This means that it is hard to use the overall aggregates to make certain inferences, e.g. concerning the extent to which the social and economic processes driving the corporate codes movement have led to uniformity in firms' commitments.

A Profile of the Codes Reviewed

The composition of the codes by type of issuer is shown in Figure 9. Individual (mostly multinational) companies issued many of the codes (118 codes). However, code activity extends beyond companies to

Figure 9. **Composition of Codes by Type of Issuer**



Source: OECD

49

industry and trade associations (92 codes), partnerships of stakeholders (mainly NGOs and unions; 32 codes)” and some inter-governmental organisations (4 codes).

The inventory contains codes addressing a variety of audiences. While association codes always state the commitments of the association, individual company codes may take different forms. These are shown in Figure 10. The main categories of individual company codes that are found in the inventory are: 1) those that set guidelines for employees; 2) guidelines for a supplier/business partner's conduct; 3) a statement of company's commitment towards the public. A code may cover more than one function mentioned above; for example, it often happens that part of a code is intended for employees, while another section is intended for business partners. Most of the codes fall into one or two of these

Figure 10. **Type of Company Codes**



Source: OECD

Table 3. **Countries of Origin by Issuer of Code**

	Number of codes
Australia	20
Austria	4
Belgium	2
Canada	17
Czech Republic	4
Denmark	2
Finland	4
France	9
Germany	11
Greece	2
Italy	5
Japan	8
Korea	7
Luxembourg	1
Mexico	3
Netherlands	2
New Zealand	4
Norway	3
Spain	4
Sweden	6
Switzerland	10
United Kingdom	23
United States	67
Two or more countries	9
International	19

Note: It was not possible to identify the nationality for all codes

Source: OECD

Table 4. **Sectoral Composition of Firms Issuing Codes**

Sector	Activity	Number of firms
Primary	Agriculture	3
	Extractive	20
Secondary	Food	7
	Textile	23
	Wood	4
	Petroleum related	12
	Chemical	22
	Plastic	5
	Metal	13
	Electronics	14
	Mechanical product	15
	Office machinery	6
	Vehicles	10
	Others	15
Tertiary	Electricity, gas, water	10
	Construction	6
	Trade	61
	Hotel/restaurant	6
	Transport and communication	12
	Financial activities	10
	Real estate and other business	9
	Others	14

Source: OECD

categories. The remaining codes are international agreements, government statements, and recommendations issued by third parties.

Twenty-three countries are represented in the codes survey (see Table 3). The distribution is a function of the willingness of respondents to submit information to the OECD. The data should not be interpreted as reflecting the “true” geographical distribution of voluntary codes.

With respect to enterprises that have issued codes, many produce more than one type of product and are involved in several business activities. For this reason, it can be difficult to categorise these firms by a simple industrial classification. Among the 118 companies whose individual company codes are available, 24 operate in the primary sector, 69 in the secondary and 91 in the tertiary sector (see Table 4). (There is evidently double counting.)

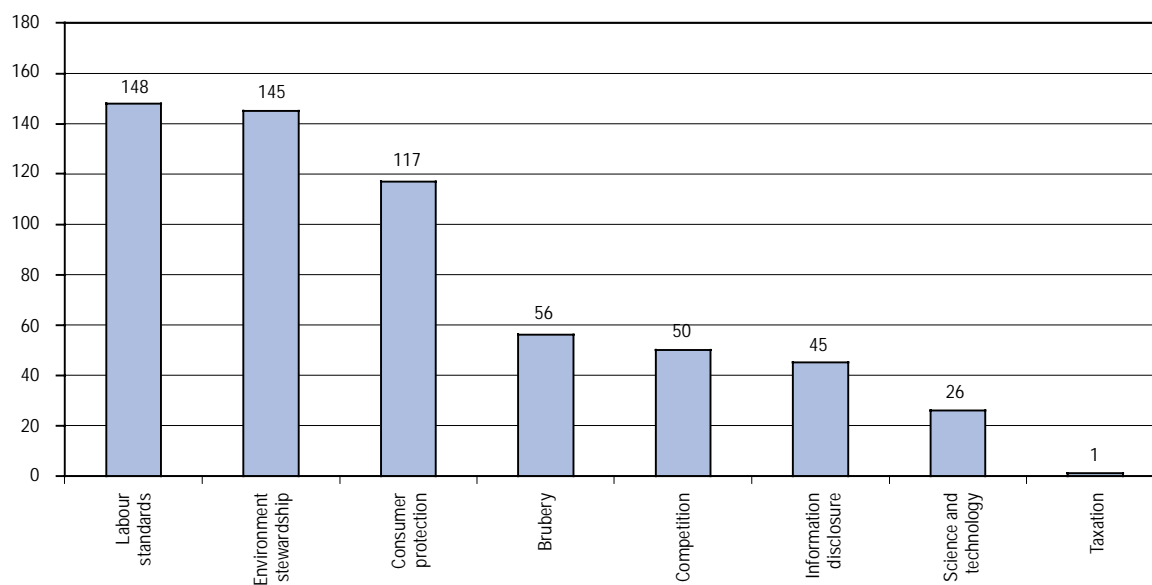
The Content of the Codes: Issues and Audiences

This section gives the results of a textual analysis of the 246 codes. It examines codes for their coverage of the following issue areas: environmental stewardship, labour relations, disclosure of information, competition, taxation, bribery and corruption, science and technology, and consumer protection (Figure 11). Environmental stewardship (mentioned by 145 codes) and labour relations (148 codes) are the issues areas most frequently addressed. The least frequently mentioned issue area is taxation, which appears in only one code.

Environmental Stewardship

Environmental stewardship is one of the most heavily cited of the areas in the extended inventory: 145 codes out of the 246 codes in the set mention it. Twenty-four of the codes are dedicated exclusively to this subject. The Secretariat has extended the initial inventory to 24 more specific attributes of the environment commitments. The attributes were selected by referring to some major environmental codes (Agenda 21, Ceres) and based on the suggestions of in-house experts. The results of this extension of the inventory are shown in Table 5.

Figure 11. Attributes of the Codes



Source: OECD

Table 5. Environmental Content of Codes

	Percentage of codes mentioning attribute*
Comply with laws	67.6
Openness to community concerns	40.0
Environmentally friendly products and services	37.9
Employee training, awareness and dialogue	35.9
Transparency to Public	35.9
Contractors, suppliers & partners	35.2
Continual improvement	33.8
Global application	33.8
Water, waste & effluent management	33.1
Conservation of Materials & Recycling	33.1
Public/customer awareness	33.1
Internal Reporting & Performance audits	28.3
Research	26.2
Accountability of Management	24.8
Energy Conservation	24.8
Prior assessment	23.4
Hazardous waste disposal/management	23.4
Sustainable development	23.4
Exceed legal requirements	20.7
Measurable objectives	17.9
Emergency Preparedness	17.2
Contribute to sound legislation	16.6
Design, construction and decommissioning sites/facilities	15.2
Bio-diversity	11.7
Transfer of technology	9.7

* These are calculated as: $100 \times [\text{the number of codes mentioning attribute}] \div [\text{the number of codes citing environmental stewardship}]$

Source: OECD

Table 5 shows the frequency with which specific types of commitment are mentioned in the codes that cover environment. A significant number of issuers include in their codes a commitment to “comply with the law”. In fact, 68% of the codes examined include such a statement. Other frequently mentioned commitments are: employee education, awareness and training (mentioned in 36% of the environment codes), openness to community concerns² (40%), environmentally friendly products and services (38%), provision of information so as to heighten community or consumer awareness (33%), obligations for contractors and suppliers (35%) and global applicability (34%).

Labour management

“Fair employment and labour rights” is a very frequently mentioned issue area, with well over half of the codes making related statements. Codes were examined further for 18 more specific attributes of labour commitments which were chosen based on consultations with in-house experts. Table 6 reports the frequency with which each of these attributes is mentioned in codes that contain text on labour relations.

In understanding the content of these codes, it is necessary to keep in mind that many of them are, at least in part, responses to NGO- or government-sponsored campaigns to improve working conditions in the sub-contracting sector of the apparel industry (e.g. the “Clean Clothes” campaign). Mass retailers and some other consumer goods companies also tend to be sensitive to this issue. Thus, 41% of the codes dealing with labour issues mention obligations for sub-contractors or other business partners. Similarly, many of them concentrate on the “cluster” of issues that came up in the course of these campaigns – forced labour (39%), child labour (43%), working hours (32%), compensation (45%) and reasonable working environment (76%). 13% of the codes that deal with labour issues mention ILO Declaration or Conventions. More generally, respect for human rights in the workplace is mentioned by 25% of these codes.

There is relatively less coverage of certain other aspects of human rights in the workplace. Thirty per cent of the codes mention respecting freedom of association and collective bargaining. Even less frequently mentioned issues are the right to information (14%) and reasonable advance notice (3%).

Table 6. **The Labour Content of the Codes**

	Percentage of codes mentioning attribute*
Reasonable working environment	75.7
Compliance with laws	65.5
No discrimination or harassment	60.8
Compensation	45.3
No child labour	43.2
Obligations on contractors/suppliers	41.2
No forced labour	38.5
Provision of training	32.4
Working hours	31.8
Freedom of association	29.7
Specific mention of “human rights”	25.0
Monitoring	24.3
Right to information	13.5
ILO codes mentioned	10.1
Promotion	8.8
Reasonable advance notice	3.4
No excessive casual labour	3.4
Flexible workplace relations	0.7

* These are calculated as: $100 \times [\text{the number of codes mentioning attribute}] \div [\text{the number of codes citing labour}]$

Source: OECD

Relations with sub-contractors and other business partners are mentioned in 41% of the labour texts. As noted above, many of the texts are, in fact, addressed to subcontractors and other business partners. Often partners are asked to sign a letter of understanding that contains language to the effect that there might be sanctions if the standard is not adhered to. However, the codes often state that, before such measures are adopted, remedial action may be taken by the contractor to achieve compliance. For example, one North American retailer states the following on monitoring and enforcement in its vendor code:

“As a condition of doing business with [the company], each and every factory must comply with this code of vendor conduct. [The company] will continue to develop monitoring systems to assess and ensure compliance. If [the company] determines that any factory has violated this Code, [the company] may either terminate its business relationship or require the factory to implement a corrective action plan. If corrective action is advised but not taken, [the company] will suspend placement of future orders and may terminate current production.”

Some of the codes come with training material and formats for data collection designed to serve as a basis for data bases tracking the labour conditions prevailing at sub-contractors' production sites.

The codes also attest to certain divergences of opinion or approach. On one extreme, for example, a North American company states that it will use legally permissible means to discourage the unionisation of its work force. In contrast, many other companies commit to freedom of association and the right to collective bargaining for their own employees and for contractors and subcontractors. Labour codes also differ in their specific treatment of particular issues. Child labour is a good example of this. Although many labour codes do not mention this issue, all those that do commit the company to contributing to the long-term goal of eliminating child labour. However, several codes recognise that the ethical considerations underpinning child labour mean that outright prohibition might not always be in children's interests. For example, a mass retailer from continental Europe has issued a code that states:

“In many countries, child labour is both permitted and common. Asking our suppliers to prohibit it completely for children under a certain age would have dramatic consequences for the children themselves and for their families (extreme poverty, prostitution...). It is therefore necessary to opt for a more gradual, pragmatic, incentive-based approach. Accordingly, [the company], in extreme situations (excessively young workers, inappropriate working conditions...) will immediately cease its commercial relations with the enterprise concerned. In other cases, [the company] will encourage its supplier to participate actively and progressively in eliminating child labour by using the most appropriate methods in the interest of the child. In order to realise this objective, [the company] will promote compliance among its suppliers with the ILO convention that fixes the minimum working age at 14 years”.

Numerous codes also specify what is to be done if a child is found to be in the employ of a sub-contractor (e.g. child is to be taken care of until some alternative is found – return to family, re-entry into school etc.) Other codes do not specify whether any special obligation to the child exists.

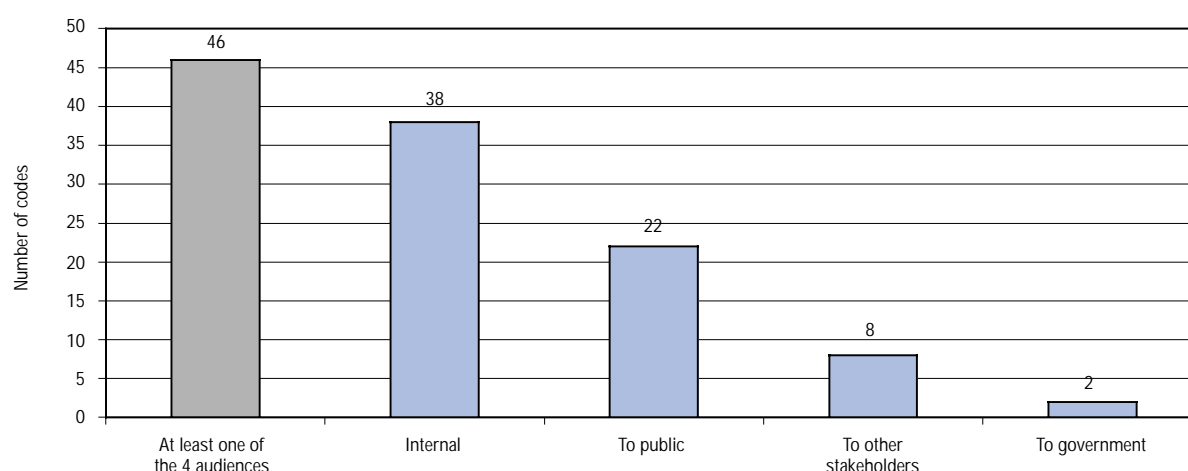
The survey illustrates diversity of and lack of consistency in treatment of issues in the labour codes. Idiosyncrasies may reduce the codes' value as tools promoting transparency and accountability. On the other hand, the diversity of codes – in addition to reflecting the inherent differences of the organisations that issue them and probable weaknesses in the methodology – also reflects an underlying lack of consensus on some of these issues.

Disclosure of Information

“Disclosure of information” is a key aspect of corporate citizenship since the disclosure policies render the firm accountable to outside assessment. Disclosure texts tend to discuss three “concepts” for disclosure (often codes cover more than one of these):

- **Disclosure of product information.** Companies promise full and accurate disclosure of product information. This is discussed in greater length in the consumer section – 41% of the texts that address consumer protection make commitments concerning disclosure of product information.

Figure 12. Disclosure Mentioned in Company Codes



Source: OECD

- **Disclosure as an aspect of financial control.** Companies commit themselves to various types of financial disclosure.

Eighteen per cent of the codes reviewed for this paper contain text on financial disclosure (Figure 11). In addition, many of the codes state the need to safeguard proprietary business and financial information and not to reveal insider information. Generally the texts deal with financial accounting and disclosure in an extremely general way. For example, one code from a consumer products multinational states:

“[Company] accounting records and supporting documents must accurately describe and reflect the nature of the underlying transactions. No undisclosed or unrecorded account, fund or asset will be established or maintained.”

- **Disclosure in relation to code commitments.** Companies promise to disclose information documenting what they are doing to implement their codes and their performance relative to the standards and aspirations set forth. However, this is not a uniform practice. Many company codes (61%) do not mention a commitment to disclose relevant information.

Also, disclosure can be to select audiences. More company codes mention procedures to inform employees, managers, and at times the board of directors (and for suppliers to provide information to outsourcing companies) than transparency *vis-à-vis* the public (see Figure 12). The latter type of commitment is most common in environmental codes, where transparency commitments *vis-à-vis* the public are mentioned in 29% of a total of 142 environmental codes included in the overall inventory. Of the labour codes, 22% promise disclosure to the public. A number of codes mention a specific obligation to report to government authorities. These are mostly environmental codes or codes governing the conduct of professional organisations. 46 company codes mention reporting to at least one of the four kinds of audiences shown in Figure 12.

Competition

Roughly 20% of the codes surveyed include statements relating to competition. Most texts restrict themselves to a general description of the virtues of fair competition³. For example, the same consumer products multinational just cited states:

"[Company] believes in vigorous yet fair competition and supports the development of appropriate competition laws. Employees receive guidance to ensure that they understand such laws and do not transgress them."

Some texts are slightly more specific. For example, a European entertainment company states:

"[Company] believes in the principle of fair competition as a basis for conducting its business and will comply with all applicable laws prohibiting restraints of trade, unfair trade practices or abuses of economic power. All purchases, sales and other contractual commitments must be based solely on consideration of quality, suitability, service, price and efficiency. In particular, reciprocal arrangements, whereby a supplier is expected to become a customer because they are a supplier or vice versa, are not permitted."

In contrast, some of the texts are extremely detailed and even technical. These texts appear to be designed for a specific legal and competition policy environment (usually North American). One U.S. company's code, for example, mentions the fact that the company is still subject to a court decree in relation to its competition practices.

Taxation

Only one code addresses the issue of taxation.

Bribery and Corruption

Twenty-three per cent of the codes in the inventory address bribery and corruption. These 56 codes vary widely in their definitions and commitments. Many of the company codes encompass concerns about bribery, corruption, political contributions and gift giving that go beyond dealings with public officials. They address corruption *vis-à-vis* customers, suppliers and employees and, in some cases, also competitors. Thirty-eight per cent of the codes that mention bribery and corruption make a distinction between the treatment of public officials and business partners. Stated rules are generally stricter when public officials are involved. The codes also often proscribe solicitation by employees of bribes or gifts from business partners.

Table 7. **The Attributes of Bribery Codes**

Attributes	Percentage of bribery codes*
Parties to bribery:	
– Bribery of public officials	62.5
– Bribery of private actors	64.3
– Both	37.5
Proscribed activities:	
<i>Vis-à-vis public officials:</i>	
– Giving bribes only	17.9
– Employees offering bribes	41.1
– Political contributions	32.1
<i>Vis-à-vis private actors:</i>	
– Giving bribes only	23.2
– Employees offering bribes	58.9
– Receiving bribes by firm's employees	23.2
– Solicitation of bribes by employees	53.6
<i>Conditions under which entertainment and gift giving is prohibited:</i>	
– Excessive entertainment and gift giving	39.3
– Seen as inducement to business	39.3
– Exceeds business practices	30.4
– Violation of laws	19.6
– Damaging corporate image	17.9
– Requirements for internal reporting of gifts	33.9
* These are calculated as: $100 \times [\text{the number of codes mentioning attribute}] / [\text{the number of codes citing bribery}]$	
Source: OECD	

The codes show a variety of approaches to this issue: some codes directly use the word “bribery” and/or “corruption” while other codes are more detailed in describing what possibly could become a bribe. Thirty-six per cent of the codes simply prohibit bribery and corrupt behaviour. It is equally common for firms to discuss the act of offering, giving, soliciting and/or receiving “gifts and entertainment” (36% cent of the codes). The codes examined here do not employ the term adopted in the OECD’s Bribery Convention, i.e. attempting to obtain “undue/improper advantage” from the activity. Some 5% of the codes make a distinction between cash and other items: although gifts/entertainment may be acceptable under certain conditions, the acceptance of cash is completely prohibited.

Most codes dealing with bribery do not prohibit acceptance of gifts or entertainment completely when they are offered or given by business partners. They normally allow employees to offer gifts or entertainment that “is not excessive in value” (mentioned by 39% of the codes mentioning bribery), “is within the business norm” (30%), “is not seen as an inducement of business” (39%), “does not violate the law” (20%), and “does not damage corporate image” (18%). Obviously, some of these pronouncements are quite ambiguous. Only 5% of the codes set a limit in monetary terms.

The codes addressing bribery also show different approaches to implementation. Thirty-four per cent of the codes require reporting and notification of the provision and receipt of gifts/entertainment. Often, however, reporting is required only when the gifts/entertainment “exceeds business norm”. The norm is generally not further defined. Thirteen per cent of the codes state that prior approval should be sought whether the gift/entertainment can be received or given. Of these, 86% of the codes require approval only in the case when the gifts/entertainment exceeds the norm. Whistle-blowing facilities are often mentioned in these codes.

Thirty-two per cent of the codes commit the firm to refrain from making political contributions – be it to a person holding an office, to candidates, or political parties. Fourteen per cent of the codes treat employees and immediate relatives of employees in the same manner. Nine per cent of the codes acknowledge the cultural differences among countries as a factor in determining what is appropriate in gift giving. Of these codes, only one code sets strict guidelines; all other codes allow exceptions on the basis of cultural differences.

Science and Technology

Twenty-six codes (or about 11%) make commitments in the area of science and technology. Five codes deal specifically with the development and diffusion of environmental technology. Three are issued by professional associations (e.g. of chemists and civil and electrical engineers) and deal with their role in the development and diffusion of technology. Three other codes refer to increasing public awareness of technology issues in order to promote acceptance of new technologies. A few codes state that they seek to promote the diffusion of technology. For example, the following text comes from a North American telecommunications firm:

“Where knowledge of product and manufacturing technology can be shared without harming [company’s] competitive position in the market place (and without contravening national restrictions on transfer of technology), [company] will engage in technology co-operation projects with industry and industry associations around the world.”

Consumer Protection

Consumer protection receives extensive attention in the voluntary codes. It is the third most common issue appearing in the codes reviewed here (after environment and labour standards): 48% of the codes address some aspect of consumer protection. The three main attributes of consumer protection in the voluntary codes are: (1) provision of safe and quality products/services; (2) provision of information on safe and quality products/services; (3) and protection of consumers’ personal information.

Figure 13 shows that provision of safe, high-quality products is the most common commitment to consumers expressed by firms. This is mentioned in 50% of the codes that include statements relating to consumer protection. The relevant texts often begin with a general commitment to customer service. For example, a British retailer states:

“We aim to achieve commercial success by meeting our customers’ needs by the provision of high quality, good value products with exceptional service and relevant information which enables customers to make informed and responsible choices.”

The provision of environmentally friendly products and services leads the list. Research suggests that this is the first phase of corporate response to ‘green consumerism’ (Jones and Baldwin, 1994). Provision of product information and protection of customer privacy are mentioned less often.

Other subject areas that are mentioned in the codes are: advertising ethics; electronic commerce; public health and safety (almost always treated as an aspect of environmental management); animal rights; genetic engineering and protection of indigenous peoples.

Economic Motivations Mentioned by Codes

Codes are expressions of obligations or responsibilities to the public or to specific stakeholders. While they seek to address public concerns, economic motivations related to the desire of companies to compete successfully and build or protect their reputation in the market place are at times also mentioned explicitly by the codes.

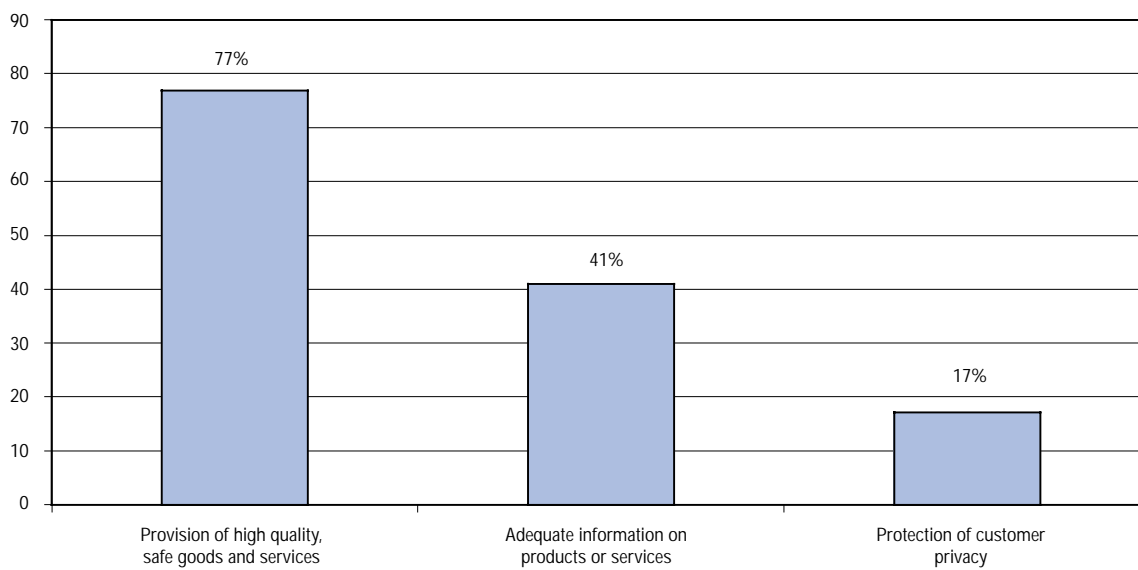
Some of the codes inventoried mention commercial benefits or competitive advantages which code issuers hope the commitments will contribute (Figure 14). Where such statements are made, they often appear in forewords to the code texts. For many large companies, reputation is an important corporate asset. Some codes assert the desire of the company to build or retain industry leadership on certain issues of corporate responsibility (see also Box 5).

Sometimes the statements made are more specific. Nine per cent of the codes suggest that the commitments made should help strengthen customer loyalty or confidence in using a service or product. A few codes (6%) mention aspects of improved business operations (better-quality products, production or working environment). Less frequently, codes are expected to strengthen the loyalty of staff. Other advantages mentioned by some codes (6%) are better control or reduction of potential risk arising from violation of legal requirements and regulations and associated sanctions, reduction in the likelihood of costly litigation, reduction in compliance costs with respect to government regulation or a reduction of government regulation itself.

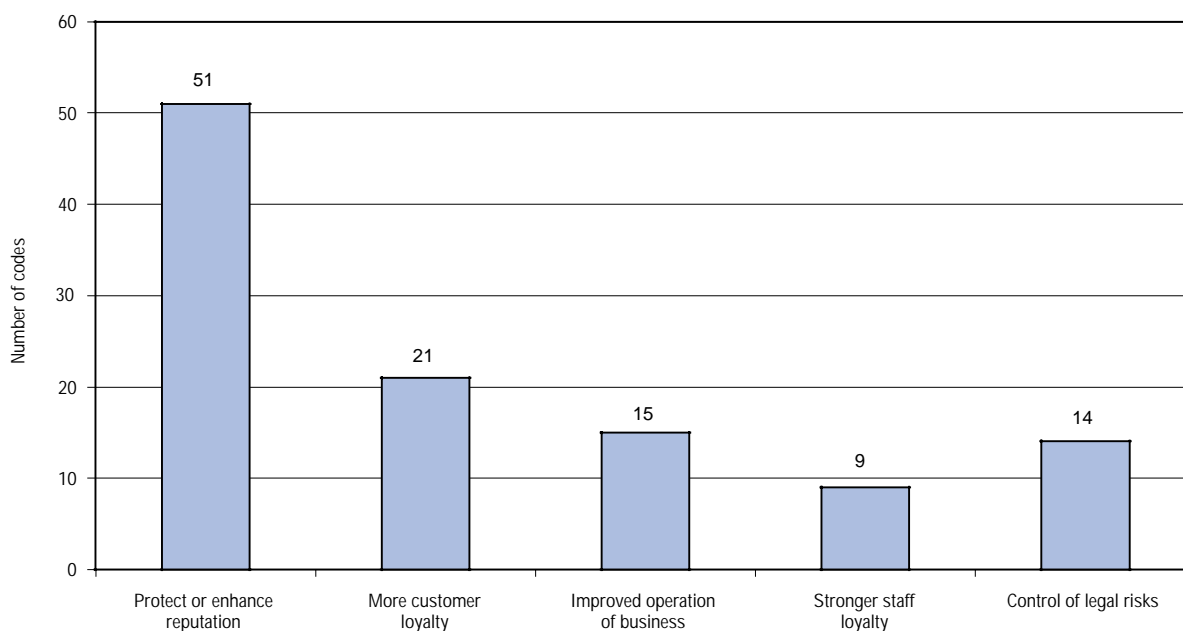
If there are economic motives prompting organisations to adopt codes, these are not readily identifiable from a content analysis. A majority of code texts is silent on this issue. Other research has investigated this question by asking code-issuing organisations directly. For example, a recent survey (Conference Board, 1999) asked 106 large companies from the United States and 21 other countries with global operations to cite their business or strategic justifications for having an ethics code. Respondents mentioned the need for establishing core principles for their growing involvement in global markets and legal issues, such as legal incentives and the desire to limit legal risks as the most important motivations. Enhancement of company reputation was considered to be somewhat less important and public relations concerns much less.

A Closer Look at the Textile and Extractive Industry Codes

The textual analysis of the inventory of 246 codes reported above covers a variety of firms and sectors – hence, the codes represent responses to a diverse array of needs and circumstances. This diversity makes it difficult to evaluate the codes for consistency and uniformity of treatment, since part of any perceived lack of uniformity may stem from the diversity of *problematic* facing the issuing

Figure 13. **Consumer Protection in the Codes**

Source: OECD

Figure 14. **Competitive Advantages Mentioned by Codes***

* Number of codes out of 246 codes

Source: OECD

Box 5. Examples of Code Statements About Competitive Advantages and Other Benefits

"...the continued good reputation of the Group depends upon our personal business ethics standards."

"Anyone who knowingly disregards these rules, or does so through negligence, causes prejudice to the profession, each of its members and the good reputation of the financial centre."

"It's good business."

"[Company name] enjoys a reputation for conducting its business with integrity and with respect to the interests of those our activities can affect. This reputation is an asset, just as real as our people, factories and brands."

"We believe that our competitiveness and future success depends not only on our employees and the quality and sincerity of our assets but also on our record as good neighbours and partners around the world."

"We want our efforts to set a precedent for others"

"In taking this action itself the [association name] feels that it will enhance both the image of the industry and the marketability of its [product name]."

"...to improve the image of the industry as a reliable source of clear and correct information for consumers."

"A well-founded reputation for scrupulous dealings is itself a priceless asset."

"This commitment – reflected in our new company mission and values – forms the cornerstone of our reputation, and our reputation is what distinguishes us from our competitors and gives us an unshakeable competitive advantage".

"...to be recognised as the preferred choice in home shopping retail achieving standards of excellence in product and services unmatched by our competitors."

"Integrity is an advantage to [company's] employees and shareholders."

"We have found that these standards result in higher quality working environment and in higher quality products".

"We believe that the incorporation of internationally recognised human rights standards into our business practice improves worker morale and results in a higher quality working environment and higher quality products."

"A track record in conforming with the Code will increase regulatory agency and stakeholder confidence in a signatory's environmental management ability. This may reduce inspections by regulatory agencies, lower licence and permit fees, and expedite environmental approvals."

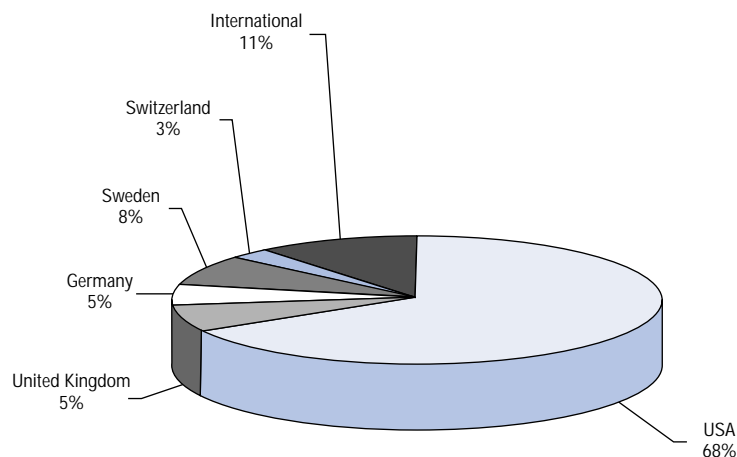
organisations, not from differences in values and commitment. This section attempts to control for one of these underlying factors – namely the economic sector.

The first of the sectors examined is apparel, a sector with a distinct set of issues (extensive subcontracting using partners engaged in labour-intensive assembly and production in less developed countries). The second sector is the extractive industries, which also faces a distinct set of concerns (environment, protection of local communities from the effects of their large and often hazardous extraction and processing facilities). Both industries have been the subject of intense public scrutiny at various points in time. This analysis will reveal some things about codes that the full inventory cannot: is there convergence of commitment? Is there evidence that firms are selective in their commitments (e.g. deliberately avoiding commitments in areas that are costly to them)?

The Apparel Codes

The set of codes contains 37 codes of conduct related to the textile and apparel industry. Five codes were published by coalitions of entities. The rest were codes published by individual companies from five countries (see Figure 15).

Figure 15. Countries of Origin of Apparel Industry Codes



Source: OECD

The overwhelming majority (25 codes) has been issued by U.S. companies. Sweden seems to account for a disproportionately large number of apparel codes in the inventory, whereas Japan and France are conspicuously absent from this set. Indeed, this is one of the few areas in which information is available on firms that do not have codes. Contacts with Japanese apparel companies show that they have not felt pressures to respond to public concerns about labour standards in their industry. Of nine apparel firms with major brand names contacted in France in mid-1999, only one was aware of the existence of codes of conduct and was currently working on a code. The others were unaware of codes as an issue and had no plans for adoption.

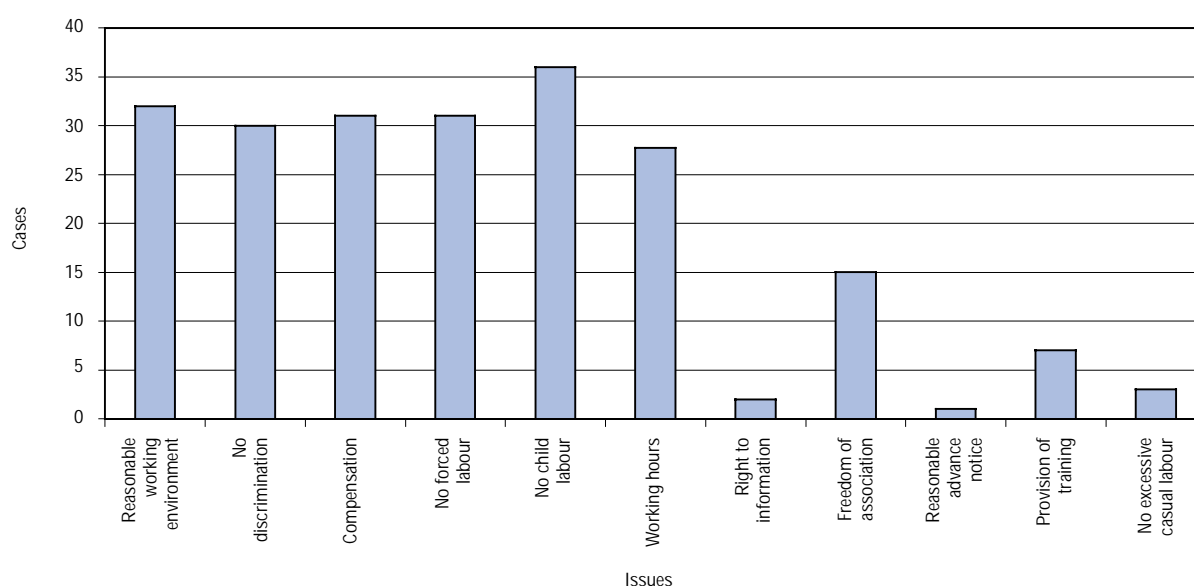
The 37 apparel codes show a strong focus on labour standards. All cover labour standards, although there are some variations in the specific topics mentioned. This will be discussed later.

Environment stewardship is listed as an area of commitment in 21 of the apparel codes (but usually not in any detail). Two companies mentioned consumer protection in very general terms (e.g. “providing quality items for customers”). Compared to the overall average of the inventory, the apparel codes tend to be very focused. None of the codes refers to such other areas of corporate responsibility as bribery, finance, science and technology, taxation and competition.

The most frequently expressed commitments in the area of labour standard are related to ILO Conventions and UN Human Rights Conventions. Such commitments, i.e. reasonable working environment, adequate compensation, no forced labour, no child labour, no discrimination and reasonable working hours, are all frequently mentioned (Figure 16), although few firms (6 and 10 firms respectively) specifically mention ILO and UN Conventions. These issues are much more strongly emphasised in the apparel codes than they are in the overall inventory. Of 32 company codes, 21 refer to all the six issues.

Also, to not employ child labour is the most frequently mentioned commitment (36 out of 37 codes). In fact, one code – issued by an association of sporting goods manufacturers – is dedicated entirely to this issue. By comparison, freedom of association is mentioned in just under half of the apparel codes. Commitments to provision of training are less frequent in the apparel codes than in the set of labour codes contained in the broader inventory. Other issues – the treatment of employees’ rights to information, provision of training, reasonable advance notice and commitment to forego use of excessive casual labour and flexible workplace relations – attract relatively little attention in the apparel codes examined here.

Figure 16. Issues Addressed in Apparel Companies' Codes of Conduct



Source: OECD

Twenty-six of the 32 company codes are addressed to suppliers and contractors. The majority of the issuers of these code are retailers. Retailers typically are close to the market and directly influenced by consumers' purchasing decision, and they normally use subcontractors to manufacture products. Therefore, they do not have a direct control over the labour standards. What they can do is to proscribe certain labour standards. In 12 cases, the codes speak of the possibility to terminate the contract if the standard is not met. A significant number (23 codes) make no mention of monitoring systems (a few appear to try to establish the possibility of whistle-blowing in their supply chains). Only three companies mention the provision of training and education for promoting the standard.

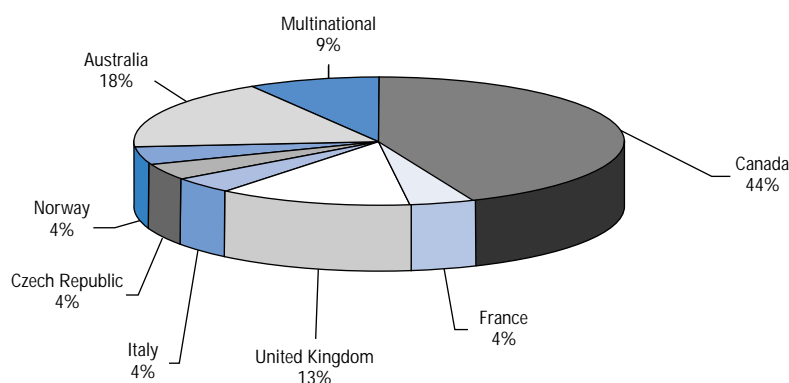
Extractive Industries

The inventory contains 23 codes of conduct issued by organisations in the extractive industry (mining, petroleum and natural gas).

These entities are based in seven OECD countries, with Canada and Australia being particularly heavily represented (see Figure 17). Seventeen codes are issued by companies and 4 by business association. One code takes the form of an agreement between business and labour union and another one an agreement between a company and governments.

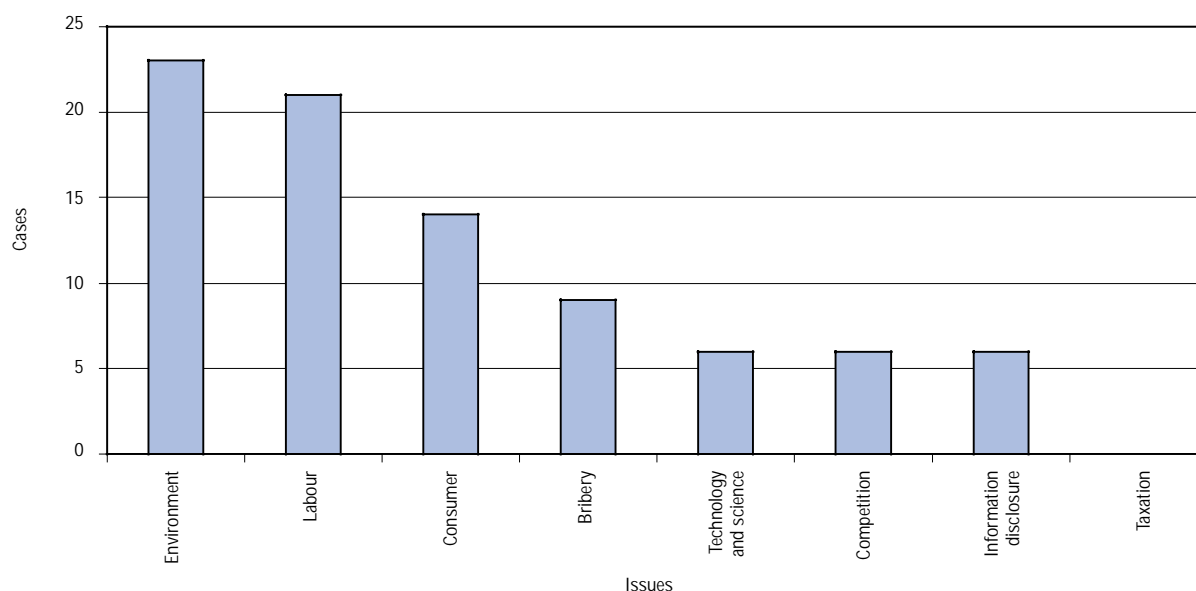
In contrast to the rather focused codes of the apparel industry, the codes of the extractive industry address a broad range of issues (Figure 18). The areas that receive the most attention are environment and labour: all 23 codes mention environmental issues, and 21 refer to labour standards. Other frequently cited commitments are general ones such as compliance with the law (20 codes), continual improvement (17 codes) and global applicability (16 codes). Another frequently covered issue area (by 17 of the 23 codes) is the need to consider the concerns and welfare of local communities. Five codes (mainly from Canada and Australia state the need to protect indigenous rights. Bribery and corruption, competition, information disclosure, science and technology and technology transfer are other issues which the codes in this sector at times address. Seventeen codes mention the use of internal reporting and performance auditing. Thirteen of the company codes mention that the company publishes an annual report on environment performance and make information publicly available.

Figure 17. Countries of Origin of Extractive Industry Codes



Source: OECD

Figure 18. Issues addressed in the extractive industry codes



Source: OECD

The most frequently cited specific aspect of the environment issue is the provision of environmentally friendly products (14 codes) and conservation of energy (14 codes), followed by conservation of materials and recycling (12 codes).

Among labour issues, the far most frequently cited commitment is the provision of a reasonable work environment (19 codes). This mostly refers to the provision of a safe work environment in the context of extractive industry and is linked to the compliance with occupational safety laws. Unlike in the apparel industry, the concern for forced labour and child labour is very low (2 codes respectively). Likewise, discrimination and freedom of association are infrequently mentioned (6 and 4 codes respectively). Thirteen codes include a commitment to human resource development through provision of training, but only five codes mention the existence of a monitoring system.

What Code Texts Show About Implementation

The purpose of this section is to explore what code texts show about the kind of activities that organisations undertake or are expected to undertake in order to put code commitments into practice.

Codes may or may not provide much information in this regard. Companies and business associations may separately issue instruction manuals, audit checklists and other documentation that map out procedures for code implementation and follow-up. In fact, 49 of the 246 code texts make reference to other, published or unpublished, material of that type, which was not available for the purpose of this study. Also, implementation may call for different types of procedures and activities depending on such factors as the issue area which commitments address, the industry sector and company size, which are not taken into account in this analysis. Therefore, examination of code content can provide only a very impressionistic picture about code implementation procedures. The data obtained from the content analysis are presented in Table 8 for the main implementation aspects covered by the 246 codes inventoried. No conclusions about actual practices can be drawn from the findings.

Activities to Promote Code Awareness Among Employees and Other Stakeholders

It is relatively common for the codes surveyed to include language describing policies and procedures aimed at familiarising relevant personnel inside the organisation and/or outside business partners (and also members in the case of business associations or partnerships of stakeholders) with the requirements of the code and the responsibilities attendant to it. One hundred and forty-seven of the codes (60%) contain provisions in this regard.

Of these codes, 108 (or 74%) mention that the organisation has a policy in place to communicate the code to internal stakeholders, such as employees or, in the case of business associations, members and their employees.

Approaches taken vary across the codes. Some statements are broad formulations. For example, the code of an Australian company in the extractive sector contains the following statement:

“It is [company’s] policy to ensure that its employees and suppliers of goods and services are informed about this policy and aware of their environmental responsibilities in relation to [company] business.”

Ninety-six (or 90%) of the codes mentioning internally oriented communication provide for an ‘active’ information policy: a requirement for managers to personally distribute codes to employees, or for management to discuss codes in meetings, or for management to show codes to newly hired employees or a requirement for employees to acknowledge periodically that they have read the code, or for suppliers to publicly display a sourcing code so that workers know of its existence.

The code of practice setting out principles for agreements between oil companies and resellers in the petroleum industry of a Pacific nation states:

“The Code Administration Committee shall publicise the existence and effects of the code and the administration rules to oil companies and resellers who are parties to the code. This should include detailed briefing of staff by their respective oil companies and of resellers by their respective associations.”

The licensee and supplier code of conduct of a North American services company includes the following statement:

“Product Suppliers shall take appropriate steps to ensure that the provisions of this Code are communicated to employees, including the prominent posting of the Code (in the local language) in their manufacturing facilities.”

In the case of a few of the other codes stating an internal communications policy, the approach taken is to make information about the code available upon request (6 codes). Contact points for answering questions about code-consistent practices and/or unclear situations are mentioned by 34 (or 32%) of the codes that provide for an internal communications policy.

The primary role of a code is to communicate principles and commitments which organisations pledge to uphold. For some of the codes included in the inventory, the importance which high-level management attach to the contents of the code and its application is underlined by how the code is presented. In the case of 22% of the 246 codes inventoried (and 30% of all company codes), the chairman of the board of a company, the president or other top officer has signed either an attached foreword, usually formulated as a message to employees or association members which introduces and stresses the importance of the commitments made, or the code text itself.

Also, 36 codes inventoried mention explicitly that the code has been adopted by the highest level of decision-makers, i.e. the council, board or equivalent body. The majority of these codes are issued by industry, trade or professional associations.

Seventy (or 48%) of the codes which make mention of a communication policy state that information about the code is or ought to be shared with external stakeholders and/or the general public, either as a general rule or in response to inquiries. For example, the code issued by an association in the Pacific region that represents a consumer products industry provides:

“The [association] shall widely publicise the existence of the Code and the administration rules (and any alterations thereto) to the industry, the general public and other relevant audiences.”

One means for making a code widely available is to post it on the Internet. Based on information provided in code texts or the type of document submitted (no effort was made to search the Internet), 38 codes are made public in this way. Codes that are made publicly available via the Internet or through other channels are more often issued by associations and partnerships of stakeholders than individual companies.

Code-related Education and Training

Education and training of staff in the meaning of codes and application of the commitments set forth is an element of ensuring compliance on the part of employees or association members, which 21% of the codes mention explicitly. The relevant statements vary in their specificity. For example, the environmental policy statement of a European forestry company contains the following language:

“Personnel are given both specialised and general training in environmental matters. The aim is to develop a sense of responsibility for the environment and its protection. This training also equips personnel to follow and take part in the public debate on environmental issues.”

A detailed statement from the business ethics code of a major U.S. company reads:

“Each operating group and division will establish a training program. The program will be designed to ensure that all employees have an awareness of the [company’s code] and the standards of conduct and legal requirements that are relevant to their work at a level of detail appropriate to their job functions. Managers and employees in sensitive positions, such as sales, marketing, finance, contract, and material, require more comprehensive training as well as periodic refresher courses.”

The fair practices code adopted by an association of services providers in New Zealand states:

“Members will train staff and their agents at all levels in the requirements of the [code], ensure that procedures are in place to train both new and existing staff and their agents, and to provide refresher courses to remind them of their obligations under the Code.”

Some of the codes that do not mention training in such explicit terms contain various illustrative and other educational material designed to give employees guidance or instructions about what would be code-consistent conduct or business practice in specific situations which employees may come to face in their dealings with customers, suppliers, etc. In particular codes issued by professional organisations can include long text with task or situation-specific instructions. A contact point (such as a manager, supervisor) where employees and other stakeholders can seek clarifications of the Code or

situation-specific advice is another way how some organisations seek to promote code-consistent behaviour.

Code Management Systems

Codes differ greatly in the information which they provide about an organisation's management systems applicable to the implementation of code commitments. Many codes do not go into the details of the management systems used, as the following statement from the ethics code of a British producer of consumer goods shows:

"We will institute appropriate monitoring, auditing and disclosure mechanisms to ensure our accountability and demonstrate our compliance with these principles"

a) Assignment of Responsibilities and Administrative Structure

It is common for the codes issued by companies and business associations to point out that the primarily responsibility for the observance of the code lies with the individual employee and member company, respectively. Some of the codes issued by companies merely state that it is the responsibility of management to ensure that the codes are understood and taken seriously by all employees. Similarly, some of the codes issued by business associations content themselves with stating that member companies are expected to set up adequate and effective internal control mechanisms and procedures.

For example, a multinational oil company states in its code of conduct:

"We expect everybody who works for [company] to take responsibility for lining up to these commitments ... Line managers are accountable for policy implementation and for providing assurance on compliance for their area of responsibility."

The environmental policy statement issued by a European company operating in the forestry sector provides that the company:

"... through its line organisation, ensure that all of its plants set objectives and impose requirements in accordance with [company's] environmental policy..."

While code administration is sometimes described as being part of the regular day-to-day management process, language contained in other codes provides for a code-specific structure and procedures for carrying out and overseeing the implementation of code commitments.

The textual analysis finds that 27% of the 246 codes mention at least one specialised body or a commitment to create such a body. Such provisions are more common for codes issued by partnerships of stakeholders and business associations than for companies. The terms frequently used are "Ethics Committee" or "Code Administration Committee"; one company has a "Committee on Social and Environmental Accountability". Responsibilities vary in scope but always require the body in question to facilitate and supervise proper implementation of the code and participate in the review the policies and practices relating to the standards or goals set.

Consider for example the following code issued by a U.S. company, which states:

"The structure includes the Corporate Responsibility Committee of the Board of Directors and the Leadership Committee, which have oversight responsibility; the Compliance Council, whose duties include education, monitoring and response; and all employees of the Company."

A code of practice for environmental marketing issued by an association of companies based in the Pacific region and operating in the consumer goods sector states:

"A Management Committee, consisting of one representative of each company which is a signatory to the Code, a nominee from an appropriate Government regulatory authority, and a representative of the [association] Secretariat will be responsible for the administration and general operation of the Code."

Some of these specialised bodies also handle complaints by employees, conduct investigations and take decisions with respect to disciplinary measures. Some (predominantly association) codes provide for separate complaint bodies and/or dispute settlement procedures (see next section).

b) *Monitoring of Compliance*

Among the elements of code implementation that a large number of the codes mention are monitoring procedures aimed at preventing and detecting violations of code commitments.

A majority of codes (66% of all codes and 71% of all company codes) mention some type of monitoring procedure. These are predominantly internal systems. In the case of company codes, internal monitoring is often described as being part of the regular management process, with managers being responsible for ensuring, as part of their regular duties, that the standards are being observed.

Closer examination reveals that a significant number (79%) of the codes that refer to internal procedures for monitoring provide for a mechanism whereby code compliance is pursued 'actively' rather than wait for suspected violations to be reported by employees. Active monitoring can range from requiring company employees to annually certify that they are complying with a code to instructing managers to regularly review code standards with their staff.

The code of a mining company from the Pacific region states:

"Each year the Managing Director will ask you to sign a reconfirmation of your commitment to and understanding of the Code of Conduct."

It is quite common for codes which extend to contractors to make specific reference to inspection of partners' production facilities and records. Consider the following statement made by the code of a North American corporation:

"[Company] and its subsidiaries will undertake affirmative measures, such as on-site inspection of production facilities, to monitor compliance with the ... standards. [Company] Contractors must allow [company] representatives full access to the contractor's production facilities and books and records and respond promptly to reasonable inquiries by [company] representatives concerning the operations of the contractor's facilities."

Of the 45 codes in the inventory which specifically target the conduct of contractors and other entities from which a company purchases (sourcing codes), more than two-third (71%) mention that monitoring will or may involve on-site inspections. A few of the remaining sourcing codes state that their compliance program consists of screening suppliers prior to the placing of any orders. Almost all of these codes address labour practices.

At times, active monitoring is complemented by policies and procedures to receive, investigate and respond to complaints. Some company codes mention only this type of compliance activity. For example, statements in some codes expressly encourage employees to report suspected violations or failure to comply with code standards. This procedure enables managers or associations to deal with violations once they have occurred. Codes adopted by business associations frequently also mention such policies. They also mention the existence of rather formal dispute-settlement bodies, which are to receive and rule on complaints about a member's conduct which other members of the association, the clients of the member companies and other interested parties may wish to bring.

Codes that mention active monitoring often also make reference to requirements for record-keeping.

Another aspect of code management which is relatively frequently mentioned in code texts are prospective penalties or other consequences of non-observance for employees, business partners or members of business associations. Forty-two per cent of the company codes and even 78% of the codes issued by partnerships of stakeholders make statements in this regard.

Performance Assessment and Reporting

Forty-five per cent of the codes examined mention some procedure of preparing and disclosing data on an organisation's performance in relation to stated commitments. Reporting can occur to the public, to selective external stakeholders (including government authorities), within a company to higher-level management, or to boards or councils within business associations. Reporting activities mentioned are usually carried out on some regular basis.

Statements affirming that an organisation's performance relative to the standards and commitments contained in the code will be evaluated periodically are found in 37% of the codes. The codes issued by partnerships of stakeholders are much more likely to include a reference (66% contain such statements) than company codes (29%).

The code of conduct by a North American manufacturer of metals products provides as follows:

"Education, updating and general compliance with [code title] will be measured by audits. These audits will also review reporting and recording procedures, compliance seminars and any refresher programs and the audited locations."

An agreement committing two organisations representing companies and trade unions in the textile and clothing sector to promoting certain labour practices among their membership and at company level provides:

"[Organisation] and the [organisation] agree to follow up ... the progressive accomplishment of the implementation of this Charter. To this effect, [organisation] and the [organisation] will conduct a yearly evaluation of the Charter's implementation, the first evaluation will take place no later than [date]."

a) Internal Disclosure

Data on disclosure commitments presented in Section IV indicate that internal reporting prevails over public disclosure in those company codes that address this issue. Codes issued by business associations tend to give external stakeholders more attention. As the examples given below show, the degree of detail of codes' provisions for internal disclosure varies, as does the scope of activities and type of information subject to reporting.

The business ethics code of a North American transport equipment manufacturer states:

"The Committee reports periodically to the Audit Committee of the Board of Directors on the company's ethics and business conduct program and related compliance activities."

The code of conduct adopted by a European financial services provider states:

"The main Board will receive an annual report from the Group Chief Executive on the extent to which the provisions of this Code are understood by all employees and applied by them in their day-to-day conduct of business."

The code of practice issued by a consumer products industry association in the Pacific region prescribes:

"The Committee shall report at least annually on its activities including the number of complaints, types of complaints, and whether complaints were substantiated. The Council [of the organisation] shall produce an annual report on the Code and its administration and make it available to interested parties."

b) External Disclosure

Provisions for reporting on the organisation's performance to external stakeholders are contained in about 29% of all codes and almost half of the 32 codes issued by partnerships of stakeholders. They are especially frequent in the codes that deal with environmental management issues. Their statements can be very short but usually contain some reference to separately issued environmental reports or

inclusion of environmental information in annual financial reports. For example, the code setting forth a North American petroleum company's health, environmental and safety (HES) principles states:

"We support the concept of accountability for HES performance and will provide annually to the public a report on our HES performance in measurable terms."

Yet more elaborate, the following statement is taken from the code of business practice of a leading multinational mining company:

"We prepare annually and half yearly reports and financial statements for our shareholders on all aspects of our business performance ... These reports are available to anyone else who requests them ... In several areas we go further. On health, safety and the environment, for example, we not only review in our annual report to shareholders major aspects of policy and practice, but we also publish a separate health, safety and environment report, extending the quality and quantity of the information we provide. The report deals with present performance in managing the key HSE issues and the work under way to achieve further improvements in the future. It is independently verified and then widely circulated within the Group. Copies are available to both shareholders and members of the public."

Of the 111 texts containing a provision for disclosure, 43% mention reporting to both, internal and external stakeholders.

Code Review and Revision

The examination of code texts finds that codes are "living documents" that organisations may choose to review and revise periodically. For example, a U.S. company's statement of business ethics included in the survey is the fourth version of a code that was issued for the first time in 1961. A total of

Table 8. **Main Aspects of Implementation Covered by the Codes**

	All codes	Companies	Business Associations	Partnerships of stakeholders
<i>Number of codes</i>	246*	118	92	32
Communication policy	147	66	59	20
<i>of which:</i>				
– only internal	75	41	23	11
– only external	39	11	22	6
– internal and external	33	14	14	3
Education and training	52	18	23	10
Body(ies) with code administration responsibility(ies)	66	21	30	13
'Active' internal monitoring	108	62	25	20
On-site inspection	44	35	4	5
Channel for reporting concerns	80	33	36	10
Formal complaint body	23	2	18	3
Penalties and other consequences of non-observance	95	50	37	25
Performance assessment	92	34	34	21
Reporting on performance	111	45	34	19
<i>of which:</i>				
– only internal reporting	30	21	4	4
– only external reporting	33	7	18	7
– internal and external	48	17	12	8
Review/revision of code	55	17	28	8
Continuous improvement of performance/ progressive code implementation	47	17	18	12

Note: * includes 4 codes issued by intergovernmental organisations that are not reported separately

Source: OECD

55 codes (22%) make mention of code review and/or revision procedures. The process can involve representatives from several stakeholders. Again, statements range from more general formulations to detailed descriptions.

The code of conduct issued by a large European consumer goods retailer provides:

“Whilst accepting the need for continuity and consistency, we also recognise that this Code must be developed over time in the light of practical experience and changing circumstances. We will therefore ensure that the Code is reviewed on a regular basis and revised where necessary. All employees and suppliers will be invited to contribute towards the further development of the Code over time.”

A professional association states:

“Comments shall be sought from interested parties on the review and evaluation of the Code and on proposed amendments.”

The code of practice issued by an industry organisation in New Zealand states:

“This Code is reviewed every three years by the [organisation], in consultation with community and consumer groups. These groups include the [names of various stakeholders].”

On the other hand, 47 codes (19%) speak of progressive or continuous improvement of an organisation's performance relative to stated commitments. About two-third of these codes set forth environmental management commitments. Many of the issuers of environmental codes also commit themselves to carrying out research and development in environmental matters as part of the overall effort to achieve stated objectives.

An illustration provides the following statement from a code of an Australian company belonging to the extractive industry:

“To fulfil this commitments, the Company will ... progressively establish and maintain company-wide environmental standards for our operations throughout the world ... continually improve our environmental performance, including reducing the effect of emissions, developing opportunities for recycling, and more efficiently using energy, water and other resources.”

Of the codes with references to continuous improvement, a few also set specific performance targets for the company or industry or mention that measurable targets for improving performance will be included in the business plan. These are almost all codes or undertakings addressing health, safety and environmental performance issues.

Another element of implementation mentioned by a few codes pertains to the sharing of experiences and best practices. Experiences can relate to substantive matters, i.e. the code principles themselves, or to the range of activities undertaken to implement code principles, for example by companies belonging to one and the same industry association that has issued a code for its members. As a multinational oil company puts it:

“We recognise that these commitments may in some cases represent aspirations for the future rather than statements of today's reality. We will share our experiences and best practices. We will endeavour to learn from our mistakes.”

Other Aspects of Code Implementation Mentioned by the Codes

The analysis of the code texts reveals certain other types of activities or elements of implementation.

Some of the codes include statements to the effect that an organisation will actively participate or work actively to assist in the development of public policies, national legislation, regulations or international treaties in those subject matters which the code commitments address.

Few codes make mention of the financial aspect of administering a code. Statements addressing this issue typically are not detailed and appear mostly in codes issued by business associations. These

organisations collect fees from members to cover the administration expenses involved in promoting and operating the code.

A number of codes describe various types of community outreach activities which organisations pursue as part of their programmes to give effect to their code and promote code values. This includes financial assistance to communities or projects, support for or sponsorship of various education and awareness programs, etc. For example, the stated policy of a European consumer goods producer is “... *to include environmental projects in our community and charity expenditure budgets*”. Another code addressing child labour mentions the establishment of an autonomous budget to help improve the life and work of children. Some of the codes include descriptions of achievements in these areas.

A few company codes inform the reader of concrete steps which the company has already taken to fulfil code commitments. The sourcing code of a European apparel retailer mentions that, because of violations of the code which the company detected in spot checks of its suppliers, business relations with two factories were cancelled. It also provides the names of these supplier factories.

In conclusion, the available code documents reveal how diverse the approaches are which organisations take to providing in the codes information about implementation structures and procedures. When deciding which elements of implementation to mention in a code of conduct and the degree of detail of the provisions, organisations are selective. While the survey finds that certain elements of the implementation process are more frequently mentioned than others, there is overall not much agreement among the organisations surveyed as to what information about implementation a code should contain.

Notes

1. This report was prepared as part of a joint project undertaken by the Trade Committee and the Committee on International Investment and Multinational Enterprises. It examines in detail the contents of 246 codes from OECD countries with respect to issue coverage and code implementation procedures.
2. Openness to community refers to the local dimension of environmental stewardship – that is, consideration and protection of communities and the environment immediately surrounding a plant site or otherwise affected by company activities
3. Fair competition refers to avoidance of actions which adversely affect competition in the market place through e.g. unreasonable refusal to deal, discriminatory pricing, or predatory behaviour toward competitors.

Chapter 4

Making Codes of Corporate Conduct Work: Management Control Systems and Corporate Responsibility

Introduction

Many companies have implemented programmes that help them to respond to societal concerns about the economic, social and environmental impacts of their activities. These help them to manage their compliance with legal or regulatory requirements and their response to “softer” forms of social control of business. These private initiatives by companies have included public statements – codes of conduct – in which they commit to norms for appropriate conduct in a variety of areas of business ethics (e.g. environment, anti-corruption, etc.). Some companies have backed these up with management systems designed to help them respect their commitments. These systems typically employ a range of tools including accounting and record keeping systems, training, hierarchical controls, compliance offices, whistle-blowing facilities, hiring practices, production controls, internal incentive systems and both internal and external audits. Management control, of course, is a core business function and exists as a separate, well-established discipline within the management field. The extension of this discipline to business ethics and its partial merging with legal risk management has been one of the more important developments in international business of the last two decades.

More generally, the question of corporate conduct – and sometimes misconduct – has attracted growing attention in recent years. Studies of corporate behaviour have tried to understand why some corporations comply with the law and with broader societal expectations while others do not¹. The answer turns out to be rather subtle, going beyond the simplistic view of a “cat and mouse” game in which, corporate actors will make a calculated decision to engage in wrongdoing if the benefits are sufficiently high and the probability of detection and punishment is sufficiently low.

The emerging picture is a more complicated one – there are multiple motivations and contexts for various types of wrongdoing. First, inappropriate business conduct can result from deliberate, calculated wrongdoing and this may take many forms and be driven by many objectives. It may for example be motivated by a desire for personal (not corporate) gain. As Punch (1996) says “the orthodox view of business crime as being ‘for the organisation’ has to be altered in light of cases where the managerial deviance was directed against the organisation and was highly damaging to it.” Examples of this kind of misconduct include embezzlement, many forms of private-to-private corruption and insider trading. At times, this form of misconduct, in which shareholders are often the principal victims, involves sophisticated networks of people working both inside and outside the enterprise. On the other hand, there have been many prominent cases of collective misconduct condoned by senior management or fostered by company culture. In such cases, there is abuse of “an organisation’s position of significant power, influence or trust” (Punch 1996) in order to further the organisation’s business objectives (e.g. price fixing, bid rigging, false advertising, undue political influence). Still other types of wrongdoing occur even when the enterprise in question faces large financial penalties and all parties involved would like to avoid misconduct (e.g. some types of public transport accidents and some of the major oil spills). In such cases, wrongdoing may involve failure to take due care in managing risks or problems stemming from innate human limitations – imperfect information or ability to assimilate information, human error,

inattention, or substance abuse. More broadly, such misconduct relates to systemic problems in the design of the enterprises' procedural and behavioural controls.

Private initiatives seek to reduce the odds that any of these types of wrongdoing will occur. They seek to reduce the risk of inappropriate behaviour by providing information appropriately, by reducing the risk of individual or group error and by instituting internal practices that reduce the scope and incentive for deliberate wrongdoing. The management tools that are employed in these initiatives can be technical (e.g. design of production processes or safety systems), employment related incentives (e.g. hiring policies, compensation and promotion practices, threat of termination) and social (e.g. promoting group behaviours that discourage misconduct).

The efforts undertaken by businesses in the area of legal and ethical compliance do not exist in a vacuum. They are closely linked to broader pressures from regulators, law enforcement authorities, shareholders, customers, employees and NGOs (see Chapter 5 for a review of the influence of public policy on private initiatives). It is important to emphasise the critical role that these broader pressures play in determining these initiatives' effectiveness – that is, their capacity to change the way companies conduct their day-to-day operations. If private initiatives are successful in changing business conduct, this testifies not only to the competence and the managerial expertise of businesses concerned, but also to the ability of societies to formulate and channel reasonable pressures for appropriate conduct. Corporate responsibility initiatives by companies – whose main implementation tools are reviewed in this chapter – have an important and distinctive role to play as part of a broader system of private and public governance. However, just as an aeroplane cannot fly unless both of its wings are functioning properly, these private initiatives cannot be expected to work if other parts of the system (including law and regulation) work poorly.

This chapter describes the management tools companies use to make good on the commitments set forth in their codes of conduct. It is based on the OECD inventory of corporate codes and on direct contacts with firms and NGOs. The codes inventory has the advantage of providing a broad overview of the practices of a large group of companies dealing with diverse ethical and legal compliance issues. One disadvantage is that the information in the inventory reflects only the public material available in the codes. Ideally, this should be augmented with a more in-depth examination of what particular companies are doing. The present discussion seeks only to draw out the broad contours of corporate compliance and implementation efforts and to try to understand how these relate to particular compliance challenges (e.g. bribery, environment and control of supply chain).

The paper addresses the following topics in three sections:

- Managerial approaches to implementing voluntary codes
- Organisations that provide external verification services
- Monitoring or auditing standards

The final section draws conclusions on the need for future development of the intangible infrastructure – especially continued work on the development of widely accepted standards for business conduct, management systems, audit and reporting – to enhance the effectiveness of private initiatives in the area of corporate responsibility.

Management Approaches to Implementing Voluntary Codes – No “One Size Fits All” Solution

This section looks at how firms implement their codes of conduct, using Secretariat analysis of the statements made about implementation in the codes of 118 individual companies². The companies are as diverse in many ways as the true “population” of multinational enterprises. Many of the codes in the inventory have been issued by huge, global firms that employ many thousands of people in dozens of countries (e.g. IBM, Shell). Other issuers are retailers (e.g. H&M, The Gap, Body Shop, C&A, Marks and Spencer) whose names are household words in some OECD countries. This latter group of companies tends to issue codes of conduct that seek to control labour management practices in supply chains

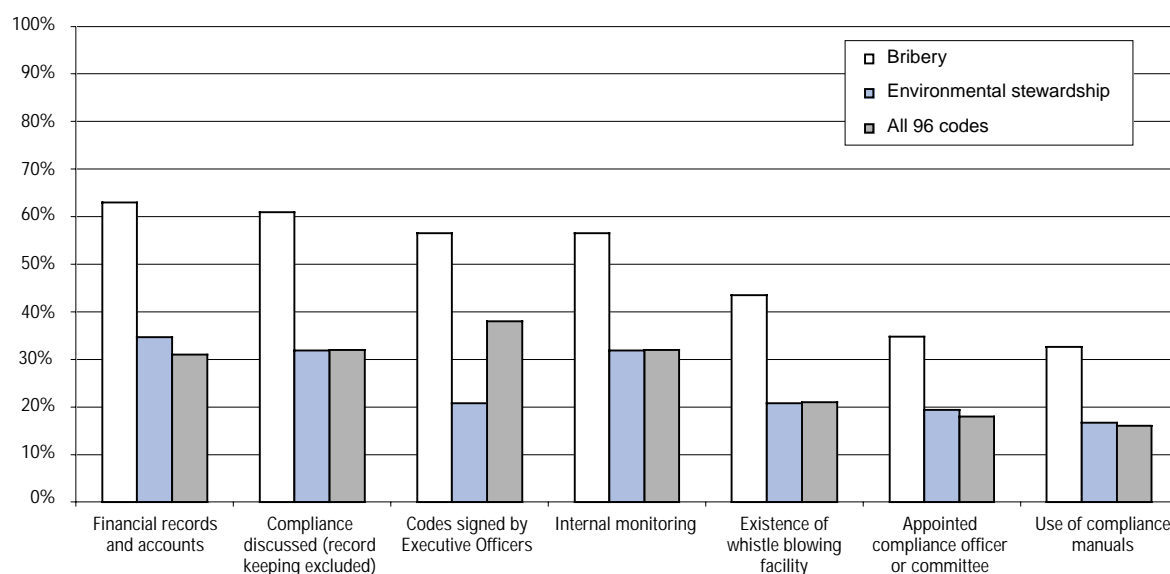
consisting of tens or hundreds of production sites. Finally, the firms in the inventory straddle all three economic sectors – primary production (e.g. mining, petroleum), many branches of industry and manufacturing (e.g. consumer goods, high technology materials, heavy equipment) and many services (e.g. finance, retailing, consulting etc.). Thus, the implementation challenges these firms face differ in many respects: the types of issues they deal with, the complexity of their operations, the resources they have to spend on compliance.

The Secretariat has looked at discussions in codes of conduct of the various management tools that are used to control outcomes. They include: internal monitoring, reports to Boards of Directors, use of compliance manuals, whistle-blowing facilities, signatures of directors, training, periodic compliance reviews by managers, employee signatures, disciplinary action, internal monitoring and external verification (see Annex for details). Financial reporting and record keeping (which these firms would normally undertake as part of their overall financial control function) are also counted as an implementation measure when they are explicitly referred to as such in the code.

The results of this analysis are presented in Figures 19 and 20. These figures reflect a division of the 118 company codes into 2 sets. The first set – shown in Figures 19a and b – covers the 96 codes that are addressed to the company itself (that is, the code establishes norms for the company's own behaviour). Figure 20 covers 22 codes that are addressed to suppliers (that is, firms that are not owned by the company issuing the codes). These codes are mainly issued by retailers and, though they often mention other issues, they tend to focus on core labour standards (child labour, forced labour, working conditions etc.). Figures 19a and b show the frequency of management techniques mentioned in codes making two types of ethical commitment: fighting bribery (44 codes) and environmental stewardship (72 codes)³. They also show the frequency of management practices mentioned in the total sample of 96 company codes. Since it is based on only 22 codes, Figure 20 does not break up the analysis by issue area⁴. It shows the percentage of the supplier codes that mention a particular management practice.

As shown in Figure 19a, 32% of all codes that are addressed to the company itself discuss implementation in one way or another. However, the bribery codes are much more likely than other

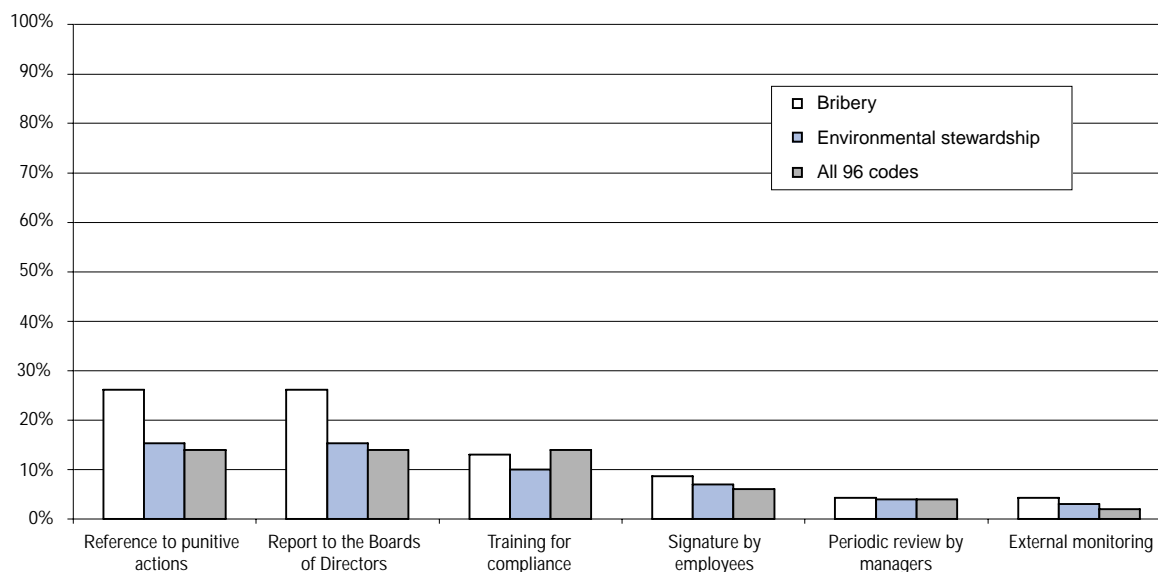
Figure 19a. **Implementation in the 96 codes of conduct addressed to the firm itself**
(as a percentage of codes mentioning a particular implementation measure)



Source: OECD

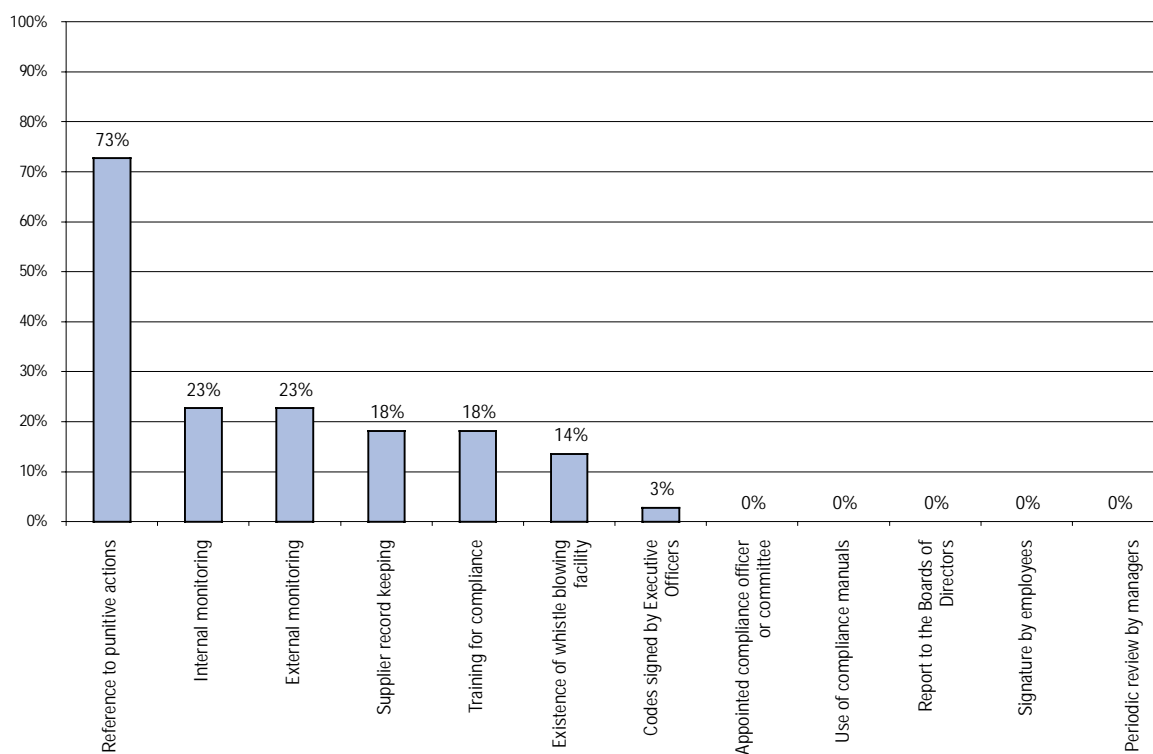
75

Figure 19b. **Implementation in the 96 codes of conduct addressed to the firm itself**
(as a percentage of codes mentioning a particular implementation measure)



Source: OECD

Figure 20. **Implementation measures in 22 codes of conduct addressed to suppliers**
(as a percentage of codes mentioning a particular implementation measure)



Source: OECD

codes to discuss implementation: 60% of the bribery codes mention it, while only 32% of the environment codes do. The bribery codes also show a distinctive pattern of deployment of compliance tools. They are about twice as likely as other codes to mention financial records and accounts as an implementation measure and they are much more likely to mention a range of more specific internal measures. The most common of these are internal monitoring by compliance officers (mentioned in almost 60% of the bribery codes, compared with 30% of the environment codes), whistle-blowing (44% for bribery and 20% for environment). The signing of codes by executive officers is a feature of 43% of the bribery codes and 20% of the environment codes. Use of compliance manuals (i.e. written training material) is another relatively important implementation tool mentioned in the codes. On the other hand, it is quite rare for these codes – regardless of the ethical issues they address – to mention external (non-financial) monitoring as a technique of management control. Only 2 of the 96 codes mention it.

The supplier codes in Figure 20 point to a different pattern of deployment of compliance tools. As noted earlier, these codes tend to focus on labour management issues raised in connection with retailers' outsourcing activities. Some of the tools that are relatively important for the codes addressed to the company itself (e.g. compliance manuals and compliance manuals) are not mentioned in any of the supplier codes. In these codes, the most common measure is threat or "reference to punitive action". This means that the code threatens some adverse economic consequence if the code is not complied with. About three-quarters of the supplier codes refer to punitive action (most often, termination of contract). Indeed, the overt use of threatening language is an important qualitative difference between the codes addressed to the company itself and those addressed to suppliers.

The supplier codes also show relatively heavy reliance on two types of verification. The first – mentioned by 23% of the codes – is undertaken by the firm issuing the code (by sending one of its employees to examine conditions in the production site). Hence, this monitoring is "internal" to the outsourcing relationship, but still has some of the difficulties associated with external monitoring. That is, someone from outside the production site must assess on the basis of records, interviews and observation what working conditions at the site are like. The second type is external or third party monitoring, which is also mentioned in 23% of the supplier codes. This is monitoring by an organisation that is "independent" of both the issuing firm and the supplier. Obviously, external monitoring is more important in the supplier codes than it is in the codes addressed to the issuing company itself since it is 10 times more likely to be mentioned. However, the codes generally avoid stating in direct terms that third party monitoring will take place. They are more likely to reserve the right to send in either their own employees or third party monitors, as they see fit⁵.

This analysis suggests that there is no "one-size-fits-all" approach to implementation and that firms tend to tailor implementation measures to the type of commitment and to their own circumstances. In some areas, external verification may not be used because it might not be very useful – for example, in areas where infractions may be unobservable to anyone except the direct parties to a transaction. This is likely to be the case in the bribery and competition areas, where wrongdoing often involves elaborate accounting and institutional subterfuges co-ordinated among several wrongdoers. Financial audits by outsiders, designed to ensure high quality records and accounting systems, can eliminate the easier forms of wrongdoing in these areas (and are especially important to prevent the cruder forms of bribery). But a wider portfolio of management techniques is needed to prevent more concerted and sophisticated wrongdoing (e.g. in bribery, the use of intermediaries and sophisticated money laundering operations). That is why some of the management systems addressing bribery and other types of economic crime (e.g. ECS 2000) emphasise not only the importance of high quality financial accounts and record keeping but also of various internal measures including whistle-blowing facilities, internal compliance and hierarchical controls.

In contrast, retailers that are trying to respect core labour standards in their outsourcing operations cannot use many of these internal measures since they do not own their outsourcing sites. Also some of them probably wouldn't work anyway. For example, whistle blowing is recognised to be less of an option in a context where workers are in an inherently weak position. Such workers may be extremely poor and

not supported by a social safety net and therefore may be less able to risk a cut in earnings if their employers “punish” whistle blowing. Also, they may not be protected by the transparency and external monitoring afforded by formal worker representation. In such situations, external verification may be one of the few feasible options. However, external verification of conditions in the supply chain is also often difficult because record keeping may be rudimentary, interviews with employees may be coloured by employee fears of retribution and the firm may be on “best behaviour” for the inspection. The effectiveness of external verification of the supply chain also appears to suffer from the lack of consensus on the scope, concepts and terms of such verification (see discussion of audit standards below).

In determining the mix of measures they use to implement their codes, firms balance cost, effectiveness and the perceived costs of failure to comply with their own codes (e.g. loss of reputation or brand capital; litigation) or with the law (legal costs, punishments, fines). Many outside parties, looking at firms’ voluntary efforts, have expressed a strong preference for external verification and are sceptical that firms can effectively monitor their own activities. However, a more comprehensive look at firms’ compliance and implementation techniques underscores the fact that no single implementation measure – including external monitoring – will be adequate to support compliance in all the areas covered in corporate codes. Governments themselves have recognised the inherent limitations of external monitoring (even when done by public authorities) and, in some areas, are making firms’ internal, compliance measures the first line of defence in public regulatory and legal enforcement strategies (see Chapter 5). Each compliance and implementation measure has distinctive advantages and disadvantages, uses and misuses. Effective management strategies for compliance and implementation will generally involve a complex mix of measures and tools tailored to the issue at hand and knowledge of how to deploy these tools is part of the growing mass of compliance expertise that these codes and their associated management systems reflect.

Organisations that Provide External Verification Services

A number of organisations provide external verification services. These include global auditing firms, more specialised external monitoring firms and NGOs, firms specialising in ISO quality certifications that have recently been branching out into ISO environmental certifications, security and specialised risk management firms. The Box 6 quotes from a more detailed description of these organisations provided by “Businesses for Social Responsibility (BSR)”, a business association that specialises in helping firms design and implement social responsibility programmes.

Three points to note about this industry are:

- The best known firms in the industry are the long established accounting and audit firms (e.g. KPMG, Price Waterhouse Coopers). These firms benefit from client relationships formed during decades of experience in business services centred on accounting, audit, and, more recently, consulting and legal services. They see this new line of business as a potential growth sector that complements their recent moves to become full-service advisors covering not just financial audit but also legal, economic and technical consulting. Their interest in diversification into other lines of business has been sharpened by the fact that their traditional services – accounting and audit – are in a “declining” sector⁶ (that is, growing at less than the rate of GDP growth).
- A number of smaller (but nevertheless multinational) firms also provide such services (e.g. Bureau Véritas and Société Générale de Surveillance). They offer a range of business services including quality (ISO 9000) and environmental (ISO 14001) certifications. For them, moving into other types of certifications appears to be a natural extension of their more long-standing activities. They have managed to establish strong reputations and to position themselves among the industry leaders.
- There is still no agreement among the various users of these services as to which organisations are most qualified to be performing them. As can be seen from BSR’s description of the big auditing firms (whose employees, according to BSR, may not be well qualified to be interviewing workers for labour standards violations in developing countries), there is some distrust of the

Box 6. **Organisations Providing External Monitoring Services
Quoted from Businesses for Social Responsibility**

Firms providing external monitoring can be divided into four categories;

- (1) global accounting firms;
- (2) monitoring firms
- (3) forensic and investigation firms; and
- (4) quality assurance or quality registrar firms.

Global Accounting Firms: Several large accounting firms offer external monitoring services globally by using auditors in various parts of the world. While these auditors have experience reviewing wage and hour records, they have been criticised by some advocacy groups for lacking the experience and skills to interview workers effectively and to examine factories for health and safety violations.

Monitoring Firms or NGOs: As monitoring of workplace conditions has grown in importance, several firms and NGOs focusing exclusively on workplace monitoring have been created in the past few years. Many of these firms, based in the United States, have staff or affiliates in exporting countries around the world and focus their efforts specifically on inspecting work sites for code of conduct violations.

Quality Registrar or ISO Certification Firms: Building on the platform established by the International Standards Organisation (ISO), a non-governmental organisation established to promote the development of voluntary standards that govern quality and environmental impacts, several quality registrar or quality certification firms have started performing workplace monitoring on codes of conduct and human rights issues. Many of these firms already visit and certify factories against ISO standards and several have begun to expand their services to include workplace assessments relating to codes of conduct and human rights.

Forensic and Investigation Firms: Other organisations currently providing external monitoring services include those from the forensic and investigation industry. Forensic and investigation firms typically use a network of professionals to investigate allegations of impropriety or perform due diligence assessments of potential or existing suppliers' ability to comply with codes.

www.bsr.org/resourcecenter ; electronic publication – 2000.

large, established firms. This distrust is even more pronounced in the NGO community, where many suspect that the for-profit firms in the sector are not really independent of the firms that hire them. Indeed, controversy about the independence of auditors plagues all audit fields, including financial audit, but is far worse in fields such as social auditing (see next section on audit standards). Parts of the business community, however, are concerned that some of the NGOs that provide monitoring services are using standards that do not enjoy broad legitimacy and acceptance⁷.

Thus, one shortcoming of (non-financial) external verification is that it tends to transfer some of the voluntary codes' problems of credibility ("you can't let the fox guard the hen-house") into problems of credibility of the auditor or monitor. However, this shortcoming is largely due to the under-developed state of institutional supports in most fields of non-financial audit. This shortcoming would be addressed, at least in part, if auditing or monitoring standards, similar to those that have been developed for financial auditing, existed in other areas. As the next section will show, such standards are being developed in some areas, but none of the proposed standards (with the possible exception of ISO 14001, an auditable standard for certifying environmental management systems) have achieved widespread acceptance by the business and NGO communities.

Monitoring and Auditing Standards – a Crucial, Missing Ingredient

Financial audit is the most developed form of external monitoring of enterprise activity. Its institutional structure has been in development for over a hundred and fifty years and has involved voluntary initiatives that have been shaped by corporate law and capital market regulation⁸. One of the

main functions of this institutional structure is to define the set of steps and statements that make up the audit and the auditor's report. The objective of an audit is:

... to enable the auditor to express an opinion on whether a statement (financial, environmental, social report) is prepared, in all material respects, in accordance with an identified reporting framework⁹.

This quote underscores how formal the financial auditing process is. Auditors deliver strictly delimited statements about whether a statement adheres “in all material respects” to “an identified reporting framework”. Financial auditing is quite a circumscribed activity and users of financial information tend to be aware of the strengths and shortcomings of the standards and frameworks that underpin the audited information. This awareness is part of the basic human capital – or expertise – that underpins any well functioning business sector in an advanced economy. Accounting and auditing standards are important parts of the business sector's intangible infrastructure.

One purpose of auditing standards is to remove discretion from the auditor so as to increase the credibility of the audit – in effect, the standard removes some (or even most) of the auditor's room for manoeuvre. This means that, after undertaking standard steps to verify pre-agreed aspects of a firm's management procedures and of the information it proposes to publish, the auditor makes standardised statements about the adherence (or lack thereof) of these procedures and information to a given quality standard. This standardisation enhances the credibility of the auditor's services because it reinforces its claim to be acting independently of the firm being audited. It also makes it easier for every one involved in the process – the firm being audited, the auditing company and the users of the information produced by the audit – to determine whether the audit has been done competently and in accordance with established norms.

In the absence of such standards – that is, if everything were to be decided on a case by case basis – then the auditor (or monitor) could be pressured to use auditing and reporting practices that shed a flattering light on the firm. One recent study has highlighted this issue in the area of social audits in supply chains (O'Rourke 2000). The author of this study accompanied social auditors from one of the “Big 5” accounting firms and conducted a “parallel” audit of respect of core labour standards in a number of Asian factories. In comparing the two sets of audit results, the researcher noted significant differences, with the accounting companies' audit tending to show a much more positive picture. The researcher alleges that there was significant pro-management bias in the accounting firm's audit results. Some of the statements in the paper underscore the difficulty of trying to conduct credible audits in the absence of a widely accepted audit standard:

[Company name] is one of the key corporate players in labour practice monitoring. The company conducts more audits than any other company in the world and is a powerful participant in several monitoring and certification schemes. However, if the three cases reviewed for this report indicate the state of their art, there is much reason for concern about [company name's] monitoring systems and findings.

[Company name] monitoring is flawed in a number of important regards. While the company's auditors were able to find minor problems in the factories I inspected with them, they consistently overlooked larger, more important issues [relating to health and safety, freedom of association, collective bargaining and others]. ... The significant and seemingly systematic biases in [company name's] methodologies call into question the company's ability to conduct monitoring that is truly independent.

In the absence of widely accepted audit standards, even well-known people or companies using or offering audit services can have different views on what comprises reasonable audit practice. In many fields of corporate responsibility (especially supply chain issues), disagreement on reasonable behaviour by firms and on audit practice is pronounced. Some progress toward consensus on basic issues will be necessary before effective audit practices – that is those that are acceptable, credible and useful to a broad cross section of information users – can emerge.

The above quote also underscores the ambiguity of the term “independent” or “external” in the context of audits and external monitoring. The firm doing the monitoring is usually paid by the firm

being monitored or audited. The auditor therefore may have a strong commercial interest in developing an ongoing business relationship with the firm being audited and may seek to nurture this relationship by producing results that its client will find flattering. The lack of auditing standards defining agreed practice aggravates this problem. Even in financial accounting, where auditing practices benefit from a long tradition, extensive standardisation and other safeguards, the independence of auditors is called into question from time to time¹⁰.

In most areas of corporate responsibility, such standards do not exist or are only just emerging. Attempts to develop them in certain areas are being undertaken by governments, firms and NGOs. Some of the noteworthy initiatives include:

- Global Reporting Initiative (GRI). This initiative has developed guidelines for sustainability reporting by firms (that is, a reporting framework is being developed that includes economic, social and environmental issues). The GRI guidelines are now being tested internationally using pilot firms from a number of OECD countries (e.g. Japan, the Netherlands, Sweden, United Kingdom, and United States). For the time being, it is unclear whether this will develop into a useful reporting framework for firms and for potential users of information on sustainability. GRI is a co-operative arrangement involving corporations, business associations and NGOs and has received some funding from the United Nations.
- The ISO 14000 series of environmental standards includes ISO 14001, an auditable standard for environmental management systems. It was issued in 1995 by ISO, a private, international standards setting organisation. ISO 14001 has attracted considerable attention and many thousands of certifications by firms. It is reasonably well accepted by the business community (though not all businesses think it is well suited to their needs) and by NGOs. However, this standard only concerns environmental management practices and commitment to continuous improvement. A firm could have poor environmental performance (measured for example, in terms of industry benchmarks for energy efficiency or effluents) and still be certified for ISO 14001.
- SA 8000 and ECS 2000: SA 8000 is an auditable standard for human rights in the workplace. It was issued by the Council for Economic Priorities, a US-based NGO. ECS 2000, issued by a private group based in a Japanese business school, covers various aspects of business ethics but concentrates mainly on bribery, corruption and other types of economic crime. Both standards have attracted considerable attention, but they have not yet gained as much acceptance by the business community as ISO 14001.

Conclusions

The foregoing analysis has highlighted the difficulties businesses face in trying to establish credibility in many areas of corporate responsibility. One of the sources of the problem is the lack of a well-developed, widely accepted framework of supporting, intangible infrastructure (especially, standards on behaviour, auditing and reporting). Such infrastructure, once developed, will make it more difficult for firms, auditors (or possibly even NGOs) to “bluff” in this area. In effect, well-designed standards – by codifying (largely) accepted norms for behaviour, management systems, audit and reporting – lower the room for manoeuvre by companies and their auditors (social, environmental or financial), while still allowing them the flexibility they need to respond to different business, ethical and legal circumstances.

Much preparatory work remains to be done before such standards can emerge. In most areas, agreement or consensus on appropriate behaviour and management practice is a crucial ingredient that does not yet exist. Although meaningful standards that are considered relevant by the business community have emerged in some areas (e.g. environmental management), progress has been very limited in others (e.g. social audit and supply chain management). In the latter areas, there is a continuing need for dialogue, research and debate on what the problems are, on appropriate business conduct and on how (and if) such conduct should be audited and reported.

In the meantime, it is inevitable that a certain amount of frustration and distrust will accompany some corporate responsibility initiatives. Firms that attempt initiatives in areas such as supply chain management and social accounting will be frustrated because even good-faith efforts will not be taken seriously. Similarly, NGOs and consumers will have a hard time distinguishing useful efforts (which they might want to reward) from initiatives that are nothing more than public relations ploys (which they might want to expose).

The main challenge of writing credible standards resides in reaching a modicum of shared understanding and agreement on the underlying behavioural, managerial and reporting issues. The different actors are influenced by different cultural, business, legal backgrounds. While the business community's views are highly relevant, other actors in civil society – trade unions, consumers, NGOs, governments at various levels – also need to be involved in various ways for the various issues. Unfortunately, this difficult, consensus-building phase cannot be skipped over. The corporate responsibility movement provides an institutional channel (aided by recent progress in telecommunications technology) through which various actors – businesses, NGOs, trade unions and governments – can air and debate different ideas. In this sense, it contributes to the eventual formation of consensus and, directly or indirectly, to the gradual emergence of the auditing and reporting standards that will enhance the credibility of these initiatives.

Finally, the analysis of the implementation content of corporate codes suggests that firms do not use external monitoring as a tool for addressing a range of ethical and legal compliance challenges. For example, the bribery codes provide relatively extensive discussions of implementation but hardly ever mention the use of external verification (aside from financial audit of accounts). Although there are a number of reasons for this (including the absence of audit standards), it points to another basic feature of corporate conduct and misconduct – that not all of it can be effectively monitored by external parties. Some types of misconduct (e.g. the more sophisticated forms of bribery) would be hard to discern for someone not close to the bribery transaction. In order to prevent these types of misconduct, firms need to deploy a larger kit of compliance tools to control the complex social, financial and technical processes within the firm. Firms, NGOs and governments are accumulating expertise in how compliance tools can be effectively deployed in different business contexts and for different types of potential misconduct.

Notes

1. See, for example, Punch (1996) and Ayres and Braithwaite (1992).
2. The complete OECD inventory has 256 codes. 138 of these codes have been issued by something other than an individual company (i.e. by NGOs, by business associations, by intergovernmental organisations).
3. Notice that there is some overlap between the set of bribery codes and the set of environmental codes; that is, some codes mention both issues.
4. This would have meant that some issue areas would hardly have been represented. For example, only two of the supplier codes mention bribery.
5. The following is typical of the language adopted in the codes. For example the following language appears in the code of a general retailer: "Suppliers and their subcontractors must make their facilities available at all times for inspections by [company name] representatives or independent inspection firms retained by [company name]." In this study, this language resulted in this retailer's code being scored for both "internal monitoring" (because the company's "representatives" might inspect the site) and for "external monitoring" (because "independent inspection firms" might become involved).
6. See "Preliminary Research on the Future of Auditing" AICPA- Assurance Services. 1999. www.aicpa.org.
7. For example, in 1999, LPA, an association of human resource executives in the United States published its analysis of SA 8000, a well known, auditable standard for socially responsible labour management. The analysis alleges that SA 8000 is incompatible with and "gives unions greater employee access than they enjoy under the National Labour Relations Act (NLRA), the primary US labour relations law."... In relation to working hours the analysis asserts that: "The SA 8000 standard is in direct conflict with US wage and hour policy and standard industrial practice." The conclusion states: "Many of the individual labour standards in SA 8000 adopt European instead of US approaches to labour law enforcement..." Published on www.lpa.org as memorandum 99-36 and dated March 18, 1999.
8. For example, formal auditing in Britain can be dated to the creation of the Comptroller General of the Exchequer in 1834 and to the creation in 1870 of the "English Institute" (an association of auditors), which was granted a royal charter as the ICAEW in 1880. The American Institute of Public Accountants was formed in 1887. Both of these are private, self-regulated associations.
9. This text is adapted from International Federation of Accountants Handbook, 1999. The Handbook refers only to financial auditing.
10. Empirical studies of the financial auditor-client relationship suggest that it has at times been influenced by commercial considerations. Of course, standardisation and other disciplines (e.g. the risk of litigation against auditors by users of reports they have audited) limit the extent to which this can take place.

Annex

Definition of Attributes Used in Textual Analysis of Codes

Record keeping and financial reporting: Codes mention attempts to set forth quality standards for record keeping and reporting. Example:

“... employees shall ... comply with all accepted accounting standards, practices rules, regulation and controls ... Ensure that all entries are promptly and accurately recorded and properly documented – no entry will intentionally distort or disguise the true nature of any transaction.”

Compliance discussed: Codes mention implementation of or compliance with codes of conduct, other than record keeping and financial reporting. Examples:

“[Company name] “Ethical Business Conduct” and related procedures constitute company wide standards of conduct. This procedure provides an overview of the [Company name] ethics and business conduct program and employees’ responsibilities.”

“As a condition of doing business with [Company name], each and every factory must comply with this Code of Vendor Conduct.”

A code of conduct has a section titled “Maintaining Compliance”.

Codes signed by Executive Officers: A code is signed by the board of directors, the chairman of the board, the president or other top officers. This often takes the form of a signed message to employees as a foreword to the code text, or it can be a signature on the code document itself. Codes are not scored for this attribute when the code text merely says that the chairman or board of directors adopted the code.

Internal monitoring mentioned: Codes mention that the company monitors or has a compliance/ implementation system for its own company codes of conduct. Codes addressed to suppliers or other business partners are not scored for this attribute. Example:

“The structure includes the Corporate Responsibility Committee of the Board of Directors and the Leadership Committee, which have oversight responsibility; the Compliance Council, whose duties include education, monitoring and response; and all employees of the Company.”

Existence of whistle blowing facility: Codes mention the company ombudsman, with clear indication of where to contact this person, e.g. address, telephone number and EM address. Example:

“Call the [company’s] Human Resources hotlines at 1-800-xxx-xxxx to report any possible violations of law or other violations of the Code of Business Conduct.”

Appointed compliance officer or committee: Codes mention company appointment of compliance officers or committees to execute compliance programmes. Example:

“... we have established a “Corporate Compliance Committee” to oversee our compliance efforts and ensure that the Company has necessary policies and systems in place to train employees in their legal responsibilities, monitor compliance and correct any deficiencies in compliance programs.”

Use of compliance manuals: Codes mention the existence of compliance manuals, or themselves look like manuals (give thorough guidance on what to do under certain circumstances, or have Questions and Answers). Examples:

“Many of the statements made here are backed up by detailed policies and procedures. These are available on the internal policy and procedure web-site at: [internet address given]”

““Handle a Concern” explains the many ways you can get a policy question answered, or report a concern or possible violation”. “What to Watch Out For” lists some of the things that may indicate a policy problem.”

Reference to disciplinary actions: Codes mention that the companies will take disciplinary actions in the case of non-compliance with the codes. Example:

“Failure to act in compliance with the Code is likely to result in disciplinary action against both the employee committing the breach and others who condone it.”

Report to the Boards of Directors: Codes mention that the Boards of Directors receive reports on compliance activities. Example:

“The Committee will report annually through the Managing Director to the Board of Directors.”

Training for compliance mentioned: Codes state explicitly that employees will be trained in code implementation or monitoring. Examples:

“Each operating group and division will establish a training program. The program will be designed to ensure that all employees have an awareness of the [Company's name] Integrity Statement and the standards of conduct and legal requirements that are relevant to their work at a level of detail appropriate to their job functions.”

Signature by employees: Codes have a section in which employees are requested to sign that they have read the codes and will comply with them. Example:

“This booklet contains an acknowledgement to sign as a statement of your personal commitment to integrity. It's a way for each of us to pledge to uphold the principles of high ethical standards and to comply with all company policies.”

Monitoring suppliers: Codes mention that the companies monitor activities of their suppliers and business partners, as opposed to monitoring their own activities (internal monitoring). Example:

“[Company's name] intends to monitor compliance with our Partnership Guidelines and to undertake on-site inspection of partners' facilities.”

Periodic review by managers: Codes mention that it is the task of managers to monitor compliance and conduct periodic reviews. Example:

“Management is responsible for instituting regular reviews of compliance....”

Chapter 5

Public Policy and Voluntary Initiatives: What Roles have Governments Played?

Executive Summary

Government involvement in “voluntary” initiatives for corporate responsibility has been extensive. This chapter reviews four main types of involvement – legal and regulatory incentives, tax expenditures on the NGO sector, contributions to compliance expertise and moral suasion.

The most influential government measures have been closely co-ordinated with broader public strategy, especially in relation to regulatory reform. Many of the private initiatives studied here are closely related to the legal and regulatory environments from which they emerge. Examples of co-operative enforcement (that is, involving co-ordinated efforts by regulators and by companies) can be found in such diverse areas as anti-money laundering, competition policy and environment. In the United States, the Federal Sentencing Guidelines create an incentive for firms to adopt credible legal compliance systems against any conduct that would be illegal under Federal law. Indeed, in some instances, these initiatives are so clearly a response to legal and regulatory incentives, that they could almost be called the extension or reflection into private management practices of public law and regulation. As a result, it is often difficult to analyse the impact or effectiveness of these initiatives independently of the legal and regulatory framework from which they emerge – the two form an interdependent system.

Offering favourable tax treatment to the NGO sector is another important, but indirect measure. In countries where such tax expenditures are high (e.g. Canada and the United States) they provide a significant boost to all eligible NGOs, including those involved in corporate responsibility initiatives. The tax expenditures in these countries form a key part of the policy framework influencing these initiatives. Governments have also contributed to the development and dissemination of expertise by allowing government experts to participate in the development of management and reporting standards and by funding, directly or indirectly, coursework and research in this area. Government have occasionally endorsed particular codes and used moral suasion to put pressure on particular companies. This policy approach appears to be less common than those listed above. All the cases noted in the course of the fact finding mission deal with the activities of multinational enterprises outside the OECD area and focus on specific human rights issues (core labour standards in the supply chain and management of security forces in the mining and petroleum sectors).

Introduction

Effective governance requires balancing and managing the changing relationships between states, markets and civil society. Governments are now working increasingly in partnership with business, labour and civil society in the functioning of the individual national economies and the international economy, particularly in establishing appropriate institutional and policy frameworks.

Overview of Governance Work at the OECD¹

Codes of corporate conduct and associated management and reporting systems are private initiatives designed to help firms achieve a variety of goals – protecting corporate reputation, improving

employee morale, enhancing consumer loyalty and avoiding costly criminal and civil proceedings. Codes of conduct – or corporate policy statements – are just one component designed to influence behaviour within companies and their business partners and to influence outside perceptions of this behaviour. As is shown in Chapters 4 and 6, firms often back these policy statements up with management systems designed to make commitments meaningful in day-to-day operations and sometimes also provide performance reports. These voluntary initiatives are widely acknowledged to be one of the more important developments in international business over the last fifteen years.

Although these initiatives are voluntary and private, they are influenced in various ways by the broader environment – cultural, social, legal, economic and political – from which they emerge. Public policy shapes this environment and forms an important part of the institutional framework influencing firms' voluntary initiatives. Indeed, a survey of company environmental programmes in North America, Europe and Asia lists domestic legislation in the home country as the most important influence on these initiatives. This is followed by “legal actions”, environmental accidents, and host country legislation (reported in Kolk, 2000).

The present paper explores the many ways OECD governments have shaped private corporate initiatives. The influences considered are the following:

- **Enforcement strategies and legal and regulatory risk management.** Regulatory enforcement has increasingly relied on private initiatives as the first line of enforcement. Because such a strategy often involves creating an incentive for firms to adopt particular management practices and systems, it boosts firms' adoption of and reliance on such systems. In addition, many systems of criminal and civil law, in considering some matter, ask that companies be able to demonstrate that “due care” has been exercised in the performance of the activity under consideration. In some countries, this creates powerful incentives to identify major risks and to develop systems to manage such risks. These often include codes of conduct and supporting management systems and practices.
- **Taxes.** Some OECD governments provide favourable tax treatment to the non-profit sector and define the non-profit sector for tax purposes so that it includes the NGOs that operate in this field. At times, this favourable tax treatment is available for contributions to other institutions (professional societies and universities) that are also active in this field.
- **Direct participation in sector initiatives.** Issuance of codes of conduct or pressuring firms to issue and adhere to such codes (e.g. the guidelines on hiring security services recently issued jointly by the US and UK governments, the encouragement given to the Ethical Trading Initiative by the UK government and to the Apparel Industry's “No Sweat” initiative by the United States government).
- **Contributions to specialised human and intangible capital.** OECD governments have played important and varied roles in the development of managerial and technical expertise that underpins voluntary initiatives. This includes provision of government expertise to the organisations (e.g. contributing to the work of the technical committees of International Organisation for Standardisation) that discuss and devise standards; the offering of coursework and degree programmes in the public university system (and more indirectly through private universities via favourable tax treatment).

Enforcement Strategy and Legal Risk Management

A new kind of interaction between government and business is emerging in which both parties see the need for co-operative rather than adversarial relationships ... [T]here is increasing evidence that a co-operative approach to solving regulatory problems can lower costs for both parties and achieve equal or better performance in relation to policy objectives...

*Co-operative Approaches to Regulation
OECD- PUMA Occasional Papers, 1997*

... A compliance system is an important element in the corporate governance and due diligence of an organisation and should assist an organisation in being a good corporate citizen, an organisational feature which many companies highly prize these days. Australian courts are also taking a closer look at an offending company's activities.

Bill Dee, Director of Compliance, Australian Competition and Consumer Commission Standards Australia, April 1999

It has been observed that, increasingly, companies implement management systems that promote both compliance with law and regulation and with broader societal expectations. Steps taken by regulatory and law enforcement authorities in several member countries have heightened interest in management systems designed to promote legal and regulatory compliance. In particular, some member countries have explicitly incorporated consideration of compliance and risk management practices into their approach to regulatory enforcement and to punishing and correcting illegal corporate activity. This creates powerful incentives for companies to adopt credible management practices in this area and also involves a significant co-ordination of private compliance and public enforcement. Indeed, the realisation that such co-ordination is often in the interests both of the business community and of the public (because it improves the effectiveness of enforcement) is probably one of the most important insights in business regulation and law in recent years. In this sense, private compliance systems are just the reflection in private managerial practice of a given legal or regulatory arrangement. The new strategy of enforcement attempts to bring together and co-ordinate private and public action in a mutually reinforcing package.

This partial shifting of the focus of legal and regulatory enforcement onto the internal practices of companies can be an attractive law enforcement option for many types of potential corporate misconduct. For example, Scholtz (1997) notes that it is not always possible to define legal behaviour in detail, in advance and in a way that is relevant for all firms. It may be more effective to define general principles for corporate behaviour – and then to provide guidance to firms on the implications for their competitive and managerial practices – than to spell out precisely *ex ante* which behaviours are prohibited. This may also be a promising strategy in the many areas where the relationship between the enforcer and companies is not adversarial – where they share objectives (e.g. occupational safety, financial stability). In such cases, there is significant scope for co-operation – enforcers and companies can attempt to determine the best ways of achieving their shared objective.

Some countries refer to corporate management practices and systems – and in particular to corporate legal compliance practices – in establishing guidelines for sentencing companies for illegal conduct. These practices could also be considered in determining whether a case should be resolved by something less than a fully contested proceeding (that is, a full prosecution of the accused company). From the company's point of view, the objective of the compliance programmes is, first, to lower the risk that the company engages in illegal activity, whether through an inadvertent act of some its employees or through conscious wrongdoing on their part. The second objective is to control damage if illegal activity does occur by increasing the odds that the company will learn of it a timely manner (i.e. before law enforcement officials notify them in the course of an investigation) and to manage the “locus of responsibility” for acts of corporate misconduct (by allowing the company to show in a credible way that the misdeed was not its policy and that the company exercised due care in trying to prevent wrongdoing).

The countries that adopt this approach to criminal sentencing often provide guidelines for what constitutes good corporate practice in the area of compliance systems (Table 9). In some cases, this takes the form of official pronouncements or guidance on the management practices that the governments feels will promote high compliance (e.g. the Australian competition authorities expression of interest in the management standard AS 3806 or the guidance on due diligence in preventing money laundering which has been provided by the Federal Banking Commission of Switzerland). At other times, governments prefer to leave it up to companies to decide which management practices are the most effective.

Table 9. **Law enforcement and management systems for promoting legal compliance**

Country	Area of compliance	Description
Australia	Competition and trade practices; emerging interest in other areas such as Finance	The compliance standard, AS 3806, outlines three essential components of an effective management system designed to promote compliance: structural, operational and maintenance. The Australian Competition and Consumer Commission has indicated that it would view favourably action taken by companies to implement this standard. The financial regulator, the Australian Securities and Investment Commission, is also using AS 3806 as a basis for its compliance activities. The Australian federal court system has given a qualified endorsement for the use of the Standard.
Canada	Competition and trade practices	Competition authorities have cited five elements that are fundamental to the success of any corporate compliance programme: the involvement and support of senior management; the development of relevant policies and procedures; the ongoing education of management and employees; monitoring, auditing and reporting mechanisms; and disciplinary procedures.
United States	Any business practice that is illegal under federal law	Federal Sentencing Guidelines. Passed in 1991, the Guidelines provide incentives for corporations to maintain credible compliance programmes. Organisations found guilty of a variety of federal law violations can reduce their fines by demonstrating due diligence in establishing an effective compliance programme.
Switzerland	Anti-money laundering	Several legal and enforcement measures for preventing money laundering have been adopted by the Swiss authorities since 1990. These require, among other things, that due diligence be exercised by financial intermediaries in preventing money laundering. In addition, supervisory authorities have issued guidelines clarifying the nature of due diligence obligations for the banking community. In response to this evolving legal environment, the Swiss Bankers' Association issued in 1998 a "code of conduct with regard to the exercise of due diligence." This code provides anti-money-laundering guidelines for financial intermediaries and deals with customer identification and with the identification and follow-up of unusual or suspicious transactions. It inspired a similar code: the Wolfsberg Principles endorsed in October 2000 by an international consortium of banks (who co-operated with Transparency International in developing the code).

This is also a prominent feature of regulatory strategy in recent years. It has been used in a variety of areas including environment in the European Union, occupational health and safety in the United States, truth-in-advertising in the United Kingdom and seafood safety in the United States. These initiatives are attempts to enhance regulatory enforcement by recognising that firms and their employees are often the best placed to identify and correct non-compliance. Generally, firms are offered inducements to participate in such arrangements – for example, the frequency and type of inspections they are subject to might be made more advantageous for the firm if it puts in place certain management or reporting systems. Another approach is to establish a penalty structure that explicitly incorporates the firms' own actions in reporting and redressing non-compliance. This might, for example, call for a lower penalty if the firm reports non-compliance to the public authorities than the penalty that is paid if the public authority finds out about through inspection or from a third party. The penalty structure then sets up a financial incentive for the firm ("voluntarily") to set up a management system designed to allow early detection of non-compliance. The combined result of these innovations in regulatory policy has been to increase firms' interest in formal compliance management systems and to promote the adoption of such systems.

As noted, numerous examples of this approach to regulatory enforcement are to be found in the OECD area and some of these are described in OECD (1997). Two particularly important examples are described in Box 7. The first is the European Union's integration of voluntary initiatives into its environmental strategy. Although this is probably the most prominent example of the use of voluntary firm-based initiatives in environmental regulation, numerous others could also be cited from non-Europe OECD, from sub-national governments and from EU member states. The second example is in the area of occupational health and safety in the United States, where the focus of enforcement has shifted away from administrative processes and toward firm-based initiatives undertaken in "partnership" with enforcement authorities.

**Box 7. Incorporation of Private Initiatives Into Regulatory Enforcement Strategy:
Environment and Occupational Health and Safety**

Enforcement of environmental regulation in the European Union: The European Union allows firms whose production sites are subject to EU environmental laws to receive advantageous treatment under public surveillance or compliance monitoring. The Eco-Auditing Management System (EMAS) is an environmental management standard and certification scheme established by EU directive. It is based on the concept continuous improvement toward the economically viable application of best available technology (EVABAT, which originated in BS 7750²). EMAS not only requires the implementation of an environmental management system, but also an independently verified public environmental statement. It requires the creation a “competent body”, established by EU members, which is responsible for the registration of new companies and the co-ordination and enforcement of EMAS regulations. The European Commission has issued a “bridging” document that is designed to encourage companies that already hold ISO 14001 certification to register under EMAS³. Generally, EMAS is considered to be a more demanding and less flexible than ISO 14001 (Ans Kolk 2000).

Occupational health and safety in the United States: After review the results of several state pilot programmes, OSHA (an occupational health and safety agency of the US Department of Labour) has unveiled a Co-operative Compliance Program. The programme gives selected businesses the option either to “partner” with OSHA or face a 100% certainty that a full inspection will be conducted. Targeted facilities number between 12,000 and 13,000 in the 29 states where OSHA has either partial or full authorisation to enforce safety and health regulations. The businesses invited to participate in the program have reported injury and illness rates of 7 cases per 100 full-time employees (about double the national average). About 500 employers with the highest rates are not invited to participate and will undergo traditional OSHA inspections. The remaining businesses choose between traditional enforcement with a guarantee of inspection or they can partner with OSHA at a reduced risk of inspection. Employers who choose to partner must sign an agreement that requires them to 1. Identify and correct occupational hazards; 2. Work toward significantly reducing injuries and illnesses; 3. Implement or improve an existing safety and health programme; and 4. Fully involve workers in the site's safety and health programme. The programme provides guidance evaluation guides for work site and hazard analysis and a scoring system for employer occupational safety programmes.

Tax Treatment of the Non-profit Sector

NGOs have played central and varied roles in the development of many corporate responsibility initiatives. Far from representing a unified movement, the NGO sector contains a diverse set of organisations pursuing diverse agendas and competing for resources in a variety of different ways. In the course of this competition for resources, NGOs – some of which enjoy tax exempt status – have positioned themselves so as to appeal to different segments of the giving public and have launched on various quasi-commercial activities. In some countries, tax policies are designed to facilitate these fund raising activities. While some OECD countries provide highly favourable tax treatment and employ broad definitions of what tax exempt organisations may do, others provide little or no tax incentives or define the scope of activities of tax exempt organisations very narrowly.

This has indirectly shaped the corporate responsibility movement and has probably been quite important in the countries where tax incentives for non-profit activity are high. Although NGO activity extends well beyond the area of corporate responsibility, NGOs are nonetheless among the principal actors in this field. NGOs have monitored the activities of particular corporations and, at times, have sponsored public relations campaigns against them. They have issued model codes of conduct that they hope will be influential – this has often been done in co-operation with the business community (e.g. the CERES principles, SA 8000). They have provided expert advice in the field on matters of corporate responsibility (e.g. NGOs advised soccer retailers as they developed their approach to the problem of child labour in Pakistan's soccer ball producing sector). NGOs have also created information systems designed to shed light on various aspects of firms' behaviour (e.g. Asahi Newspaper Foundation in Japan, Council on Economic Priorities in the United States and the Ethical Investment Research Service in the United Kingdom).

Some OECD governments promote these developments indirectly through tax incentives that may take several forms: 1) Deductions of contributions from personal income or personal tax credits; 2) Deductions of contributions from corporate income or corporate tax credits; 3) Tax exempt status for other revenue raising activities undertaken by organisations designated as being eligible for such treatment. (For example, many sell products or services and are not taxed on the “profits” from these quasi-commercial activities). The determination of eligibility for such tax treatment is an important consideration and several countries define a non-profit organisation in such a way that many NGOs active in the corporate responsibility area would not be eligible.

Table 10 summarises this information for a selection of OECD countries. Among the countries covered, tax treatment of the non-profit sector varies from not extending any special treatment whatsoever to providing generous tax deductions on both personal and corporate income.

Table 10. **Tax Treatment of the Non-Profit Sector**

Country	Criteria for attributing legal entity status and tax exempt status to an organisation	Tax status of contributions to such organisations – individuals; households	Tax status of contributions to such organisations by companies
Canada	Qualifying organisations must provide a tangible benefit to the public. Objectives may include relief of poverty, preserving the environment, providing services for people in distress, protecting the welfare of children, providing public amenities and the advancement of education.	A federal tax credit (on federal, provincial and territorial taxes) of 17% is available on the first C\$200 and 29% of the balance. The amount eligible for credit is 75% of yearly net income.	No deductions or credits allowed.
Denmark	Organisations must be engaged in health research, charitable or religious activities. Museums and the Red Cross are also eligible.	Contributions worth a minimum of 500 K and a maximum of 5000 K per year are eligible for a deduction.	No deductions unless corporation is owned by a certain type of foundation. For these companies, a 25% deduction is allowed.
Finland	Eligible organisations must seek to support Finnish cultural heritage and scientific research and art. Not all NGOs would qualify.	No deductions allowed	Companies can deduct a minimum grant of FIM5000 to foundations and research institutes and universities.
France	An organisation has to be registered as “association” in order to obtain legal entity status – then called “association déclarée”. Criteria to become “association déclarée” are: at least two members, not-for-profit and not involved in illegal activities. Among the “association déclarée”, the ones that fulfil following criteria may be registered as “association reconnue d'utilité publique”: 1) for public benefit; 2) have been active as “association déclarée” for at least three years; 3) have over 200 members; 4) active nation-wide.	Contribution to normal not-for-profit organisations (association déclarée) may be exempted from tax if the Tax Authority approves the application. For individuals, generally up to 50% of contribution is exempted from tax with the ceiling of up to 1.25% of taxable income. Contributions to designated organisations (associations reconnues d'utilité publique) are tax exempt. For individuals, generally up to 50% of contribution is exempt from tax with the ceiling of up to 5% of taxable income.	Contribution to normal not-for-profit organisations (association déclarée) may be exempted from tax if Tax Authority approves the application. For legal entities, up to 0.2% of annual sales can be exempted from tax. Contributions to designated organisations (association reconnue d'utilité publique) are tax exempt. For legal entities, up to 0.3% of annual sales can be exempt.
Germany	Eligibility of tax exemption does not require legal entity status. If the Tax Authority decides that the organisation is for public benefit (using authorisation criteria that are rather broad), then the organisation will be exempted from tax.	For individuals, up to 5% of annual income is in general exempted from tax. If the contribution is made to academic, cultural, or charity purposes, the ceiling is 10%.	For legal entities, up to 5% of annual income is in general exempted from tax. If the contribution is made to academic, cultural, or charity purposes, the ceiling is 10%. Alternatively, 0.2% of the sum of annual sales and overheads can be used as the ceiling.

Country	Criteria for attributing legal entity status and tax exempt status to an organisation	Tax status of contributions to such organisations – individuals; households	Tax status of contributions to such organisations by companies
Japan	To obtain legal entity status as a non-profit organisation, following criteria are required. Organisations must be non-profits engaged in the following activities: health, education, culture and art, environment, emergency rescue, local security, human rights and peace, international co-operation, gender, children's health and education, and others. The main activity of the organisation cannot be religious or political. In addition there are restrictions on the composition and remuneration of the Board of Directors and on the number of employees. Organisations that are designated by the Ministry of Finance as "Public welfare organisations" are eligible for tax exemption.	No deductions allowed.	Any company may deduct as expenses contributions to eligible organisations equal to the sum of 1.25% of its income and 0.125% of the paid-in capital. However, contributions to institutions designated by the Ministry of Finance as "Public Welfare Organisations" may be fully deducted from income and are not subject to contribution ceilings.
Netherlands	Eligible organisations include churches, cultural, scientific and other religious institutions and all other institutions whose objective is to serve the public interest. Activities could include child protection, development aid and nature conservation.	Donations may be deducted from income tax if they exceed a minimum of 1% of gross income and 120 Dutch Guilders. Maximum allowable deduction is 10% of gross income.	No deductions allowed.
Sweden	No special treatment	No deductions allowed	No deductions allowed
United Kingdom	Eligible organisations do not have to have legal entity status, but have to be registered with Charity Commission. Organisations can be registered if they are for "public benefit", working in the following areas: poverty alleviation, promotion of education, promotion of religion and other public benefit activities. Once the organisations are registered, they are automatically granted with tax exemption status.	If an individual makes a contract with registered charity that the former will make donations for over four years. For individuals, some tax exemptions may apply for high taxpayers. Both individuals and legal entities can exempt from tax if they make more than 250 pounds donation at one time.	If a legal entity make a contract with registered charity that the former will make donations for over four years. Legal entities can allow 100% tax exemption. Both individuals and legal entities can exempt from tax if they make more than 250 pounds donation at one time.
United States	Eligible organisations fulfil prerequisites set in Internal Revenue Service legislation 501 (c)(3). These organisations may be involved in relief of "the poor, the distressed or the underprivileged, advancement of religion, education or science, lessening the burdens of government, lessening of neighbourhood tensions, elimination of prejudice and discrimination, defence of human and civil rights secured by law and combating community deterioration and juvenile delinquency". Organisations have to apply to obtain non-profit legal entity status and tax exemption status separately.	Contributions are tax deductible, but limits of 20%, 30% or 50% of gross income may apply depending on the type of property being donated and the type of organisation. NGOs involved in corporate responsibility would generally be subject to the 50% limit.	Deductions allowed. 10% of gross income.

Direct Participation in Sector Initiatives

Governments have also been involved more or less directly in the development of codes of conduct – that is, in statements intended either for the general public or for the employees of enterprises giving behavioural commitments in one or more areas of business ethics. Perhaps the most common way of doing this is through their participation in international organisations. The recent adoption of the revised OECD Guidelines for Multinational Enterprises is a case in point. The World Bank's Environment, Health and Safety (EHS) Guidelines, which are also applied to the International Finance Corporation's (IFC) activities, are another influential code issued by an international organisation.

Similarly, individual governments influence business activities through government funded export credit agencies. Some agencies, such as the Export/Import Bank in the United States and Japan Bank for International Co-operation (the former Export/Import Bank of Japan), publish environmental guidelines which aim to set environmental standards of those companies that seek financial support from the agencies. Similarly, government procurement policies can influence the behaviour of corporations that are involved with government contracts. Australia and New Zealand Government Procurement Agreement, for example, set out procurement guidelines that includes a section on integrity and ethics.

In addition, individual governments have occasionally pushed for the development of sector specific codes. Here they attempt to use moral suasion to encourage firms to adopt particular practices. Examples of such activities are provided in Box 8. The initiatives presented in Box 8 focus on rather specific issues (core labour standards in the supply chain, security forces) and on multinational enterprise operations outside the OECD area.

Box 8. Examples of Direct Promotion of Codes or Related Management Systems by OECD Governments

European Union

As set out in the Fifth Programme of Policy and Action in Relation to the Environment and Sustainable Development, the long term goal of the EU is to transform the European economy into one whose development is sustainable for generations to come. In order to help integrate the SD strategy into industry practice, several information services have been set up. These include a database containing examples of “best practice” environmental management; eco-labelling; studies on integrated product policy (Life-cycle assessment); and an EMAS helpdesk (i.e. to provide information and assistance on the EU’s environmental management standard). Funding is available for firms through the LIFE program. Currently more than 600 projects (have) received support under this programme.

United Kingdom and United States

The governments of the United States and the United Kingdom announced a new set of guidelines to protect human rights in security operations linked to international mining and energy projects. The guidelines are the culmination of tripartite discussion hosted by the two governments and involving leading companies and NGOs from both countries.

USA

The United States Department of Commerce promotes voluntary corporate codes of conduct through the implementation of the ‘Best Global Practices’ program. Elements of the program include:

- an award for the US company with extraordinary achievements in meeting one or more of the goals in the BGP program
- electronic clearing house with codes to serve as examples for other firms
- information on NGOs which can provide additional info to the corporation

The Apparel Industry Partnership Agreement was promoted by the United States Department of Labour in response to concerns that various apparel manufacturers were using child labour in hazardous, sweatshop conditions, both domestically and internationally. The partnership, convened by the government, brought together representative of industry, consumer and human right groups to discuss these issues. This led to an industry code prohibiting child labour, recognising workers rights like freedom of association, prohibiting discrimination and placing a cap on working hours, and guaranteed the payment of minimal prevailing industrial wage. The code is meant to influence the conduct of apparel manufacturers in all countries in which they operate.

Contributions to Human and Intangible Capital in this Field

One important outcome of these voluntary initiatives is the development of specialised managerial and technical expertise. Indeed, the amount of expertise required to implement environmental and other management systems is considerable. For example, an environmental manager attempting to implement the ISO 14001 environmental management system (or any other EMS) would, have to undertake the following:

- See to the issuance of an environmental policy statement setting forth the firm's environmental objectives and targets and how it plans to go about meeting these. This statement should be underpinned by an inventory of the firm's environmental impacts and of the relevant legal and regulatory considerations.
- Oversee the implementation of the environmental management system. This includes definitions of structures and responsibility within the organisation, the design and implementation of a "training, awareness and competency" programme. It also includes an internal and external communications plan, a document control system, an operational control system (including emergency preparedness) and a means for checking and correcting action (including an internal EMS audit)⁴.

A new group of management professionals, "EHS" managers, has emerged over the last two decades. Accompanying institutional supports such as professional degree programmes and course work (see below) and the creation of professional societies are also being created. In addition, firms have taken steps to pool their knowledge in this area by participating in the creation of management standards, of which the environmental standard, ISO 14001 is the most prominent example.

Here, again, governments have played a role in promoting the accumulation of human and intangible capital. Some governments have contributed expertise to the technical drafting groups that provided inputs for the ISO technical group that developed the ISO 14000 series of environmental standards. However, governments have also developed their own sets of criteria for defining what management systems for corporate conduct should look like (see examples in Box 8). And some governments (e.g. the European Commission, Australia, Canada and the United Kingdom have information (sometimes accompanied by research) services. Among other things, these provide information on recent developments in this field and promoting "best practice".

Table 11. **Examples of Higher Education Programmes in Business Ethics – Netherlands**

Nijenrode Business School	Business school, European Institute of Business Ethics. The MBA programme has one course of business ethics.
Erasmus University, Rotterdam	The Environmental Management section offers graduate courses and a post-graduate masters program. The MSc programme offers a required course on business ethics and an elective course on environmental management.
State University of Groningen	A course called 'Ethics for Managers' is offered in the International Business programme.
University of Amsterdam	A course in 'Environmental Management' is offered at the undergraduate level and a course called Environmental accountancy at the graduate level in WIMM, the Scientific Institute for Environmental Management, within the Economics Department. Strategic Environmental Management is also offered as a "master-class" for environmental professionals.
Technical University of Eindhoven	Institute TDO (Technology for Sustainable Development) offers courses in integrating environmental considerations in technical design. Topics covered include: energy, cleaner production, sustainable construction, behaviour and communication.

Source: OECD

Governments have also promoted human capital accumulation by sponsoring research, course work and degree programmes in some of these fields. As compliance expertise has become more standardised, it has been possible to organise formal coursework in some areas. Again, this is particularly noteworthy in the area of environmental, health and safety management. An examination of the curricula of leading universities makes it clear that many now offer coursework, most often in environmental management but sometimes in broader ethical areas as well. All but one of the top 25 business schools in the United States (*Business Week's* ranking) offer coursework in environmental management or general business ethics. Ten public universities in the United Kingdom offer coursework or degree programmes in these fields. See Table 11 for the coursework available at universities and technical institutes in the Netherlands.

Notes

1. C(2000)91/REV1/ADD1
2. BS 7750 – An environmental management system created by the British Standards Institute. It is a precursor of EMAS and ISO 14001.
3. ISO 14001 is part of the ISO 14000 series, which covers standards in the field of environmental management tools and systems. Firms can use ISO 14001 as a standard for internal auditing purposes, for self-declaration or for third party certification. The standard builds on the Deming cycle of quality management as set out in ISO 9000 (plan, do, check and act). Ans Kolk (2000).
4. The ISO 14000 Information Guide (1999).

Chapter 6

Corporate Environmental Management Practices in European, Japanese and Non-member Asian Firms

Introduction

Environmental concerns have gained prominence in the public debate about domestic and international policy. Public policy is essential in addressing these concerns, but company behaviour is important as well. It is now widely recognised that firms, through better management practices, can play a major role in addressing many environment problems (Faulkner, 1992). Driven by a variety of pressures (e.g. from customers, employees, environmental interest groups, and regulators), many companies have taken steps to control, measure and report on their environmental performance. This chapter presents internationally comparable information on an important trend in international business: the development and adoption of advanced environmental management practices.

In particular, it examines the environmental management practices of European, Japanese and five non-member Asian firms (from Indonesia, Malaysia, the Philippines, Chinese Taipei and Thailand). In addition to shedding light on European practices, it tests the hypothesis that Asian companies are adopting more advanced environmental management techniques, just as their European counterparts do. Such management techniques usually evolve in three steps. The first step is the issuance of a policy statement, which sets forth the basic principles and norms for the company's environmental management and performance. At more advanced levels of environmental practices, companies put in place formal management systems designed to control their environmental impacts. Environmental performance reporting is an even more advanced practice.

The organisation of this paper mirrors these steps. After discussing the methodology and the data used, the paper is organised in three sections: environmental policy statements, management systems, and reporting. This also follows the concept found in typologies of environmental strategies developed by various researchers (Hunt and Auster 1990, Roome 1992, EIRIS, 1999). This organisation will allow for answering the following questions:

- What percentage of firms publishes an environmental policy statement?
- What environmental commitments are made in these statements?
- How do environmental commitments differ by nationality and sector?
- What percentage of the firms in the sample has an environmental management system?
- What percentage of the firms has standardised EMSs (e.g. EMAS or ISO 14001) and what percentage opt for "tailor made" systems?
- Are EMSs more likely to be adopted by firms operating in sectors where environmental impacts are high?
- What percentage of the firms report on environmental performance?
- How detailed is the information firms report on environmental performance?

Data and Methodology

This paper reports on the environmental management practices of a sample of more than 1600 European firms, 187 Japanese firms and 100 non-member Asian firms. The European and non-member Asian firms have been analysed using similar data and the same analytical framework; the data-collection method and analysis for the Japanese firms differs. The Annex to this chapter describes the research methodologies in more detail.

As regards the European firms, raw data from a non-profit organisation, the Ethical Investment Research Service (EIRIS) have been used. Based in the United Kingdom, EIRIS provides company information to ethical investment services (e.g. specialised mutual funds) and organisations (pension funds, churches) engaged in ethical investment. The present study is based on the EIRIS database, which covers over 1650 publicly traded firms in the UK and in continental Europe. The OECD Secretariat aggregated these data in order to form an overall view of enterprises' practices in the areas of environmental commitment, management and reporting. The firms in the EIRIS database range from large multinationals to smaller, quoted companies. They engage in many types of economic activity and 424 firms, or 26% of the firms, operate in sectors that EIRIS describes as having a *high environmental impact* (HEI)¹.

The OECD, using the same methodology and scoring standards as EIRIS for the European sample, has collected the data for the matching non-member Asian firms. The selected firms are quoted on the non-member Asian stock exchanges and were all chosen from high environmental impact sectors. Information is available for 42 out of the 100 companies contacted (3 Indonesian, 16 Malaysian, 5 Filipino, 10 Chinese Taipei and 8 Thai firms). It is not known whether non-responding companies do not employ any environmental practices or whether they have not responded for other reasons (e.g. language barriers, lack of interest). Non-responding firms are counted as firms not publishing any information on environmental management practices. Hence, the estimates presented here of the percentage of firms adopting advanced environmental practices represent "minimum" values, in the sense that further research may reveal that additional firms do indeed employ such practices.

The data on environmental practices of the 187 Japanese companies are based on the survey² conducted by the Asahi Newspaper Foundation. The survey covers a wider range of corporate social responsibility issues and includes questions on environmental management practices, such as the existence of environment policy statements, the extent of ISO 14001 certification, the use of environmental auditing and the information disclosed on environmental issues.

The sampling and data collection methodologies used by the Asahi Newspaper Foundation differ considerably from the ones used for the European and non-member Asian firms. *First*, the firms in the Japanese sample are defined as "high profile companies", making it difficult to compare this sample to the other two studies' samples. *Second*, the survey uses an industry classification system that does not strictly correspond to the division of high- and low environmental impact sectors as used by EIRIS. *Third*, the survey by the Asahi Newspaper Foundation asks respondents to provide information which the company has not necessarily made publicly available (whereas the EIRIS database uses only publicly available information). In addition, the Asahi information looks at a somewhat different set of environmental practices than EIRIS does. *Fourth*, the methodology based on the Asahi survey is potentially subject to non-respondent's bias (that is, the firms that choose to respond to questions may not be representative of the entire population of firms), especially for auditing and reporting issues. Non-responding firms are assumed not to engage in the activity mentioned.

Environmental Policy Statements

The International Organisation for Standardisation (ISO) defines the environmental policy statement as a statement by an organisation of its intentions and principles in relation to its overall environmental performance. The statement provides a framework for action and for the setting of the organisation's environmental objectives and targets (ISO, 2000). Of all non-member Asian firms, 27%

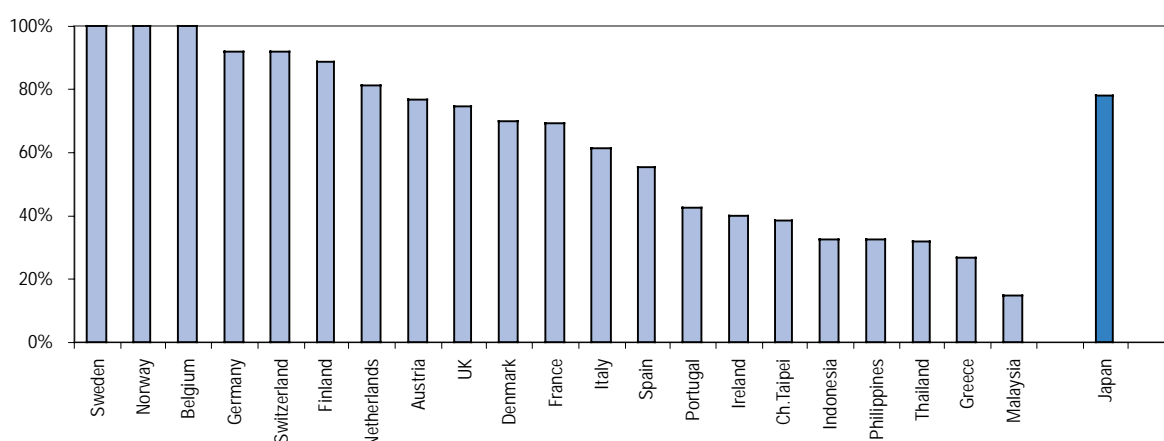
publish a policy statement, with firms from Chinese Taipei standing out with 39% (see Figure 21). Of the European firms, on average 45% do so. Some of the non-member Asian economies have rates of policy issuance that are comparable with the lower ranking economies such as Greece, Portugal and Ireland. 78% of the Japanese firms report they have an environmental policy statement.

Publishing environmental statements involves costs. It absorbs management time and entails direct expenses for design, publication and dissemination. It might be reasonable to expect that firms for which the environment is a major strategic and risk management issue – that is, those operating in the high environmental impact sectors – would be more likely to assume such expenses. The sample of European firms suggests that this is indeed the case. Among firms operating in high environmental impact sectors, the percentage making detailed statements of environmental commitment rises to 75% (compared to the 45% overall average). For Japanese firms this pattern differs, as the performances of high- and low environment impact sectors diverge hardly. 79% of the high environmental impact companies in Japan have such statements, compared with 74% of the low environment impact companies in Japan.

Figure 21 shows that even within the high environmental impact sectors, significant variation among companies from different national origins exists. In some countries (Belgium, Norway and Sweden), all of the firms operating in high environmental impact sectors have a formal environmental policy. The lowest percentage for high impact European firms was found for Greece, where only about one firm out of four operating in high impact sectors publishes a statement.

Also the degree of environmental policy statements *among* various high-impact sectors varies widely. Of the non-member Asian companies, the oil industry has the highest percentage with environmental policy statements (50%), followed by the building materials sector (35%). Non-member Asian firms in the food sector score relatively low; only 12% have an environmental statement. In the European sample, firms in the utility sector have the highest percentage of policy statements, with 100%. These are followed by chemicals (92%); forestry and paper (83%); mining (70%); steel (68%) and oil and gas (67%). As regards the Japanese firms, the ones active in the paper, steel and chemical sectors, as well as in construction, *all* stated that they have environmental policies in place.

Figure 21. **Environmental policy statements in HEI sectors**
(as percentage of sample by country)



Source: OECD/EIRIS

Perhaps more important than the question whether a firm has a policy statement, is the content of that statement. The EIRIS database categorises companies' policy commitments as follows: *first*, commitment to comply with the law; *second*, commitment to exceed legal requirements; *third*, commitment to best practice. About 26% of the European firms publishing a policy statement, indicate that they intend to comply with the law, 18% state that they will try to exceed legal requirements, while 2% target "best practice".³ Among the non-member Asian firms that publish a policy statement (i.e. 26 firms), 15% aim for "best practice", and an additional 58% state to try and exceed legal requirements.

Though on average aiming at higher standards, in general, the environmental statements by the non-member Asian companies do not seem to have the same level of detail as those of the European companies. The majority of the published policy statements are very simple and general. Unlike European companies, where 42% of companies with environment statement cover all the key issues as identified by EIRIS⁴, the majority of the environment statements by the non-member Asian companies do not refer to any key issues.

Other organisations – especially business associations, international and non-governmental organisations – also publish policy statements regarding commitments to good environmental practices. Few companies refer to these external statements in their own statements. The most common reference European firms made is to the International Chamber of Commerce's Business Charter for Sustainable Development, which was mentioned in about 5% of the environmental policy statements. Firms from non-member Asian countries do not refer to outside standards in their policy statements. In general, companies apparently prefer to keep their commitments "self-contained" by not mentioning outside standards or declarations in their policy statement.

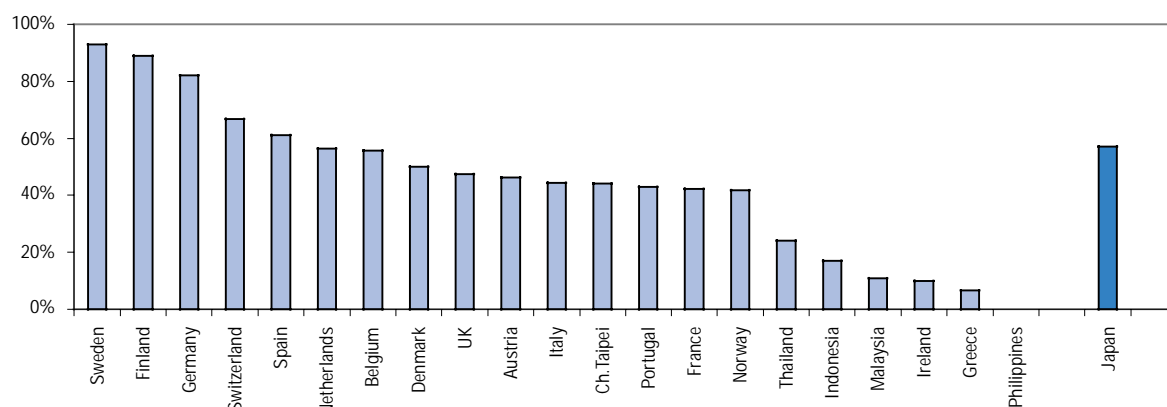
Environmental Management Systems

Publication of an environmental policy statement is only one part of a multi-stage process that companies need to undertake in order to gain control of their environmental performance and to manage their environmental risks. Often companies also employ a range of tools that frequently draw on the management control practices used in other aspects of the firms operations. Sometimes, these practices are formalised as an explicit environmental management system (EMS). Kolk (2000) defines these as follows: "An EMS is that part of the overall management system which includes the organisational structure, responsibilities, practices, procedures, processes and resources for determining and implementing the firm's overall aims and principles of action with respect to the environment. It encompasses the totality of organisational, administrative and policy provisions to be taken by a firm to control its environmental influence." Though the EMSs of different organisations may vary widely in details, all usually include an environmental policy statement; an initial review; environmental objectives and targets; implementation procedures; internal monitoring and auditing; and internal reporting.

Among the roughly 1600 European firms, 26% refer to some type of environment management system; in high environmental impact sectors, this is 52%. National differences between companies as regards their degree of adoption of formal environmental management systems are evident, see Figure 22. Countries whose high impact companies have high rates of EMS adoption are Sweden (93%), Finland (89%) and German (82%). Low degrees of adoption of formal EMSs can be found in HEI firms in Greece (7%) and Ireland (10%). Among the non-member Asian companies (which are all in high-environmental impact sectors), Chinese Taipei scores highest with 44% of firms adopting a formal EMS⁵. This is comparable to lower-middle ranking economies in Europe such as Italy, France and Norway. Indonesia and Malaysia score lower (33% and 25% respectively); in the Philippines none of the companies appears to have implemented an EMS.

As regards differences among industries, the non-member Asian oil industry and the civil engineering industry report the highest rates of implementing EMS (50% and 35% respectively). The rate of EMS implementation of the oil industry is higher than that of its European counterpart (47%). On the other hand, there are no non-member Asian companies in the food industry that have reported implementing an EMS.

Figure 22. **Environmental management systems in HEI sectors**
(as percentage of sample by country)

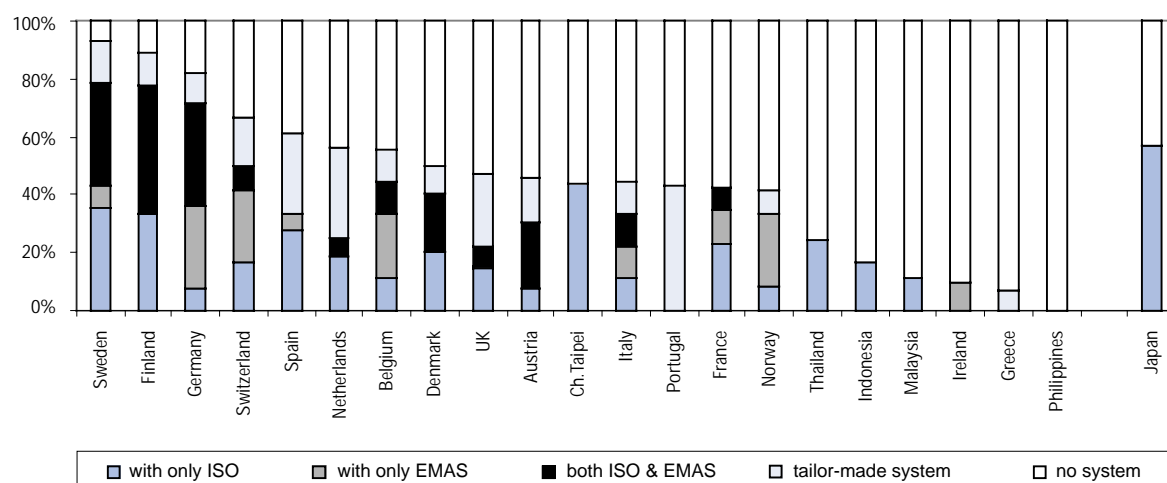


Source: OECD/EIRIS

Among European firms, EMSs are most often mentioned in utilities: of all sectors, electricity (96%); forestry and paper (83%); water (75%); mining (70%); chemicals (63%) and gas distribution (60%) score highest.

Some firms opt for self-designed EMSs that are tailored to the individual company requirements and problems. Other firms use or adapt environment management standards. The tension between tailor-made management systems and standardised systems has been observed in other areas of management and the similar trend may also be present in EMSs. Standards may distil and disseminate information about effective environmental management practices and may enhance the credibility of the firms' environmental measures if the management standard is widely accepted. Standardised systems provide quick and relatively inexpensive access to advanced management techniques – allowing companies to avoid “re-inventing the wheel”. On the other hand, a potential drawback of standardised systems is that they may not be tailored to individual company needs.

Figure 23. **Standardisation of EMSs**
(as percentage of total EMSs by country)



Source: OECD/EIRIS

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The most common standardised EMSs are Eco-Management and Audit Scheme (EMAS), the EU supported management system and certification scheme introduced in 1993, and ISO 14001, an international environmental management standard which was published in 1996. These standard systems seem to attract considerable interest among firms operating in high environmental impact sectors. About two thirds of the European high impact firms use a standard management system. This tendency towards standardisation is even more evident for the non-member Asian firms. In fact, *all* companies that report to have an EMS have been certified with ISO 14001. This represents a substantial difference with the European data, where about one-third of the companies relies on tailor-made systems, see Figure 23. Of the Japanese companies, 58% responded that a part of their Company Group has been certified by ISO 14001, while a further 12% is currently working on the certification.

The *degree of coverage* of EMAS or ISO 14001 certification varies from company to company. Of the 13 non-member Asian companies that clarify the coverage of their ISO certification (out of 19), eight companies have certified more than two thirds of the Company Group; two companies have certified between one third and two thirds, and three certified less than one third. This contrasts with the European companies, where the majority (82% of the total number of the firms that have achieved either EMAS or ISO14001 certification in at least one part of the Company Group), certified less than one third of the total Company Group⁶. Only 2% of the European firms have achieved either EMAS or ISO14001 certification that covers the entire Company Group. However, these figures may understate the true degree of coverage due to the time lag in companies' reporting of certification or in the public registries of certification.

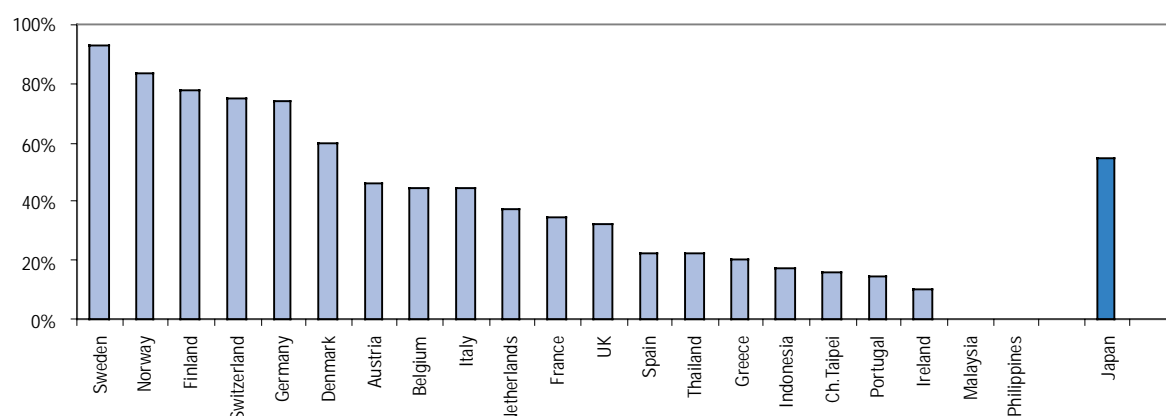
Various *tools* have been developed to assist business in implementing their EMSs, *inter alia* Environmental Impact Assessment, Environmental Accounting and Life Cycle Assessment. These tools may be employed for monitoring environmental impacts, setting a course of action and providing means of communication. In the non-member Asian companies included in this survey, six (6% of the total sample) mention that they perform Environmental Impact Assessment, of which two assess their suppliers as well. None of the European firms state that they perform Environmental Impact Assessments or supplier assessments.

Environmental Performance Reporting

In economies where environmental management practices have been widespread, the demand for high quality environmental reports is mounting. Companies are facing ever-greater pressure to publish a thorough report on their environmental performance, including quantitative information going back several years and reference to negative experiences. Indeed, an increasing number of firms publish information on the environmental impacts of their activities. However, in the absence of internationally agreed reporting standards, the content of such reports ranges from rudimentary reporting to full-scale sustainable development reporting. For the purposes of this paper, environmental reporting refers to the practice of making information on environmental performance available to the public, whether in a stand-alone environmental report, or included in the company's annual report.

Of the three environmental practices considered in this paper, reporting is the least common. 17% of the European firms (and 41% for the high environmental impact firms) report in some way on their environmental performance⁷. High environmental impact companies in Sweden are most likely to make an environmental report – about nine out of ten such companies do so. Austria shows an extremely unusual pattern, since low environmental impact companies are more likely to engage in environmental reporting than high impact firms. Of the non-member Asian firms, 9% of the (all high environmental impact) companies in the survey state that they publish reports on corporate environmental performance. 16% of the Chinese Taipei, 17% of the Indonesian and 22% of the Thai companies in the sample publish information on their environmental performance. 54% of the surveyed Japanese companies replied they disclosed information related to environment (55% of the high environmental impact companies and 51% of the low environmental impact companies that responded to the question).

Figure 24. **Environmental performance reporting in HEI sectors**
(as a percentage of sample)



Source: OECD/EIRIS

Consistent with the results for environmental policy statements and EMSs, in non-member Asia, the oil industry has the highest propensity to engage in environmental reporting: 38% of the oil companies in the sample publish information on environmental performance.

The publication of a stand-alone environmental report usually implies that the data provided is more detailed. Again, a comparison shows significant variation in reporting practices among companies of different nationalities. The number of European firms that produce a stand-alone environmental report is rising rapidly: 131 companies now publish a separate environmental report, compared to 51 in November 1998 (EIRIS, 1999). Countries whose high environmental impact companies are likely to publish stand-alone environmental reports include Sweden (64% of high impact companies), Finland (56%) and Switzerland (50%). On the other end are Ireland and Greece, where none of the high environmental impact firms in the EIRIS sample produce stand-alone reports. 3% of the total non-member Asian sample publishes a stand-alone environmental report.

In the absence of an agreed standard for environmental reporting, firms make their own choices as regards the scope and depth of their reporting. 13% of the total number of European companies – or 62% of the firms that report some aspects of environment performance – provide some quantitative data in their reporting. Among those companies reporting quantitative data, 15% report on all key issues (using EIRIS's definition of key issues⁸). Seven per cent of the companies report on some financial dimensions such as expenditure, capital investment, saving or additional income, environment liabilities, risk and provisions. Of the non-member Asian firms, 6% report on financial dimensions, on both expenditure and capital investments. Sixteen per cent of the Thai companies (that is, all the Thai companies that report environmental performance) make some details available

In order to increase accountability, some firms report "bad news", such as fines, prosecutions, instances of non-compliance, spills, and accidental releases. Four per cent of the European firms in the sample publish this kind of information, whereas none of the non-member Asian companies' reports do so. Of the total Japanese sample, 19% – or 35% of the companies reporting on environment performance and practices – said they publish negative information in their report. Among the European countries, Finland and Norway show a comparable figure to this one, 23% and 16% respectively⁹.

Of the European firms, 43% of the firms publishing environmental reports mention independent verification of their reports. Most of such firms have EMAS registration, which requires both environmental reporting and independent verification of reports. Few companies use audits or verification beyond data accuracy. None of the non-member Asian firms mentions independent

verification of their environmental performance reporting. Some Japanese firms (10%) make the result of external environmental audits publicly available.

Environmental reporting is still relatively uncommon and high environmental impact firms differ markedly in how they publish their information and the data they include. Unlike other areas of business reporting (e.g. financial reporting), there are few widely accepted standards to help firms decide what information should be included in their environmental report. An interesting development in this area is the Global Reporting Initiative (GRI), where a group of NGOs, corporations, and business associations works together to provide guidelines for sustainability reporting by firms. Other guidelines, frameworks and standards have also been developed. Examples are Social and Ethical Accounting, Auditing and Reporting, Corporate Community Investment by the London Benchmarking Group, Fondazione Eni Enrico Mattei, Health, Safety and Environmental Reporting Guidelines by the European Chemical Industry Council, and Public Environment Reporting Initiative.

Summary

In summary, the survey results provide the following answers to the questions set out in the beginning of this report:

- Environmental policy statements:
 - 27% of non-member Asian firms publish a policy statement, with firms from Chinese Taipei standing out with 39%. Of the European firms, on average 45% do so. 78% of the Japanese firms report that they have an environmental policy statement.
 - 18% of the European firms publishing a policy statement, indicate that they will try to exceed legal requirements, while 2% target “best practice”. Among the non-member Asian firms that publish a policy statement, 58 % state that they try to exceed legal requirements, while an additional 15% aims for “best practice”.
 - 42% of European companies with environment statement cover *all* the key issues as identified by EIRIS. The majority of the environment statements by the Asian companies do not refer to *any* key issues.
 - Few European firms make reference to external standards. None of the non-member Asian firms do so.
- Environmental management systems
 - 52% of the European firms in high environmental impact sectors implemented an EMS. Among the non-member Asian companies, Chinese Taipei scores highest with 44%.
 - About two thirds of the European high impact firms have certified their EMS. All non-member Asian companies with an EMS, are certified with ISO 14001. Of the Japanese companies, 58% responded that a part of their Company Group has been certified by ISO 14001, while a further 12% is currently working on the certification.
 - The majority of non-member Asian companies that clarify the coverage of their ISO certification, have certified more than two thirds of the Company Group. This contrasts with the European companies, where the majority certified less than one third of the Company Group.
 - 6% of all non-member Asian companies mention to perform Environmental Impact Assessment (EIA). Two assess their suppliers as well. None of the European firms mentions to perform EIA, nor an assessment of their suppliers.
- Environmental reporting practices
 - Performance reporting is the least common of the three environmental practices considered in this paper. 41% of the European firms in high environmental impact sectors report in some way on their environmental performance. 16% of the Chinese Taipei, 17% of the Indonesian and 22% of the Thai companies publish information on their environmental performance. 54% of the surveyed Japanese companies replied they disclosed information related to environment.

- 22% of the European and 3% of the total non-member Asian sample publish a stand-alone environmental report.
- 7% of the European and 6% of the non-member Asian firms report on financial dimensions such as expenditure and capital investment.
- 4% of the European firms publish negative information (“bad news”), whereas none of the non-member Asian companies’ reports do so.
- 43% of the European firms that publish environmental reports mention independent verification of these reports. None of the non-member Asian firms do so. Some Japanese firms (10%) do make the result of external environmental audits publicly available

As shown by the information summarised above, environmental management practices seem to be taking off in Asia. In some economies or sectors, the adoption of advanced practices is catching up with Europe, but there is still some way to go. This can be seen in the lack of details of their environmental policy statements, as well as in the small number of companies that report on environmental performance.

Notes

1. High environmental impact sectors include such sectors as extractive industries, civil engineering, building materials and chemicals, aerospace, metallurgy, vehicle manufacture, food producers and retailers, utilities, transport, textiles and leather manufacture and waste disposal.
2. See annual publication ‘Yuryoku Kigyo no Shakai Kokendo’ (Social Responsibility of Large Corporations), PHP Kenkyusha.
3. For the remaining firms, it was not possible to determine the commitment standard.
4. EIRIS identified the following as key issues in environmental performance and management: suppliers, contractors, resources and materials, energy use and efficiency, emissions to water, emission to air, transport, waste minimisation/reduction/disposal and recycling, packaging, product and/or stewardship/design, social impact, noise, bad neighbour, visual blight, employee training, green housekeeping, sustainability and industry specific issues.
5. All the companies that have an EMS are certified with ISO 14001, which requires to make a ^{policy} statement. Hence, all the firms that have the certification should have an environmental policy and the frequency of environmental policy statement should be at least equal to that of EMS. However, in some cases the statement was not found in publicly available document while ISO certification was mentioned.
6. In some cases, the extent of the coverage is not clear.
7. This corresponds to the number of firms that report one of the following items of information: description of main impacts, quantitative data, performance against targets, bad news, financial dimensions, stakeholder relations, sustainability and independent verification. However, the report may cover only a part of the Company Group.
8. Key issues as identified by EIRIS.
9. It should be kept in mind that sample size of Finnish and Norwegian companies is much smaller than the Japanese sample. The difference in survey methodology implies that there may be a larger number of companies that claim to publish negative information (Asahi survey) than the actual number of companies that are judged by the third party to do so (in the case of EIRIS study).

Annex

Methodology

The EIRIS database on environment management and reporting contains over 1600 firms in Europe (approximately two-thirds of UK companies and one-third continental Europeans). It covers firms in the Financial Times Stock Exchange (FTSE) All-Share Index in UK and the FTSE European Index as well as other publicly quoted companies. The characteristics of the EIRIS sample, by country of origin, are shown in Table 12. Here, country of origin is defined as the location of exchange on which the corporate entity has its “primary listing”. Thus, a company that is listed on multiple exchanges would only be counted as having one nationality. Secretariat analysis suggests that this designation of nationality is highly correlated with alternative definitions (e.g. location of headquarters, nationality of top management team). The database provided the raw data as it existed on 11 January 2000 and will have since been modified by takeovers, mergers and general updating.

The database contains information on environment management systems that is found in company annual reports, environment reports, web-sites and other materials made publicly available by the firm. Furthermore, the EIRIS database also draws on other public information sources such as the EMAS Register. It is possible that some indicators exist for a particular company, but the company does not publish this information and it is not available from other publicly available sources. In such cases, the database does not include it. In putting together its database, EIRIS concentrates on information that allows it to give a company a “grade” in its report to ethical investors. Other information about the firms’ environmental practices may go unrecorded; for example, supplier audits or environmental impact assessments may not have been mentioned if the company also has a more comprehensive environmental management system. For more detail, see “Corporate Environmental Policy, Management and Reporting” (1999) EIRIS.

The selection of non-member Asian firms for this study is based on the information obtained from the IFC-global index of the Emerging Markets Stock Database (EMDB) of the International Finance Corporation and Standard & Poor. There are 422 quoted companies in five Asian economies; Indonesia, Malaysia, Philippines, Chinese Taipei and Thailand. Only firms in high environmental impact sectors, as defined under the EIRIS methodology are included, since they are the ones for which environmental practices are most pertinent. The high environmental impact sectors refer to sectors that have highly significant impact on the environment and to sectors that have a high public exposure, namely mining and quarrying, integrated oil producers, oil exploration and production, civil engineering, steel, building materials, aerospace, metallurgy, vehicle manufacture, food producers, paper and packaging, airlines, electricity, gas, water, food retailers, textile and leather manufacturing, waste disposal, chemicals and rail and road.

The restriction reduced the total sample to 100 companies – 6 Indonesian, 39 Malaysian, 12 Filipino, 18 Thai and 25 Chinese Taipei firms. Twelve industries are represented; food, chemical, paper, mining, steel, civil

Table 12. **National Affiliations of Companies in EIRIS Sample**

Country	Number of cases	Country	Number of cases
Austria	23	Italy	63
Belgium	22	Luxembourg	1
Czech Republic	2	Netherlands	45
Denmark	35	Norway	31
Finland	22	Portugal	16
France	96	Spain	39
Germany	83	Sweden	42
Greece	50	Switzerland	40
Ireland	27	UK	1019
		Total	1656

Source: EIRIS

engineering, textile, oil, building materials, electricity, airlines and diversified. It should be recognised that the sample size of Indonesian firms may be too small to make any generalisable conclusion.

The data collection took place in the period May-July of the year 2000. First, an Internet search was conducted, a mailing was conducted (asking the firm to send a list of publicly available information, including annual reports, environmental reports, policy statements, published documents on environmental management practices. This was followed up by telephone calls. 42 companies have responded to the survey (3 Indonesian, 16 Malaysian, 5 Filipino, 10 Chinese Taipei and 8 Thai firms).

The data used for the Japanese firms are based on information from the Asahi Newspaper Foundation, a Japanese not-for-profit organisation. This organisation has conducted surveys on social responsibility of large Japanese companies for over a decade, to draw public attention to corporate social responsibility by providing a ranking of these companies. The survey includes some questions on environmental practices, such as the existence of environment policy statement, the extent of ISO 14001 certification, environmental auditing and information disclosure of environmental issues. The questionnaire was sent to 187 companies that are well known or have great exposure to consumers in Japan (so-called "high profile countries"). The secretariat of the Foundation sends out a questionnaire and follows it up with telephone calls.

The sample includes subsidiaries of non-Japanese multinational enterprises operating in Japan. It covers thirteen sectors – food, textile, cosmetics/drugs, electronics/precision instruments, automobile/machinery/other heavy machines, retail, travel/transport, communication, paper/steel/chemical, real estate/construction, banks/insurance, energy and *sogo shosha*. Among them, ten would be categorised as high environment impact sectors according to the EIRIS methodology.

Among the 187 companies, two did not respond at all, and a further 56 responded to selected questions only. Nearly one third remained silent on questions concerning environmental auditing and reporting. This suggests that a non-respondent's bias (that is, the firms that choose to respond to questions may not be representative of the entire population of firms) may be a problem for some questions. In reporting the results of survey results for questions where the portion of non-responses was high, the study adopts a conservative assumption – it assumes that all non-respondents do not engage in the activity mentioned (that is, they don't audit, they do not report negative information, they do not publish environmental reports).

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