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Business and Global Governance: The Growing Role of Corporate Codes of Conduct

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These are, in many ways, halcyon days for global business. In a vast ideological shift in the late 20th century, markets rather than governments came to be seen as the road to prosperity. Governments that once nationalized foreign firms now seek out the investment, technology, and managerial expertise such companies can bring. The halls of the United Nations used to ring with calls for international regulation of those dreaded evil-doers, the multinational corporations. Now the UN instead implores business to join with it in a voluntary Global Compact to ensure respect for internationally agreed environmental, labor, and human rights standards.

And business has truly gone global. Surging transportation and communications technologies in the past few decades have encouraged firms the world over to cross borders, and revitalized industries in Europe and Japan have offered new competition to U.S. firms. At the beginning of the 1990s, some 35,000 parent multinational corporations had roughly 170,000 foreign affiliates. By the end of the decade, 60,000 parent companies had more than 500,000 foreign affiliates, accounting for a quarter of global output in the late 1990s. As transnationals reorganize the production of goods and services, production itself is becoming global in structure.

But there are clouds on the global business horizon that go beyond the current dour economic climate. The lack of effective international (and often national) regulation to protect workers, communities, and the environment has spurred the development of a powerful movement aimed at promoting corporate social responsibility, whose partisans have on occasion forced significant changes in business practices through campaigns aimed at consumers and investors. And because unregulated business activities can cause societies to question the legitimacy of corporations, corporate leaders themselves are struggling with fundamental questions about how far their social responsibilities extend: to shareholders, employees, local communities where they operate, humanity as a whole, future generations?

National Regulation?

Repeated efforts, starting with the proposed International Trade Organization in the 1940s, to create internationally agreed rules to regulate cross-border business have all failed. Regulation of these firms thus falls to national governments. But governments are often finding it difficult to cope. Megacompanies' huge resources dwarf those of national prosecutors, making legal control a challenge. Changes in the ways global corporations produce goods also complicate national regulation. Companies both big and small contract out with suppliers in far-flung parts of the world—Disney reputedly has some 300,000 separate suppliers. A company with a brand name such as Levi Strauss or WalMart effectively controls a long chain of frequently shifting suppliers based primarily in low-wage countries, thus controlling much of what suppliers do: what product quality standards and schedules must be met, what products will be produced. But for the most part, control over such matters as working conditions in and environmental spillovers from those suppliers' facilities remains in the hands of the national governments where suppliers are located. Because enforcement of labor and environmental standards in those low-wage countries is often, to put it mildly, less than fully effective, this pattern of production enables richcountry firms to reap the benefits of low production costs without having to pay attention to the associated social costs.

Even in countries with well-established regulatory systems and effective courts, a determined company can flout the law. Some get caught, but only after doing extensive damage. Louisiana-Pacific Corporation was recently assessed the largest criminal fine in the 28-year history of the U.S. Clean Air Act. The company, which employs some 13,000 people in the United States, Canada, and Ireland and grossed $2.5 billion in sales in 1997, pleaded guilty to 18 felonies and agreed to pay $37 million in penalties and $5.5 million for criminal violations of the Clean Air Act.

The corporation was caught only because a former company supervisor filed a lawsuit against it alleging that he had been fired for refusing to tamper with one facility's pollution monitoring equipment. That is a rather haphazard way to regulate, but federal and state environmental officials cannot possibly closely supervise the vast array of firms operating in the United States.

National regulation, where it exists, falls far short. Many governments seem unable or unwilling to ensure that national standards exist and are adequately enforced. No matter how much corporations may complain (sometimes justifiably) about the heavy hand of government regulation, the market side has the upper hand.

To fill the governance gap, an extraordinary variety of nongovernmental groups has sprung up. Activist groups are proving adept at shaming or coercing corporations into paying attention to what activists say are the broader social responsibilities of the private sector. And some in the corporate world seem to be listening.

Corporate Codes: Cover Up, Try-out, or Buy-In?

During the late 1970s corporations began to face nongovernmental pressures to change the way they saw their role in the world. Principles and codes of conduct began appearing, mostly among U.S. companies responding to waves of bad publicity from revelations that some had been paying bribes overseas—a practice banned by the 1977 U.S. Foreign Corrupt Practices Act.

As corporate cross-border activity blossomed, new campaigns demanded change in corporate practices on everything from worker rights to environmental sustainability. By the 1990s, a new "corporate social responsibility" movement was in full swing. Corporations began learning that failing to comply with consumer and investor preferences about their behavior can be costly.

Today many companies are creating "codes of conduct" that go beyond what local law requires. The codes are meant to protect company reputations and reassure consumers that their production processes are environmentally benign and that working conditions are decent.

Sometimes governments encourage the code-of-conduct trend. In the United States, the Clinton White House set up an Apparel Industry Partnership that put forward a code of conduct setting standards for working conditions, applicable not only to participating companies but also to their foreign contractors. Business associations have also gotten in on the act. In 1990 the International Chamber of Commerce set forth a Business Charter for Sustainable Development that has since been signed by more than 2,500 companies worldwide.

But the big push for such codes has come from civil society groups, whose intense public criticism of corporate behavior can drive away customers and investors if left unanswered. Their spotlight has shone even on firms that consider themselves socially progressive. Starbucks Coffee, faced with intense picketing by activists denouncing conditions at the Guatemalan coffee plantations where it purchases beans, eventually issued a code of conduct and action plans for all its suppliers.

By now, almost every self-respecting large corporation has a code of conduct. But the codes are highly controversial. Proponents generally see them as a valuable way to get corporations to buy into new norms of behavior without the need for government intervention, making them attractive to corporate leaders who want to fend off government regulation. More ambitious proponents see them as a means of gradually achieving consensus around standards of behavior that can be tried out voluntarily, then eventually adopted and enforced by governments. Detractors portray them as mere fig leaves.

Corporate codes are of two sorts. The first is "aspirational"—a general statement of what corporations aim to do. The Caux Principles, put forward by the Caux Roundtable, a group of senior executives from leading firms based in Europe, Japan, and the United States, are a good example. They consist of general principles, broad to the point of mushiness (corporations should operate in a spirit of honesty and fairness, should contribute to the economic and social development of the communities where they operate and the world community at large), and slightly more specific stakeholder principles—essentially promises to obey the law and not to cheat. Human rights get a brief mention. But the Caux Principles' formulators point out one big selling point: because the document was devised by business leaders, its ethical norms are more likely than those from other sources to be broadly accepted by the business community. Many firms use the Caux Principles as the basis for their own codes of conduct.

These aspirational codes require no confirmation of whether firms are meeting their commitments. Because the codes are arising piecemeal—by the thousands, all with different specifications—comparing what various firms are promising to do is difficult. And many firms do no monitoring at all.

The second type of code is more demanding. It requires specific commitments on labor or environmental standards, along with independent confirmation of whether commitments are being met. Once a code is established, an independent external auditor comes in, assesses whether a company is in full compliance, and if so certifies it. The firm can then advertise its compliance and display the stamp of approval on its products. The nonprofit Council on Economic Priorities, in collaboration with human rights organizations, businesses, and auditing companies, devised a code of conduct called Social Accountability 8000, intended to become the global standard on workers' rights. Companies that adopt the code permit outside auditors to inspect every facility and assess practices on child labor, health and safety, freedom of association, the right to collective bargaining, discrimination, disciplinary practices, working hours, and—a matter excluded from most corporate codes—whether compensation provides workers a living wage.

Compliance with such externally monitored codes of conduct is completely voluntary. No government enforces them; no international organization has made the standards law. Instead, the assumption is that corporations will want to be so certified because they will find it good for business—because consumers will prefer to buy certified products.

How successful such codes will be remains unclear. A few big companies, including Toys R Us and Avon, have announced they will buy only from SA-8000-certified suppliers, and Avon is the first to be so certified. But some industry groups object strongly, arguing that the ever-mounting costs of certification with the growing array of standards are too great and that industry should set and monitor its own standards.

They have a point. Certification is expensive. Corporations are being flooded with demands to meet standard after standard. Some demands come from groups whose claim to represent a broad public interest seems dubious. It is not at all clear who should decide exactly what standards the codes should uphold.

Another question is: "*Quis custodiet custodes'*"—who will watch the watchers? The complexities show up in the current competition over who should monitor the treatment of overseas labor by U.S. garment manufacturers, who are often accused of subjecting their workers to sweatshop conditions. On one side is the Fair Labor Association (FLA), the outcome of a Clinton administration presidential task force that included both human rights groups and major corporations. On the other is the Worker Rights Consortium (WRC), a university coalition formed by the United Students Against Sweatshops (USAS). The two groups hotly contest each other's motives, methods, and primary goals. FLA member companies agree to have conditions in their overseas contractors' factories monitored by independent agencies, but the company hires the monitor and the reports are not made public. The USAS says this is not good enough, and it set up the WRC to inspect factories that produce goods bearing the trademarks of and licensed by American colleges and universities.

Such problems are not surprising. The certification approach is essentially an effort to replace a government function?—inspection—that even most governments have found difficult to do. There is no particular reason to think private inspectors will systematically do better than public ones or that private resources can readily be found to pay for necessary inspections if public resources are unavailable. By default, many of the private inspections are being carried out by big accounting firms, whose expertise lies in a different kind of inspection.

PricewaterhouseCoopers, the leader in "social accounting," allowed Dara O'Rourke, of the Massachusetts Institute of Technology, to accompany its auditors on factory inspections of labor practices in China and Korea. O'Rourke's report is disturbing. In one inspection, the PwC auditor found some questions she was supposed to ask workers "embarrassing" and skipped them; she answered other questions herself without bothering to ask the workers. In another, the factory president selected the workers to be interviewed, and the auditors skipped all questions about freedom of association, collective bargaining, child labor, and forced labor, claiming that because the factory had no union the questions were not relevant. In both cases, the auditors, financial specialists who had gotten a crash course in social and environmental monitoring, missed major health and safety violations.

The Global Compact

A third model can be found at the United Nations. In 1999, UN Secretary-General Kofi Annan promulgated a "Global Compact" which he asked corporations to sign to indicate voluntary adherence to nine widely accepted UN principles on human rights, labor standards, and the environment. Signatories are supposed to report annually on progress in implementing these principles. The Compact thus does not require outside certification but does insist on at least some degree of public accounting.

The Global Compact, like most compromises, provokes criticisms from both sides. Activist groups object to the unverified self-reporting, claiming that notorious corporate bad guys will be allowed to wrap themselves in the UN logo without making any real change. The head of the International Chamber of Commerce protests that "business should not be called upon to meet demands and expectations that are properly the preserve of governments."

Despite such skepticism, voluntary corporate codes may improve corporate behavior even without the coercion that backs up governmental regulation. Companies do care about their reputations. Reputations are increasingly going global, leaving corporations increasingly vulnerable to new pressures.

Even self-reporting systems such as the Global Compact could turn out to be more effective than expected if corporations take seriously (or are pressured into taking seriously) the reports they are supposed to file each year. Self-reporting, while not ideal, has two potentially beneficial effects. First, it forces the corporation to take a look at its own practices, if only to justify them. Although many corporations will seize the opportunity to exercise the art of spin, some will discover things about themselves that they may want to change. Second, activist groups won't accept those reports at face value. Several groups have already promised to scrutinize them. By signing the Compact, the corporations have agreed to be held to standards of behavior going beyond what governmental regulations require. The activist groups intend to provide the fire to hold to the corporations' collective feet.

Who Knows?

Whether the groups can do so depends on whether they can amass meaningful information about the degree of corporate compliance. The big missing piece in the corporate code puzzle has been how to make the necessary information public in some systematic fashion that makes it possible to compare organizations and to evaluate claims of good (or bad) behavior.

Into the morass has stepped the Global Reporting Initiative, a polyglot array of corporations, accounting firms, and environmental, human rights, and labor organizations, which has developed a framework for voluntary reporting on corporate economic, environmental, and social performance. Its Sustainability Reporting Guidelines, tested in draft form on 21 companies in the late 1990s, were revised in June 2000 and again in 2002. Already, companies are using the GRI framework to report on their compliance with the UN Global Compact.

Who Cares?

All disclosure-based "regulation" depends on the assumption that someone somewhere cares about the information that gets released. The usual argument, especially by certifiers, is that consumers care, particularly consumers in rich countries with the buying power that impresses corporations. Unfortunately, the share of consumers who demonstrate a preference for "certified" goods is substantially lower than the share who make that claim in marketing surveys. Consumer pressure has had far more success improving product safety than working conditions. It took unions—workers looking out for their own interests—to do that.

But corporations have other obligations besides those to consumers. They must also satisfy investors. And rapidly growing numbers of investors are adding social responsibility to their criteria for selecting companies in which to invest. Shareholder activism first became prominent in the late 1970s as part of an anti-apartheid campaign against South Africa and has flourished, most strikingly in the United States. In 1984, according to the Social Investment Forum, roughly $40 billion in U.S. assets under professional management had undergone some sort of social or environmental screening. By 1995, the total was $639 billion. Two years later, it had cracked the $1 trillion mark, and by 2001, it had reached $2.3 trillion.

What constitutes socially responsible behavior varies according to who is doing the screening. The single most widely used criterion is simple: no tobacco. Screens can include everything from environmental sustainability to treatment of workers to animal rights. Religious mutual funds and indexes use the beliefs of specific faiths as criteria.

Focusing on investors addresses one key legitimacy question about screening. Even in the most conservative perspective on the social role of the corporation, those who own it are entitled to a significant say in what goals it should be trying to achieve. And with evidence mounting that screened investments match or outperform the market, the $6 trillion locked up in U.S. pension funds may offer another avenue for growth. People who control workers' pensions just might find themselves under pressure to take seriously workers' rights.

Regulation by Revelation

The effort to devise meaningful rules for global corporations matters greatly. Future global prosperity depends in part on whether corporate practices encourage a widespread sharing of the benefits of economic integration, and future environmental stability depends on whether corporate activities are carried out in an environmentally sustainable fashion. The private sector could decide of its own volition to behave with the necessary degree of social responsibility, either out of altruism or from an enlightened view of long-term self-interest. Some will, but most probably will not. Nor will governments be able to regulate them into compliance with high standards, given the lack of capacity of many governments and the growing ability of corporations to pick up and leave any too-effective jurisdiction. Thus the need for credible regulation by revelation, using transparency to determine whether corporations are adhering to codes of socially responsible conduct.

Those who distrust corporations on principle will not be satisfied with such "soft law," and no one can yet be assured the approach will work on a large scale. This soft approach is an evolving process. Increasingly, corporations are being held to new standards of social responsibility that go far beyond legal requirements to enrich shareholders and obey the rules governments make. The dispute over exactly what those standards should be—and who should decide—has just begun.