

CSR and Competitiveness in China

中国快速成长的民营企业：
企业社会责任和可持续性发展

沈艳 姚洋 著



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A report prepared for IFC PEP-China

沈 艳 姚 洋 著

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ACRONYMS

| | |
|--------|-----------------------------------------------------------------------------------------------------|
| ACFOE: | All-China Federation of Enterprises |
| BSR: | Business for Social Responsibility |
| CPDF: | China Project Development Facility |
| CSR: | Cooperate Social Responsibility |
| DID: | Difference In Difference |
| EP: | Environmental Protection |
| ERM: | Enterprise Risk Management |
| FDI: | Foreign direct investment |
| FIAS: | Foreign Investment Advisory Service |
| GRI: | Global Reporting Initiative |
| HMT: | Hong Kong-Macao-Taiwan |
| IFC: | International Finance Corporation |
| IILI: | Institute of International Labor and Information |
| ILRF: | International Labor Rights Fund |
| ISO: | International Standard Organization |
| MLSS: | Ministry of Labor and Social Security (the present Ministry of Human Resources and Social Security) |
| MNCs: | Multi-National Companies |
| MoA: | Ministry of Agriculture |
| MOL: | Ministry of Labor (the former body of MLSS) |
| NGOs: | Non-government Organizations |
| NLU: | National Labor Union |
| NPC: | National People's Congress |
| NBS: | National Bureau of Statistics |
| QM: | Quality Management |
| SETC: | State Economic and Trade Commission |
| SMEs: | Small and medium enterprises |
| SOEs: | State-owned Enterprises |
| TCS: | Three-party Coordination Scheme |
| UNIDO: | United Nations Industrial Development Organization |
| WBCSD: | World Business Council for Sustainable Development |
| WRC: | Workers' Representative Conference |

EXECUTIVE SUMMARY

In 1999, the International Finance Corporation (IFC) carried out a major study of the private sector in China and published a report, *China's Emerging Private Enterprises: Prospects for the New Century* (IFC, 2000). That report has become a standard reference for researchers on the Chinese private sector both inside and outside China. The private sector has grown rapidly since 1999 and now accounts for more than two thirds of China's industrial GDP. However, the quality of the growth has not been uniform across the board. As China gains share in international commodity trade and becomes the world factory, this issue has increasingly gained international attention. Recent international exposure of the low quality and hazardous products that China exports is but one example. The international community as well as serious scholars and policy makers within China are becoming increasingly concerned with the implications of the private sector development for the sustainability of the Chinese economy. The concept of corporate social responsibility (CSR), has been gaining ground in both public debate and within the business arena. It is against this background that the IFC, under the assistance of the China Project Development Facility (CPDF), helped to initiate this study. The China Center for Economic Research at Peking University was the organization that conducted the study.

This new study covered 12 cities and surveyed more than 1,200 firms, most of which were private. The aim of the study is several-fold. First, it is intended to establish the status quo of CSR performance of private firms as compared with state owned enterprises (SOEs), foreign firms, and domestic-foreign joint ventures. Second, it tries to find the link between CSR performance and the financial performance of enterprises, that is, it tries to find a business case for firms to engage in CSR activities. Third, it aims, based on the findings of the study, to provide concrete suggestions to the Chinese government and enterprises to strengthen the private sector contribution to the sustainability of the Chinese economy. Lastly, it is intended to provide a case study of sustainable development strategies for other emerging economies.

The results of this study have strong implications for government policies and business operations. This executive summary will first summarize the main findings and then put forward a set of recommendations for government and enterprises, respectively. We would like to emphasize that our findings are based on the analysis of a relatively large sample of 1,268 firms from twelve cities with different geographic, social, political, and economic characteristics. Although this does not mean that our sample is representative of the whole country, the size of the sample allows us to test our results by sophisticated statistical methods and thus gives us confidence in our findings. At the very minimum, this study provides the first set of systematic empirical results for CSR and its relationship with firm performance in China. In particular, it builds up a clear business case for CSR in China.

1. Summary of findings

Chapters 3–10 provide rich sets of results. Two sets of findings are especially consistent through all these chapters and bear important policy implications. One is that market competition and supply chain pressures have an unambiguous effect in promoting CSR among firms, and the other is that there is a real business case for CSR because it improves firm profitability by helping firms to retain a more stable workforce,

gain a larger market share, and obtain more external finance. More specifically, the main findings of the chapters are:

CSR Awareness

- A firm is more aware of CSR than other firms if it is an SOE, an exporting firm, a large firm, a firm operating in a competitive market, or a firm with better educated management.
- CSR activities are mainly confined to the first generation type, i.e., providing donations and meeting the expectations of the law.
- Joining business associations helps firms to increase their CSR awareness.

Labor Standards

- Only half of the correspondents in the individual survey had a written contract with their employers in their last job. The majority of the contracts were short term. Worker age (middle-age workers are favored) and education, firm ownership, size, and sector are factors affecting whether a worker can get a written contract. Firms offering written contracts tend to have shorter working hours, pay their workers higher wages and provide larger coverages for pension and medical insurance.
- Labor unions play a positive role in worker protection. Firms with a labor union tend to have shorter working hours and offer a larger coverage for pension and medical insurance. However, they do not offer significantly different wage rates from those offered by firms without unions.
- Collective bargaining does not provide tangible benefits to employees. *It still takes time for collective bargaining to have an impact.*
- SOEs and foreign-invested firms and Hong Kong, Macao, and Taiwan-invested firms are much better than domestic private firms at treating their employees.
- Local employees enjoy much better treatment than migrant employees.

Environmental Standards

- Firms facing more intense competition put more effort into complying with national environmental standards and spend more on environment-related investment.
- Firms that are more aware of CSR perform better in protecting the environment in all aspects than firms with low awareness.
- Domestic private firms have the smallest proportion of firms with ISO14000, and are the least aware of cleaner production.
- There are large regional and industry variations in environmental protection, suggesting that government efforts and industrial policies are an important driver for better environmental protection.

Quality Control

- Over 80% of the sample firms have a quality management department and the majority of them chose to establish the department when they established the enterprise.

- In addition to establishing the quality management department, firms enhance their product quality by obtaining product quality certificates, such as ISO9001, establishing product brand names, and inspecting the product quality of their suppliers.
- Joint ventures are more confident about the quality of their products.
- Firms that are more aware of CSR are likely to spend on establishing brand names and inspecting their suppliers.
- Firms in more competitive markets often outperform those operating in markets with moderate or low degrees of competition. These firms spend much more on establishing brand names. They are also much more careful in inspecting the quality of their suppliers.

Corporate Governance

- Firms operating in more competitive markets are more likely to have a better governance structure, hire professional managers, and have better information disclosure and risk control.
- Firms that are more aware of CSR perform equally well in these respects.
- Privatized (gaizhi) firms are more eager to establish modern governance structures and provide contracts for their managers than traditional SOEs. They also do better in information disclosure and risk control.

The supply Chain and CSR

- The majority of the sample firms are subject to labor and environmental requirements imposed by their customers. By the frequency of requirements, the order is: customers in developed countries, large FDI firms in China, customers in developing countries, small and medium FDI firms in China, SOEs, and domestic private firms.
- However, only one fourth of the sample firms place labor standards and half of them place environmental standards on their suppliers. Firms' own records of labor standard compliance are not a significant factor affecting their decision to impose labor standards on their suppliers, but their better environmental compliance does increase their tendency to impose environmental standards on their suppliers.
- Large firms are far more likely than SMEs to impose CSR requirements, especially environmental standards, on their suppliers. Foreign and HMT-invested firms are doing better than domestic firms, and exporting firms are doing better than non-exporting firms. In both cases, environmental standards are more emphasized than labor standards.
- In general, firms impose CSR requirements on their suppliers not because they value CSR themselves, but because they face outside pressures to do so.
- Firms favor court settlements over private settlements in commercial disputes. There is weak evidence showing that firms in cities with a better legal environment tend to trust the court more than firms in cities with a slacker legal environment.

CSR and Financial Performance

- Better compliance with labor and environmental standards is associated with higher rates of profitability and labor productivity, but better quality control does not have a significant impact on either profitability or labor productivity.
- In the case of environmental standards, a causal relationship between better compliance and better financial performance can be established.
- There is also a causal relationship between supply chain requirements of labor and environmental standards and better financial performance.
- The positive effects of CSR on financial performance come through the following channels: lower turnover rates, larger market shares, and better access to external finance.

2. Recommendations for the government

The results of this report have important policy implications. They provide insights for several important areas in the current CSR debate in China.

- The race to the bottom story does not hold; instead, there is a story of race to the top. That is, market competition has not forced firms to lower their CSR standards, but instead has encouraged them to enhance their CSR performance. This has a lot to do with the business environment in China. One critical factor is the transmission of international standards and practices through the international supply chain. Another factor is the demonstration effect of better performing firms, including SOEs and FDI firms. In such a business environment, trying to save on cutting CSR expenditures will not fulfill the goal of long-term profitability; instead, better CSR performance can help firms get ahead of others in retaining a better workforce, getting a larger market share, and obtaining more external finance.
- Multinational companies have played a positive role in promoting CSR in China while not having hurt the profitability of Chinese firms in serious ways. This positive role is played through supply chain transmission of international standards and the local demonstration effects of FDI firms.
- SOEs are doing better than other types of firms in most areas of CSR. However, they do not play an active role in transmitting their code of conduct to a larger part of the business world.
- Firms adopt CSR more because of the external pressures they face than because of their own willingness.

Based on these clarifications and the relevant results summarized in the last section, we propose the following recommendations for the Chinese government. They may also be useful for governments in other developing countries.

- Leveling the playing field and providing equal opportunity to all firms are not only pivotal for fair competition, but also helpful in promoting CSR.

- Setting up their own CSR standards is needed by government and society so as to take a proactive role in promoting CSR and gain ground in multinational endeavors. However, those standards should not be used to discourage international companies from pressing their suppliers to implement higher standards. International companies can serve as catalysts for better CSR.
- Implementation of existing laws and government regulations provide incentives for firms to build CSR into their business strategies.
- Policy and media coverage should direct attention away from the first generation type of CSR activities in which philanthropy is the most significant part; instead, they should induce more efforts on the part of the companies to build CSR into their business strategies.

3. Recommendations for companies

The most important result that this study offers to companies is that CSR can be an important source of competitiveness in China. In particular, we have the following recommendations for companies.

- Companies should seriously consider making CSR an integral part of their business strategies.
- The kind of CSR activities that may bring immediate payoffs are improving the treatment of workers, increasing compliance with environmental standards, and strengthening corporate governance.
- SOEs should think hard about how to cash-in on their superior CSR performance in the market. They can play this card in getting more orders and better deals in the international market. They should also transmit their own code of conduct through their own supply chains, for doing so not only brings significant social gains, but also helps leveling the playing field in which they operate.
- Multinational companies should continue to use CSR as leverage in the marketplace. Companies producing in China should continue to be the role models for better CSR performance. Companies having suppliers in China should continue to impose relevant code of conduct on their suppliers, but in the meantime realize that standards applied in the developed world may not be immediately applicable in the developing world. It is thus important for them to manage a delicate public relations campaign in their home countries.
- Small domestic firms may be under smaller pressures to strengthen their CSR. However, they would better be prepared if they wanted to expand to medium and even large scale. They should realize that CSR can be one of the bottlenecks in this transformation. Getting acquainted with CSR is the first step towards putting them on the right track.
- Overall, firms need to scale up their efforts to comply with the national laws and regulations regarding labor, environment, and product quality. Opportunism will bring short-term benefits, but honesty will deliver payoffs that last longer.

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Chapter 1

Introduction

In 1999, the International Finance Corporation (IFC) carried out a major study of the private sector in China and published a report, *The Emerging Private Sector in China* (IFC, 1999). That report has become a standard reference for researchers on the Chinese private sector both inside and outside China. The private sector has grown rapidly since 1999 and now accounts for more than two thirds of China's industrial GDP. However, the quality of the growth has not been uniform across the board. As China gains share in international commodity trade and becomes the world factory, this issue has increasingly gained international attention. Recent international exposure of the low quality and hazardous products that China exports is but one example. The international community as well as serious scholars and policy makers within China are becoming increasingly concerned with the implications of the private sector development for the sustainability of the Chinese economy. The concept of corporate social responsibility (CSR), has been gaining ground in both public debate and within the business arena. It is against this background that the IFC, under the assistance of the China Project Development Facility (CPDF), helped to initiate this study.

This new study covered 12 cities and surveyed more than 1,200 firms, most of which were private. The aim of the study is severalfold. First, it is intended to establish the status quo of CSR performance of private firms as compared with state owned enterprises (SOEs), foreign firms, and domestic-foreign joint ventures. Second, it tries to find the link between CSR performance and the financial performance of enterprises, that is, it tries to find a business case for firms to engage in CSR activities. Third, it aims, based on the findings of the study, to provide concrete suggestions to the Chinese government and enterprises to strengthen the private sector contribution to the sustainability of the Chinese economy. Lastly, it is intended to provide a case study of sustainable development strategies for other emerging economies.

This introduction will discuss the notion of CSR, the business case for CSR, debates around CSR, the drivers behind its emergence, and its introduction and controversies in China. At the end of the chapter, we lay out the plan of the report.

1.1 The Concept of CSR

CSR is a notion which originated in the developed economies. This section reviews its definitions, relationship to sustainability, its content, international standards, and the debates around it in the developed economies. China is at a different stage of development from the developed economies, and the notion of CSR could be different in China than in the developed economies. We defer that discussion until Section 1.5.

Definitions of CSR

Although the notion of corporate social responsibility can be traced back to 1924 when Oliver Sheldon first proposed the concept, it is in the last twenty years that CSR has become an important part of the international business environment. It mainly stemmed from consumer and civil society pressures for companies to act in a socially responsible way while pursuing profit. In developed countries, this amounts to asking companies to act beyond what the law requires them to do. The following are several examples of the definition of CSR. By these definitions, CSR is:

“Being socially responsible means not only fulfilling legal expectations, but also going beyond compliance and investing more into human capital, the environment and relations with stakeholders.” (European Union, 2001).

The continuing commitment by business to behave ethically and contribute to economic development while improving the quality of life of the workforce and their families as well as of the local community and society at large.” (World Business Council for Sustainable Development, see WBCSD, 2001)

“Operating a business in a manner that meets or exceeds the ethical, legal, commercial and public expectations that society has of business.” (Business for Social Responsibility, see BSR, 2006)

Essential to these definitions is the broad notion of contingent stakeholders that not only include shareholders, but also workers, the local community, and society as a whole. While the shareholders are only concerned with company profits, other stakeholders are concerned with humane treatment of the workforce, the environment, the coherence of society, as well as product quality. In many circumstances, these two strands of interests conflict with each other.

While a company's abiding by the law will give workers a fair employment contract, it is not guaranteed that workers are being treated in a humane manner. For example, in economies with a flexible labor market, large layoffs are expected when economic downturns come. This is within the realm of action allocated by the legal system to the company, but for many workers, especially those in their late age of employment, it is humiliating and in many cases devastating.

Because of the classical problem of externality, companies may well ignore the negative impacts of their production and products on the sustainability of the environment and the ecosystem. Much has been dealt with by government regulation, but the problem remains because of lack of knowledge, the lack of sufficient action on the part of the government, and evasive action by companies. For instance, until cleaner production is required by government regulation, companies seldom start thinking about the environment in their product design phase. Another example is global warming. Although some scientists began to give warnings twenty years ago, it was not until the evidence became undeniably strong that world leadership as well as individual countries began to take concrete action to abate emissions. It is also noteworthy that government regulation varies with the stage of development. The southern countries have laxer government regulation, and companies in the north can move their production to the south to avoid stringent regulation in their home countries.

Companies are an intrinsic part of society. However, unattended business conduct, even if it appears lawful, may well destroy the fabric that the coherence of the society hinges on. The spread of pornography

is but one example. In countries where the law is less comprehensive, there is ample room for companies to infringe the wellbeing of ordinary citizens while remaining in conformity with the law.

Last but not least, producers have much more information and control over the quality of their products than consumers do. The government may not have sufficient information and resources to monitor product quality in every company. In this situation, it entirely depends on companies themselves to ensure that their products are not harmful to consumers.

CSR requires companies to take voluntary action to fulfill their obligations to the workforce, the environment, and society beyond legal expectations. CSR is a voluntary responsibility, not a legal duty. This is so because CSR does not have a clear boundary and making it a legal duty is impossible. Companies have the discretionary power to decide what kinds of responsibilities they wish to assume and to what extent. This seemingly imperfect arrangement actually has the advantage of forging a cooperative relationship between the business world and the society at large through peaceful negotiation and deliberation.

Related to CSR is the notion of sustainability. The original meaning of sustainability, as defined by the Brundtland Commission, is meeting the needs of the present generation without compromising the ability of future generations to meet their needs. Used in the corporate world, sustainability means that companies should contribute to the sustainable development of society. In other words, sustainability is about ensuring long-term business success while contributing towards economic and social development, a healthy environment and a stable society. (Developing Value, 2005) There are three components of sustainability, often referred to as “the three P’s”, “People, Planet, and Profits”, or the “triple bottom lines” (Developing Value, 2005). In a broad sense, the meanings of sustainability coincide with those of CSR. This report will use CSR to refer to the responsibilities companies owe to the society, but occasionally will also use the term sustainability.

The scope of CSR

According to a UNIDO report (UNIDO, 2002), there are three generations of CSR. The first generation focuses on philanthropic activities. At this stage, companies treat CSR as a pain reliever that helps them to exchange favors with the general public. The second generation incorporates CSR as one of a company's integral business strategies that bring tangible gains. That is, this generation of CSR makes a business case out for CSR and makes it a really voluntary action of the company. The third generation goes one step further and calls for companies to actively pursue the public good, that is, to make the pursuit of public good an intrinsic part of their goals. Currently, companies are in the transition from the first generation to the second generation and the third generation has yet to come.

The UNIDO report also identifies the contents of CSR for each of the three generations of CSR (Table 1.1.) The contents are categorized into four areas of action, namely, focus of accountability, business case, level of engagement, and degree of influence. The first area is concerned with a company's source of accountability; the second area is about how CSR is integrated into its business strategy; the third area takes up its engagement with the society; and the fourth area looks at its actions to influence society. The first generation of CSR is concerned with passive reactions; the second generation involves more conscious actions to accommodate different stakeholders, to integrate CSR into a well-defined business