

## CEC Update

(April, 2005)

### The Corporate Social Responsibility Phenomenon: An Overview

#### • Part 2 •

#### Introduction

This article, which has been divided into two parts, provides an introduction to corporate social responsibility (“CSR”) and codes of conduct, particularly for employers who may be faced with CSR issues in their workplaces.

As you will recall, Part I set out the meaning of the term “CSR”, the types of codes of conduct, outlines the various international frameworks governing CSR regulation on an international level and presented an update on current CSR initiatives in Canada and internationally. Part II examines the elements of a code of conduct in greater detail and addresses the benefits and pitfalls associated with code of conduct adoption.

#### What is CSR?

As discussed in Part I, CSR includes: (i) compliance with domestic laws, even if those laws are poorly enforced; (ii) adherence to international standards; and (iii) adoption of voluntary codes of conduct.

“Codes of conduct,” the primary instrument through which CSR is carried out, may be classified in a number of ways, but there are five main types:

- *Company Codes* are adopted voluntarily by companies and can relate to a company’s head office operations, or be applied specifically to the company’s suppliers.
- *Trade Association Codes* are adopted by associations of firms based in developing countries or by developing countries themselves.
- *Multi-stakeholder Codes* are adopted as a result of negotiations between several stakeholders, including firms or their industry representatives, non-governmental organizations (“NGOs”) and/or trade unions. Governments may also be involved in the development of such codes.

- *Model Codes* are designed to provide a benchmark of what a particular organization regards as good practice, and act as a guide for companies and trade associations that are contemplating adopting voluntary measures.
- *Intergovernmental Codes* are negotiated at an international level by national governments. They include the OECD Guidelines for Multinational Enterprises, the ILO's Tripartite Declaration of Principles Concerning Multinational Enterprises, the UN Norms of Responsibilities of Transnational Corporations and other Business Enterprises with Regard to Human Rights, and the Global Compact (all discussed below).

## The Anatomy of a Corporate Code of Conduct

- **Scope and Application**

Codes of conduct vary tremendously in scope, depending on the industry in which the corporation is involved, the issues addressed by the code and the objectives of the code. Nevertheless, some general considerations should be addressed by all such codes:

- Any meaningful code of conduct must address the corporation's external relationships and not just narrowly focus on internal employees. The code should apply to suppliers, subcontractors and their employees.
- Should adoption of a code of conduct be compulsory for a company? Is a company permitted to withdraw from the code scheme at any time?
- Should a code of conduct's terms be mandatory or not? Are signatories bound by mandatory terms once they have signed, and are these obligations expressed with sufficient precision to influence and assess actual behaviour?
- How does the code address compliance? Even a voluntary code may be constructed to allow for a definitive measure of compliance. Is performance aggregated across the code's requirements as a whole, so that failure to meet an individual requirement does not lead to an overall failure to adhere to the code?

- **ILO "Core Labour Conventions"**

The ILO has identified a number of its conventions which it regards as "core," or minimum, labour standards, and which NGOs, unions and human rights organizations argue should form the basis of any corporate code of conduct related to labour. Based on the ILO Declaration of Fundamental Principles and Rights at Work, the core conventions have been identified as:

- C87: Freedom of Association & Right to Organize
- C98: Right to Organize and Collective Bargaining
- C29 and 105: No Forced Labour

- C138: Minimum Age (Abolition of Child Labour)
- C100 and 111: No Discrimination
- C110: Equal Remuneration

These ILO conventions have a high degree of legitimacy within the ILO's tri-partite membership, as they are directly derived from the founding principles of the Organization that bind all members. Hence, explicit reference to these conventions allows parties to a code of conduct to have access to decades of ILO experience in implementing and interpreting these complex industrial rights.

- **Implementation**

For a code of conduct to be effective, it should contain a clear method of implementation and a means to ensure compliance. While a code will include a statement of principles concerning business behaviour, this does not necessarily result in the application of those principles in the firm's operations. The IOE, for example, has estimated that 80% of codes are really just statements about general businesses ethics and contain no implementation plan.

- **Monitoring, Reporting & Auditing**

While the monitoring of proper code implementation may be done successfully through internal means, the legitimacy of the code will be heightened by external reporting or auditing of code compliance. External verifiers may be engaged in observing the actual practice of a firm or its suppliers or subcontractors, and may issue a direct report based on such observance. Alternatively, a financial audit analogy can be used—that is, the company itself undertakes the bulk of the information collection, which can then be turned over to externally accredited experts for an audit.

It may also be possible for code of conduct compliance to be audited and certified by an audit company established specifically for that purpose. The independence of both auditors and monitors is critical to the success of voluntary codes of conduct, as is their ability to judge whether a code has been complied with or not. The function of auditors and monitors range from basic observation (e.g. is the factory's fire door blocked?) to more specialized judgements (e.g. are equal pay practices being adhered to?).

There is also the further question of what sanctions may be imposed when a code is not adhered to. In many cases, no clear sanctions are defined. Approximately 60% of the company and business association codes in the OECD inventory do not specify any penalties for non-compliance.

## **The Benefits of Voluntary CSR**

Although voluntary corporate codes of conduct have been subjected to much criticism, there are some very clear benefits for those companies that choose to implement them. There are also benefits for employees who are the beneficiaries of code provisions, along with NGOs, suppliers and their employees, and consumers generally.

More and more consumers are “buying ethically” and are specifically seeking out goods and services that are produced under fair labour conditions. Publishing a corporate code of conduct and adhering to it may allow a company to benefit from ethical purchasing, raise its profile as a responsible producer, vendor or retailer and allow it to respond genuinely to criticisms of unethical labour practices.

The financial sector’s interest in CSR may at least in part be explained by a recent Global Compact report undertaken in partnership with the Swiss government and endorsed by twenty major investment companies. The report, entitled “Who Cares Wins: Connecting Financial Markets to a Changing World”, suggests that implementing CSR practices can lead to financial benefits. A 2003 survey indicated that 78% of European fund managers and analysts believe that the management of environmental and social risk has a positive impact on a company’s long-term market value.

Another direct benefit of adhering to a code of conduct is the potential of attracting socially responsible investment. No longer a fledgling concept, ethical investing is now a mainstream force. While some estimates are more conservative, the UK Social Investment Forum has estimated that socially responsible investment assets in the UK alone increased from 22.7 billion pounds in 1997 to 224.5 billion pounds in 2001.

Finally, major stock exchanges in Europe and North America have now created indices comprised of ethically responsible companies, such as London’s FTSE4Good.

## **The Shortcomings of CSR**

In spite of an increased willingness on the part of employers to address the regulation of labour standards on a voluntary basis, many labour and NGO groups argue that CSR does not go far enough.

Practice shows that many codes of conduct do not take the ILO core conventions into consideration. In a study of 140 codes of conduct in the OECD inventory, there was tremendous variation in the labour issues covered. Only three issues were dealt with in more than half the codes surveyed, namely: a general commitment to a reasonable working environment, an agreement to comply with local laws, and protection against discrimination or harassment. The ILO core conventions were specifically mentioned in only one in ten codes.

The other major limitation of existing codes of conduct is a lack of independent monitoring. Of the 246 codes included in the OECD inventory, only just over 10% included provisions for independent external monitoring and only 4 out of 100 individual company codes had such provisions.

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