Business ethics and peace

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1. An Introduction to business ethics and peace

Business ethics has been defined variously by practitioners, scholars and policy-makers. Some focus on ethical behaviour by employees of a firm (the so-called ethics in business approach), others point to sets of rules that regulate businesses, while others highlight a set of values and principles that define corporate culture. While these definitions differ, they all speak to a set of underlying moral imperatives that could frame the way a company conducts its business.

In this sense, ethics define the way a firm makes profits, relates with the labour force, treats the environment and fulfils contractual obligations. When discussing business ethics we are considering an array of dynamics and relationships that go well beyond the firm, but are intrinsically linked to its core mission.

The set of values that we will call business ethics are more akin to a moral obligation than a legally binding requirement. This has made it difficult to explicitly build ethics into the structure of firms, which, by definition, are primarily motivated by making profits. This issue can be traced back to ancient philosophers and religious texts.

- Plato’s Republic condemns the pursuit of wealth through trade for its own sake; hinting at the importance of ethical behaviour by entrepreneurs in ensuring prosperity, social equity and stability in society.

- Religious texts like the Bible stress the moral obligation to conduct business free from fraud, usury and deception. Here also, the emphasis is placed on doing business in a manner that it benefits society as a whole. This goes beyond the usual profit maximisation motive.

Many modern scholars point to Adam Smith’s The Wealth of Nations as an important defining work in understanding the concept of business ethics. This work is noted for its analysis of individual self-interest in the functioning of free market, as orchestrated by the invisible hand. In their view, self-interests of business partners will maximise profits and (eventually) benefit society as a whole. They see no place for business ethics in the organisation of commercial enterprises, which are perceived to be founded on notions of private interest rather than the public good. In reality, while the division of labour that Smith describes could have broader societal impacts, the invisible hand often fails. Even Smith recognized this in his earlier work The Theory of Moral Sentiments, where he discussed the nature and value of moral considerations in business. He was not opposed to the inclusion of moral obligations in the conduct of private enterprise.
In recent times, the birth of business ethics as an academic discipline could be traced to the post-World War II period, when a combination of post-war depression, civil rights and suffrage movements in the U.S. and Europe, and independence/liberation movements in the developing world led to a re-evaluation of the role of business and the relevance of business ethics. Countries and communities were demanding more from the private sector. Business as usual was no longer an option; firms were being pressured to do business ethically. Critics of this approach maintained that markets were relatively efficient and market participants had narrow interests. Business ethics was largely viewed as being about altruism. This is why initial approaches to business ethics essentially viewed efforts in this area as being forced upon businesses by advocacy groups and, therefore, not taken very seriously. Over time empirical evidence has been advanced to show that businesses work best when shareholders, customers and suppliers are treated with dignity and respect, when regulations are followed and the planet is treated responsibly.

Many now argue that business is a form of social cooperation with wide ranging ramifications. It is about societies cooperating to create value that no single company or group of companies could create alone.

This course will focus on identifying and analysing the core sets of values that allows businesses to align their core profit motives with a broader set of objectives that impact social justice, human rights, environmental protection and community development. These moral obligations should not be viewed as altruistic duties that businesses have to perform; they are part of (and beneficial to) their core business functions.

1.1. Types of business

Although much of the discussion in this course will make reference to large multinational firms in the extractive sector (e.g. mining and timber), the findings and conclusions are equally relevant to smaller companies and firms that operate in other sectors. We will focus on this subset of businesses to make the discussions more manageable and to emphasise the business-peace linkages more clearly.

The ownership and organisation of firms could be important in helping to understand the extent to which business ethics forms part of the corporate culture.

1) Private firms that are listed on stock exchanges are generally believed to be most profit-oriented and more likely to put shareholders' wishes (usually the desire to maximise returns) above everything else. As such, their main motivation is for private gain and not public good.
The 2010 BP oil spill in the Gulf of Mexico and the 2010 Upper Big Branch Mine disaster in West Virginia, USA are examples of incidents where business ethics are thought to have taken a back seat to profit motivation—with disastrous consequences.

Corruption charges against Dutch-owned Shell relating to their operations in Nigeria's oil-rich Delta Region could also be cited as an example.

However, the converse could also be true. Shareholders could force businesses to act ethically, as was the case with the British-Canadian Heritage Oil Company, which was forced to leave Sudan after the company was accused of doing business with a government blamed for the atrocities in Darfur and elsewhere. Consumer pressure could also tarnish corporate images and force change.

Listed companies were relatively easier to pressure to adopt ethical codes (many of which will be discussed later in this course).

2) This is not true of **non-listed companies**, who tend to be less susceptible to outside pressure to change. While they may not flout local or international law, they are less likely to voluntarily respond to demands for improved business ethics. This is partly because they have much more defined missions/mandates and partly because adherence usually has costs they are either unable or unwilling to absorb.

3) **State-owned enterprises** represent another category. They usually take their cue from their host nations. Companies either partly or fully owned by the Chinese government are often criticised for not taking business ethics seriously.

The role of the China National Petroleum Corporation and China National Offshore Oil Corporation in doing business with oppressive regimes (such as in Burma/Myanmar and Sudan), as well as lax safety standards (such as the 2009 explosion at the Xinxing Coal Mine) can be cited as examples.

On the contrary, Norway's Statoil has a reputation as a global leader in business ethics, particularly relating to environmental, labour and safety standards.

In a 1999 article published in the *Law and Contemporary Problems Journal* titled "The Purposes and Accountability of the Corporation in Contemporary Society: Corporate Governance at a Crossroads", Michael Bradley and others divide businesses into two groups:

- **contractarian** and
- **communitarian**.

This differentiation is helpful in understanding approaches to business ethics in contemporary firms.
1) The **contractarian approach** views firms as entities connected by a set of (management, operational and oversight) contracts that allow them to achieve their primary goal, which is to meet (or exceed) the expectations of shareholders. This view believes that the public good is best served via the efficiency of the market-based contacts and that **transparency** is the most important social function that could be performed. Contractarians do not see the firm as having the same responsibilities as a legal entity, but rather as a *nexus of contracts*, as some scholars describe it. This view holds the transparency will enable all stakeholders to know what the firm's responsibilities might be and they hold them accountable if problems arise.

2) The **communitarian approach** views the firm’s remit as much broader, with responsibilities to a broad range of stakeholders. This approach views the firm as a legal entity based on **cooperation and justice** rather than contracts. This more expansive view of corporate responsibilities is more difficult to implement in practice.

### 1.2. Business ethics and peace

So what does all of this have to do with **peace**? Quite often, we discuss businesses as conflict enablers in fragile and conflict-affected countries. Examples abound. A joint publication by the UK-based International Alert and Norwegian Fafo Institute unearthed the following:

- In 2003, an American company executive was charged in the US for allegedly arranging for $78 million in kickbacks to Kazakh officials in order to obtain oil and gas contracts in Kazakhstan.

- A court in the Netherlands imprisoned a Dutch businessman for providing chemical components that the Iraqi military used against Kurdish civilians in 1988.

- In 2005, an American bank pled guilty in a US court and paid a $16 million fine to clear up criminal charges laid in relation to suspicious transactions involving the assets of Chilean dictator Augusto Pinochet.

- A Japanese company was sued in Japan for its involvement in the alleged involuntary resettlement of people in Indonesia prior to the building of a dam.

Other examples include the violent competition for control of resources (Liberia’s Charles Taylor with the timber and diamond trade), businesses propping up oppressive governments (petroleum companies and the regime in Burma/Myanmar), businesses flouting labour laws (Chinese companies in Zambia’s copper belt) or business pollution resulting in environmental disaster and community suffering (petroleum companies in the oil-rich Niger Delta).
It is clear that poor business ethics could have a negative effect on peace prospects. The next session in this course will deal with these issues in greater detail.

On the other hand, it is worth noting that ethical businesses can be a force for peace. And in promoting peace they not only provide benefits for society but also reduce uncertainty and the costs of doing business. This symbiotic relationship makes a compelling case for the adoption of ethical business practices.

Peacebuilding requires much more than military action, peace accords, security arrangements and focused diplomacy. Practitioners, scholars and policymakers agree that success in this regard requires the effective leverage of all stakeholders—including the business sector. This would facilitate a lasting end to protracted and costly conflict and deliver tangible peace dividends. As discussed earlier, the notion of business fostering peace is now well grounded in the scholarly literature. Three key lines of enquiry have been pursued.

1) First, economic activity can foster peace by providing jobs, diversifying economic opportunity beyond extractives, transferring technology that can upgrade the economy of emerging market countries, transferring good management approaches to effectively running businesses and providing a forum for people of different religious and ethnic backgrounds and nationalities to work together—in business—for a common goal.

2) Second, companies that respect the rule of law and abide by international labour and environmental standards principles make positive contributions to peace rather than exploit asymmetrical power relationships. In particular, since corruption has the potential to stoke instability and violent conflict, businesses with strong ethical principles and zero-tolerance policies towards corrupt practices move the needle toward peace and away from violence. In short, business models and practices matter.

3) Third, to the extent that companies espouse the principles of good corporate citizenship they can promote diplomatic relations between that country and the United States. This is a concept already well-established in the U.S. Department of State through its Award for Corporate Excellence. This relationship is borne out in a number of leading management theories of effective business performance.

Bibliographical reference


2. Challenges facing businesses in fragile environments

We learnt that business ethics is about a fundamental set of values that help guide business decisions and business practices. Business decisions relate to the kind of activities firms engage in, while business practice describes the ways in which firms go about their business. Although businesses are primarily profit-driven, there is a growing body of literature that suggests that the set of values adopted by businesses not only impacts their profitability, it also influences people, relationships and the environment in their areas of operation.

In other words, business ethics are important and must be integral components of a firm’s business model.

While some scholars agree with this proposition, others maintain that ethics involve moral judgments that have no place in the boardroom. Scholars and practitioners on both sides of this debate agree that the negative socio-economic impacts of business operations cannot be ignored. There needs to be some agreement on a general set of ethical standards that guide the business community.

Many examples of unethical behaviour could be cited. This is true of small-scaled microenterprises and larger multinational corporations; private and state-owned enterprises; secular and non-secular businesses; of Eastern or Western cultures. The problem is pervasive. All types of businesses have behaved unethically by being involved in corruption, fraud, human rights violations, environmental mismanagement and labour law violations. Most of these unethical practices take place in countries or regions that are fragile – i.e. they are either under-developed or conflict-affected.

This session examines whether conditions in fragile states or regions could help explain why businesses act unethically – many times with impunity. Questions worth pondering include:

- Do governance weaknesses and market failures make bribes necessary?
- If inefficient official institutions make processes costly, are businesses justified in seeking alternative channels?
- If local laws are not enforced (or enforceable) are businesses justified in trying to circumvent them?
• Are ethical options too costly for firms?

• Are unethical practices in fragile regions a rational business response to conditions in difficult environments?

Before exploring these questions in some detail it would be helpful to examine how market failures and governance/institutional weaknesses could impose costs that businesses might try to avoid by adopting unethical practices. It must also be noted that these factors could be viewed as loopholes for cost-savings by predatory firms who seek to maximise profits or gain influence.

2.1. Challenges in fragile regions

Conditions in fragile regions increase the risks to businesses for a number of reasons, including:

• a myriad of uncertainties (e.g. security, stability and policy framework),

• poor information flows (e.g. inadequate information on key players, inefficient information sharing mechanisms and information asymmetries) and

• weak (political and economic) governance at all levels of government.

Whether individually or in concert, these factors could raise costs for firms and present opportunities for predatory business practices. We will now examine each in turn.

1) Uncertainties

A significant proportion of fragile countries/regions are resource-rich. They either have considerable mineral deposits (e.g. petroleum, mineral ores or precious stones) or abundant agricultural potential (e.g. timber and export crops). Doing business in these sectors often requires external investment because of the need for large-scale financing at the start of operation, as well as technology and skills that are not usually available locally. Fragility increases the risks investors face. This higher risk profile could translate into higher investment costs. Since most of these countries/regions are affected by conflicts and the rule of law has been severely compromised, investors find innovative ways to safeguard their investments. Unfortunately, this often includes unethical practices like bribery and non-compliance with contractual obligations or domestic/international law.

In some fragile states, elite capture of both politics and the economy has resulted in a policy framework that is both vague and uncertain.
This means that the groups controlling the government would manipulate policies, regulations and practice to maximise their economic rents.

Firms investing and operating in these countries or regions are forced to navigate a very complex and costly maze of regulations, institutions and individuals. Some argue that many cases of corporate malfeasance are coping mechanisms adopted by firms in order to ensure their financial viability in very difficult environments.

2) Difficult information flows

Markets in most fragile regions are rudimentary and fragmented. This is either the result of decades of bad governance or the debilitating effects of protracted violent conflict. Reliable records hardly exist; non-formal markets generally undermine formal institutions and a pervasive war economy has skewed incentive structures.

Consequently, it is hard for investors to gather reliable data on risk profiles or incentive structures in the local economy.

By the same token, capacity constraints in these countries/regions make it difficult for local officials and stakeholders to know much about the contractual obligations of external investors (not about the aspects of international law that regulate their behaviour). These information asymmetries create a situation where unethical behaviour related to the non-fulfilment of contracts and fraud could thrive with minimal chances of detection.

3) Weak governance and institutions

As already explained, weak governance could facilitate and perpetuate unethical practices by both corporations and domestic authorities. Examples of weakness could include poorly designed policy frameworks, inadequately trained or skilled staff and an inability or unwillingness to enforce laws.

These issues could create distortions, delays and inefficiencies that add to business costs.

Firms either avoid those costs (via corruption or avoidance) or pass the costs on in the local environment (via pollution and disregard of domestic laws). Another dimension of this dynamic is the fact that weak governments and institutions create conditions for poor oversight and supervision by local au-
2.2. Examples of unethical behaviour in fragile regions

Firms face peculiar challenges in fragile regions, where there is widespread violence, human rights abuses are rampant and ‘elite capture’ has led to the establishment of repressive regimes. Some businesses take advantage of the situation and seek to maximise profits in the shortest possible time by behaving unethically. Others adopt unethical practices as survival mechanisms. Regardless of the motivating factor (or factors), many firms operating in these regions do not adhere to internationally acceptable ethical standards. Some examples follow. They are largely based on a list compiled by the Red Flags project¹:

1) **Non-payment of taxes.** Lax enforcement and corrupt officials facilitate tax avoidance by companies, particularly those in the extractive sector. Inadequate transparency, creative accounting and layered contracts make it easy for companies to do so. Local officials are bribed to look the other way. According to Philippine government audit reports, two major oil companies underpaid taxes to the tune of $1.1 billion between 2003 and 2009.

2) **Expelling people from their communities.** Some companies have worked with local authorities to forcibly move people to either operate or construct infrastructure like petroleum pipelines. The Bolivian gas pipeline is an example of attempted displacement in some sections. This resulted in civil unrest and violent conflict. The threat or use of violence to force people out of their communities can be a crime under international law. A company may face liability if it has gained access to the site on which it operates, where it builds infrastructure or where it explores for natural resources through forced displacement.

3) **Forcing people to work.** Indentured labour is sometimes present in mining and agricultural operations. Vulnerable groups like minorities or children are exploited. One example would be the cocoa industry in Cote d’Ivoire, where allegations of the widespread use of child labour is well documented. Companies using people working against their will through the threat or use of violence may face liability. The use of such labour by a joint venture partner or state security forces may also pose a liability risk.

4) **Questionable financial transactions.** In 2005, an American bank pled guilty in a US court and paid a $16 million fine to clear up criminal charges laid in relation to suspicious transactions involving the assets of Chilean dictator Augusto Pinochet. Receiving funds that may have been associated with

(1) A joint initiative by UK-based International Alert and Fafo, a Norwegian think-tank.
criminal activities exposes companies and individuals to legal risks. Holding, managing or hiding such funds, including funnelling suspicious funds into legitimate financial channels, may result in prosecution and lawsuits.

5) **Bribery and Corruption.** Most large business contracts in fragile zones are what can be described as ‘high value, low frequency’ contracts. While they are large enough to sustain the signing parties for many years, such opportunities are relatively rare so firms are willing to do anything to secure the contract. In 2003, an American company executive was charged in the US for allegedly arranging for $78 million in kickbacks to Kazakh officials in order to obtain oil and gas contracts in Kazakhstan. The accused is challenging the charges and the case is pending. Any significant off-the-book financial transactions may create legal liabilities under laws against corruption or bribery.

6) **Engaging abusive security forces.** The use of disproportionate force by government or private security forces acting on behalf of a company can create liabilities for the company itself. These liabilities may rise even where the actions of the security forces (e.g. killing, beating, abduction or rape) were neither ordered nor intended by the company. Legal risks may be greater where security forces have a history of abusive conduct. A US oil company operating in Nigeria was sued in a US court after government soldiers engaged to provide security to the company allegedly shot demonstrators at an offshore oil platform they had occupied and allegedly destroyed two villages following protests. The company has challenged the claims and the case is pending.

7) **Violating international sanctions.** A court in the Netherlands temporarily imprisoned a Dutch businessman for alleged violations of UN sanctions against Liberia by arranging for arms imports. The accused challenged the allegations and the conviction was overturned on appeal. A company may be held liable for buying, selling or transporting products, commodities or assets originating from or going to a country, group or individual under international sanctions. The most common embargo is on arms, but increasingly sanctions are imposed on specific commodities, such as diamonds, timber and on financial assets.

8) **Providing the means to kill.** Businesses may face liabilities if they provide weapons or dual-use equipment to governments or armed groups that use those products to commit atrocities. This may be the case even where import and export regulations are fully respected. A court in the Netherlands imprisoned a Dutch businessman for providing chemical components that the Iraqi military used against Kurdish civilians in 1988. The accused challenged the allegations. On appeal, the court confirmed the conviction, increasing the sentence to 17 years.
2.3. Ethical standards in difficult environments

Conditions in many fragile environments make it relatively easy for companies to behave unethically. Some even argue that questionable business practices are necessary because of the distortions and inefficiencies that exist in these markets. However, while unethical practices may benefit a few in the short-run, both businesses and host communities stand to lose a lot more in the long run. It is also worth noting that unethical practices create and perpetuate income inequality, worsen poverty, exacerbate social injustice and damage the environment. By so doing, they heighten social tensions in ways that could trigger or sustain violent conflict. Clearly, addressing unethical business practices could have a wide range of social, economic and (even) political benefits. This is why every effort should be made to conduct business ethically in these environments. But is this feasible in fragile environments? Does the fact that information and power asymmetries between investing firms and local governments or communities make this very difficult to accomplish?

Building good business ethics in fragile environments should start with some agreement about what constitutes acceptable business practice. This should be complemented with specific action to strengthen and empower local authorities, align domestic practices with international standards, improve capacity building and stakeholder sensitisation, implement strategies to enhance transparency and introduce robust mechanisms to sanction unethical behaviour domestically and internationally. Steps should also be taken to improve predictability in the policy realm, make officials more accountable and ensure that processes are transparent and monitored.

These developments would require all domestic and external stakeholders to be fully committed to the new arrangements. This will not be easy because key players are often vested in the old way of doing things because they derived substantial benefits. Reform should, therefore, involve incentives to motivate those prepared to change and deterrents and sanctions to enforce compliance from the potential spoilers. The public good must be placed before private gain if lasting progress is to be made.

Bibliographical reference


3. Understanding corporate social responsibility

Extractive industry firms play a major role in resource-rich fragile states, principally by significantly contributing to the macro-economy of producing states. This is evidenced by healthy growth rates realised in these countries. However, the benefits of this growth seldom trickle down to benefit most citizens because of resource capture by elites, weak governance and unethical behaviour by investing companies (in collusion with host governments).

In Nigeria, proceeds from the oil account for one-fifth of the country’s gross domestic product (GDP) and over half of fiscal revenue. In Afghanistan, anticipated receipts from the copper industry could account for as much as one-third of fiscal revenue in 2013/14 (when exports are scheduled to start). Burma earns over $1 billion from natural gas exports.

However, in each of these countries, while the companies involved in these industries are making profits, host communities continue to suffer from poverty and deprivation – partly because of weak governance (i.e. the host governments are not using the country’s wealth to benefit the majority of the people) and partly because some of these firms choose to act unethically. Examples already discussed in this course include tax evasion, bribery, environmental pollution and violations of basic human rights.

3.1. Defining corporate social responsibility

Unethical business practices impose additional costs to the firms and adversely impact host communities. These practices also increase the likelihood of violent conflict between local communities and the companies and/or the governments.

Many observers highlight the dominant role played by businesses in fragile environments and believe that companies owe a debt of social responsibility in their areas of operation.

Bibliographical reference


This is the genesis of what has come to be known as corporate social responsibility (CSR). Since the 1970s, activists, community leaders and non-governmental organisations have called on companies to be good neighbours and give something back to the communities in which they operate or conduct business. Companies were called upon to invest in human capital and physical infrastructure, and to support education and income generation projects. (By supporting health, education and income generation projects.)
The argument was that CSR investments would help empower local communities, improve living standards and ease community-corporate tensions that frequently result in delays and destruction of property.

Before discussing the nature and scope of CSR and its potential to encourage ethical corporate behaviour, it would be helpful to spend a bit of time on the definitions of CSR.

The World Business Council for Sustainable Development (WBCSD) defines CSR as the commitment by businesses to behave ethically and contribute to economic development by improving the quality of life of their workforce.

This entails the adoption of business values that integrate social, environmental and human rights. Ideally, these values should permeate the firm’s mission, vision, policies, decision-making and practices. This broad definition is what could be described as the expansive view of CSR.

A much narrower view considers CSR to be no more that corporate philanthropy, where the extent of the companies' ethical obligation relates to charitable donations in the local communities.

This view was popular during the early days of contemporary CSR when random corporate donations were often deemed sufficient.

There is a third view that incorporates political dimensions.

This view (also called political CSR) requires firms to go well beyond the social and environmental spheres and take steps to advance civil rights in their areas of operation.

Bibliographical reference


This approach was espoused in the 1960s during the civil rights era in the United States and during the liberation struggles in Africa and Latin America.

Although vestiges of the three broad definitions could still be found in various parts of the world, the most dominant approach among scholar and practitioners is the expanded socio-environmental view (as defined by the WBCSD). Using targeted investments, this approach could be a win-win for participat-

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1. By financing or constructing roads, bridges, electricity facilities and potable water facilities.

2. The World Business Council for Sustainable Development defines CSR as the commitment by businesses to behave ethically and contribute to economic development by improving the quality of life of their workforce.

3. A discussion of this broader definition is found here: "From Challenge to Opportunity: The Role of Business in Tomorrow’s Society" for more information: http://www.wbcsd.org/DocRoot/CZ2dt8wQCizKX250wXMp/tomorrows-leaders.pdf.

ing firms and host communities. On the one hand, investments in both physical and human capital could reduce business costs by reducing delays and disruptions, as well as by improving the potential labour force. On the other hand, communities could benefit via enhanced growth of local businesses, which could become part of the value chain. The investments could improve their ability to provide high-quality goods and services. Unlike the charitable donations under the narrow definition, which often have little to do with the core business of the firm, these investments are generally targeted to advance corporate objectives while also fostering sustainable local development.

3.2. The CSR debate

A recent survey by BSR and GlobeScan\(^3\) indicates that the vast majority (over 80 percent) of global businesses surveyed will intensify targeted CSR investments over the next five years. Over 90 percent of these firms will either maintain or increase their CSR budgets in the coming years.

CSR is clearly **gaining in importance** and firms are recognizing that these investments could be a win-win.

CSR spending is expected to focus on six main areas:

- **Environmental sustainability projects** will include projects to reduce the lasting effects of water and air pollution, improve sanitation, improve the disposal of industry-related waste and mitigate the potential impacts of climate change.

- **Human rights investments** will include efforts to cushion the effects of displacement, reduce the impacts of the war economy on the supply chain and prevent violations of international law (such as forced labour, child labour and inhumane working conditions).

- **In the area of governance, CSR investments** are expected to target rule of law, transparency and accountability.

- **Community investments** will focus on cultural, social and recreational facilities/activities that benefit local groups or communities.

- **Economic development investments** will include projects that aim to raise living standards and address poverty. These could include microfinance, job creation programmes and trade promoting initiatives.

- **Social investments** include interventions that improve health and education outcomes in local communities.

\(^3\)BSR/GlobeScan survey results are available here: http://www.bsr.org/reports/BSR-GlobeScan_State_of_Sustainable_Business_Poll_2010_Final.pdf.
The prevailing view of CSR suggests that a firm's responsibility should not only be with its shareholders, but should also lie with a broad range of stakeholders – i.e. all those directly or indirectly affected by the operations or activities of the corporation.

In this context, ethical business refers to the careful balance between private gain (the profits) and the public good (the workers, customers and the environment).

These ideals were popularised by British entrepreneur and environmentalist John Elkington, who introduced the concept of the triple bottom line (profits, people and the planet). He argues that the firms of the 21st century will be operating in a complex and inter-connected globalised world and that firms are being forced to pay attention to corporate social responsibility in a way they had not done before.

Not surprisingly, this renewed focus on CSR has sparked a debate on its utility. In an article published in the Wall Street Journal in August 2010, Professor Aneel Karnani described CSR as "an illusion, and a potentially dangerous one". He contends that CSR is irrelevant when corporate and private interests are aligned because social welfare would be enhanced while firms make profit and there will be no need for specific targeted investments. For example, companies operating in disease-prone regions will be motivated to provide health care to keep the labour force healthy. In his view, firms will make the investments without having to subscribe to CSR. Karnani goes on to argue that if corporate and public interests are not directly aligned (e.g. the construction of a community centre), CSR is likely to be ineffective because executives are unlikely to act voluntarily in the public interest and against shareholder interests.

Similar objections were made by economist Milton Friedman in 1970. He noted that businesses are in business to make profit and not to provide social services. In his view, CSR is a "fundamentally subversive doctrine" that undermines the core functions of a firm. He adds that "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". While there might be some merit to Friedman's arguments, his views do not reflect the reality of today's globalised business climate or the peculiar challenges of operating in fragile environments.

Other critics of CSR argue that responsibility for the provision of social and physical infrastructure should lie with host governments and communities. For their part, companies should pay their taxes and the governments should use the revenues to care for their people. Critics further argue that corpora-
tions have neither the resources nor the skill sets to embark upon social/physical investments in a meaningful or sustainable manner. CSR, in their view, removes the spotlight/responsibility from inept, ineffective or negligent governments by requiring private firms to perform these functions. In time, these societies grow dependent on the companies, while the governments are hardly held to account.

3.3. Conclusion

Firms could choose to be good corporate citizens. This is not the same as corporate philanthropy, which many firms tended to view as a badge of honour rather than a concrete call to action. Being good corporate citizens would require companies to be profitable and respect the people and natural resources in their areas of operation. The two need not be mutually exclusive. Targeted investments could build bridges with local communities, while at the same time address process, capacity and infrastructure deficiencies that could adversely impact the firms. This approach was adopted by Rio Tinto in its ‘financial valuation’ model that internalises corporate spending on social and infrastructure projects. The IFC’s Community Development Department has developed a version that could be used with relative ease.

Bibliographical reference


Successful CSR requires firms to recognize that ethical behaviour is also good for their bottom line. That way, firms could be responsive to the needs of both shareholders and stakeholders. It must not be something imposed on businesses. This will only increase costs, promote waste and may even end up doing more harm than good. Done strategically, ethical CSR could help firms reduce risk and costs, develop local legitimacy and gain a distinct competitive edge.
4. The role of international standards

An important step in helping improve business ethics on a global scale is reaching some consensus on sets of standards that would guide business practices. In addition to corporate social responsibility, the adoption of standards has helped firms to focus on the development, implementation and monitoring of sound business ethics. The last section provided an introduction to corporate social responsibility and discussed its strengths and weaknesses. The section concluded with recommendations for increased effectiveness. In this section we will be analysing the extent to which international standards could promote business ethics.

International standards aim to hold corporations accountable for their acts of commission and omission, thereby promoting business ethics. They focus on standardising key values by seeking consensus around important social and environmental issues that define business practice. While they are voluntary in nature, they can serve useful purposes by (a) focusing the business community and stakeholders on important social and environmental issues, (b) laying the foundation for more stringent regulations over time and (c) engaging civil society in the design, implementation and evaluation of business ethics. There are many international standards in existence. Two broad categories of standards relate to business ethics:

1) Principle-based. These are international standards that broadly outline social and environmental guidelines for businesses. These standards quickly become points of departure for discussion among stakeholders and eventually become the basis of sound practice in these areas. Although they are not intended to be considered 'seals of approval', they are broadly considered as such by both the industry and key stakeholders. Examples of principle-based international standards are the UN Global Compact and the Equator Principles.

2) Reporting. These international standards provide standardised frameworks for economic, social and environmental reporting. They compile metrics of financial and non-financial variables that help measure a corporation's level of effort in meeting standards. These standards also facilitate the communication of both process and metrics to a wide range of non-technical audiences, particularly the civil society. Examples of reporting standards include the Extractive Industries Transparency Initiative and the Global Reporting Initiative.

The role of international standards in fostering business ethics could be analysed within the context of a principal-agent framework on two levels.
• On the first level we have the people that technically own natural resources (and are 'principals') and the governments entrusted to act on behalf of the people (the 'agents'). In many cases agents fail to seek the interests of principals and information asymmetries (particularly regarding profits and remuneration) make it almost impossible for the principals (citizens) to identify the conflicting interests of the agents (government) or sanction them.

• On the second level we have the shareholders of firms investing in resource-rich countries being the principals and the firms as the agents. The firms do everything to win contracts, get concessions and maximise profits –including bribery. The governments of the resource-rich countries have fewer incentives to seek the interest of their people and focus their attention on maximising rewards from the firms. The self-interest of the governments (mainly fuelled by greed and the desire to remain in power as long as possible) adds a perverse twist to the principal-agent discussion. This whole system is based on enduring information asymmetries. International standards reduce the impact of these asymmetries by highlighting transparency –so information on the transactions, payments and contractual obligations are readily available to all parties. However, according to Shelder, there are three facets to accountability: transparency of actions, justification of actions and sanctioning of wrongdoing. That most international standards focus on transparency without full accountability has been their Achilles Heel.

4.1. Some benefits of international standards

1) Reduced likelihood of corruption. International standards foster improved transparency by reducing the likelihood for corruption. It does so by requiring both parties (the government and the companies) to be transparent and publically declare monies paid and funds received. Conceptually, this should deter corrupt practices by making illicit activity much easier to detect.

2) Greater predictability in the investment climate. International standards could make the investment climate more predictable. Investors, bilateral donors, multilateral institutions and private foundations are reassured about the likelihood of corruption in resource-rich countries because of the reporting and disclosure requirements imposed by the initiative. In addition, a number of ratings agencies have started reflecting compliance with international standards in their country ratings/assessment reports. This makes the countries more attractive to investors and should (in principle) facilitate the inflow of capital and technology.

3) Empowering civil society. By publishing the results of the audits, international standards provide much-needed information to citizens and civil society groups in resource rich countries. This information empowers civil society
by letting them know how much governments receive from extractive industries and enabling them to demand accountability, equity and justice. This information can also provide the basis of productive dialogue among civil society, the companies and the government.

4.2. Some short-comings of international standards

1) Voluntary processes. International standards represent what some literature terms 'soft law' because it is not enforceable in a court of law. The initiatives could shed some light on parts of the value chain and reduce the likelihood of illicit behaviour, but, because non-compliance cannot be sanctioned by law, many consider them toothless. The most that can be done is to 'name and shame' in the hope that they would improve their ethical standards. In some cases, both shareholders and stakeholders could use the standards to judge the ethical standards of particular firms and demand change where necessary. However, this self-policing mechanism is unlikely to override the profit maximisation motives in most cases.

2) Widening participation. Allied to their voluntary nature is the problem of patchy participation. International standards can only be fully effective if all major players in the industry fully participate. Emerging markets (like China) and some traditional players (like Saudi Arabia and Russia, which are significant OPEC members) need to be onboard.

3) Multiplicity of standards. Over the last couple of decades a number of international standards have been popularised –some with conflicting aims, while others have vague objectives. This makes monitoring a nightmare since oversight bodies and/or civil society representatives are unlikely to have the broad set of skills/technology to evaluate (and report on) compliance.

4) Data quality. To be effective, international standards must be based on robust data. Deficient collection and verification mechanisms in many resource-rich countries undermine the efficacy of these standards.

5) Weak civil society. As mentioned earlier, civil society organisations play important roles in ensuring the efficacy of international standards. They help monitor results and pressure principals when change is necessary. However, in many cases, civil society groups are weak (in terms of resources, skills and political clout) or not independent enough to engender reform. This limits the extent to which information or reports arising from international standard initiatives could become change agents.
4.3. Case study: The Extractive Industries Transparency Initiative (EITI)

The EITI is a voluntary initiative that requires participating countries to publish information on payments received from firms investing in their petroleum and mining industries. These payments would include fees, royalties, bonuses and taxes. These payments are then compared with the amounts reported by the companies. The two amounts are reconciled by an independent, internationally recognized auditor who reports to the EITI’s Multi-Stakeholder Group. The results are subsequently published as the EITI Country Report—with the consent of the government. This open reporting system is seen as a way of reducing corruption and ensuring transparency. The EITI helps ensure that citizens and analysts could reconcile what a country receives from investors (the revenue side) and what gets recorded in government accounts (the expenditure side).

Some studies indicate that governance indicators for EITI signatories are worse than resource-rich countries not participating in the initiative. Dilan Olcer\(^6\) points out that Worldwide Governance Indicators for EITI countries actually deteriorated between 2002 and 2007. The EITI alone cannot bring about much-needed change. It must be part of a broader set of reforms if it is to make a significant and lasting impact. This is partly why the World Bank introduced EITI ++, which takes a broader view of corruption, contract compliance, corporate citizenship and transparency. This wider remit also includes revenue management (to mitigate negative impacts of price volatility) and the responsible investment of revenues from the extractive industries.

Some critics question the central EITI modality of reconciling amounts paid and received. The initiative reconciles the amounts but does not verify them. The EITI does not have mechanisms to ascertain whether the amounts being reconciled are correct (relative to the contractual obligations). In other words, there is no way to tell whether the companies paid the right amounts or whether or not those amounts were paid on time.

Also, because the EITI does not require disaggregated data, it is not always easy to determine the source of dispute when there are difficulties with reconciliation. It would be helpful to know for certain whether the discrepancies arose from non-payment of royalties, fees or taxes, or whether receipt and recording mechanisms for one or more of those items happen to be deficient.

Other critics point out that the EITI primarily focuses on the middle or end of the value chain for extractive industries, while a significant amount of corruption happens during the contract award and pre-contract phase.

\(^6\)Dilan Olcer, "Extracting the Maximum from EITI" OECD Working Paper No 276 (February 2009).

4.4. Case study: The United Nations Global Compact

The UN Global Compact was established in 2000 to help galvanise the business community to enhance corporate citizenship worldwide. The initiative has two primary objectives: first, to promote a core set of corporate citizenship values for business and, second, to promote collaboration among the business community, civil society and governments in the area of corporate citizenship. Participating businesses must adhere to a set of ten principles and provide periodic reports for discussion with a broad range of stakeholders.

Critics argue that Global Compact reports are of limited value because it is tantamount to a self-evaluation by the firms. In addition, the firms could select which of the ten principles to report on at any point in time. This makes it difficult to get a complete picture of ethical standards in participating firms.

Other critics assert that the Global Compact has paid more attention to the needs of large trans-national firms that the socio-economic concerns or stability of countries where they operate. Many see it as a club for influential corporations and a badge of honour rather than a true commitment to meaningful reform. A survey in the Global Compact’s 2007 annual review revealed that networking was the second most important reason firms participated in the initiative.
4.5. Conclusion

International standards are not a panacea that would resolve problems with business ethics, particularly in the extractive sector. It must be well targeted and implemented as part of a more comprehensive approach. To the extent that these standards are removing the cloak of secrecy that has long enabled questionable business ethics, they are performing a laudable function. Addressing some of the shortcomings identified in this section, simplifying frameworks, strengthening civil society and ensuring participation by all major sovereign and corporate players would help guarantee lasting success.
5. Developing a strategy to improve business ethics and peace

Firms should not consider business ethics as distinct from their vision, mission and practices, something that needs to be done to satisfy social concerns, advocacy demands or moral responsibility.

Business ethics should be part of a firm’s core business model, something that defines management, operational and financial decision-making.

There is a growing awareness that ethical business is good business. The costs of unethical behaviour outweigh any short-term gains. The costs include losses from corruption, the costs of crime, inequality and poverty, human rights violations, environmental degradation and violent conflict. Eventually, the companies, host countries and involved communities all lose. In spite of this recognition that unethical behaviour can be costly, it has not been easy to integrate ethics into business practices; particularly in the most fragile environments. Countries or regions that are impacted by weak governance, inadequate institutions and violence are especially challenging because of the peculiar risks they pose. In many cases, these peculiar circumstances (such as the war economy and conflict survival strategies) make it difficult to determine what is ethical and what is not.

In recent years, a number of international initiatives (like the Global Compact, the Equator Principles and the Extractive Industries Transparency Initiative) have sought to develop frameworks within which scholars and practitioners could understand and implement business ethics. While these initiatives have helped sensitize a broad range of stakeholders about the benefits of good business ethics, they have met with limited success for a number of reasons, including their voluntary nature, the fact that non-compliance has minimal consequences and that implementation is not always easy to monitor. Also, while business ethics has grown as a discipline (as evidenced by the increasing number of university courses and scholarly publications) we are still a long way away from having business ethics institutionalised in the average business school degree. In 1970, Milton Friedman famously surmised that “the business of business is doing business”\(^7\). Our thinking has evolved since then as both academics and entrepreneurs discovered that how business is conducted affects the bottom line. There is also wide recognition that the relationships between the firm and a range of stakeholders could also impact profitability and sustainability. These sentiments are captured by Grayson and Hodges (2004), who declared that “the business of business is now everybody’s


\(^8\)Grayson, David and Adrian Hodges Author (2004), "Corporate Social Opportunity!", Greenleaf Publications.
There is a clear need for a comprehensive strategy to enhance business ethics that would involve a broad range of stakeholders and address a range of critical issues both inside and outside the firm.

5.1. Strategies to promote business ethics inside the firm

Business ethics could be greatly improved by taking the following four strategic steps within the firm:

- adopt and implement a code of ethics,
- establish integrity pacts,
- internalise business ethics within the core business model and
- provide mechanisms and protection for whistleblowers.

1) **Code of ethics.** A code of ethics is the set of moral values and business practice that emphasises the firm's commitment to high standards or business practice (even beyond legal prescriptions) and help provide reporting mechanisms that help prevent and detect unethical behaviour by the staff and the corporation. It also establishes guidelines for a variety of complex ethical situations and circumstances a business may face. Codes of conduct normally cover honesty, quality of work, caring for staff and respect for communities and the environment. They focus on mechanisms that would incentivise ethical behaviour, promote legislative and regulatory compliance, and ensure financial responsibility and transparency. Sensitising staff and ensuring that the standards laid out in the code are infused through the firm (and at every level) will ensure that the values become an integral part of the firm's business.

2) **Integrity pacts.** Integrity pacts could be defined as agreements between service providers (be they private sector or the public sector) and the recipients/beneficiaries. Although originally applied to the bidding process in government institutions, integrity pacts could be important tools to measure performance and business ethics in the business sector, especially since a significant number of extractive industry firms in emerging markets are fully or partly owned by the state. An integrity pact could stipulate the rights and obligations of the firm vis-à-vis a broad range of stakeholders. This could include bribery, collusion, fraud, human rights abuses and environmental protection.

**Integrity pacts**

Integrity pacts were first introduced by Transparency International to regulate contractual obligations in the public sector bidding process. The framework and tools are particularly important when dealing with firms that are either partly or wholly owned by the government. See the definition at Transparency International's website: http://www.transparency.org/global_priorities/public_contracting/integrity_pacts.

3) **Internalising business ethics.** Business ethics must be internalised and adopted by the firm. As discussed earlier, these standards are a lot easier to integrate when their adoption has demonstrable value for the bottom line. This concept of ensuring alignment with the firms profit motivation allows for the
kind of innovation and complementarity that John Elkington\(^9\) describes in his idea of a ‘triple bottom line’. A more recent example of internalising ethically-based, social investments in the firm’s business practices could be found in the financial valuation model developed by Rio Tinto, but popularised by the International Finance Corporation\(^{10}\) in 2010. This approach calculates a probable range for the NPV of a portfolio of sustainability investments, including both the direct value creation and the indirect value protection of these investments. By highlighting the relative value of specific investments, this tool helps align the firm’s core business objectives with the ethically based sustainability investments it would have to make in its area of operation.

\(^{10}\)The Community Development Department of the International Finance Corporation presents a financial valuation model that enables firms to internalise social investments in their core business models. For details, see: http://commdev.org/content/document/detail/2723/

4) **Whistleblowers.** Ethical standards within a firm will be impossible to uphold or sustain if employees do not feel secure or confident enough to point out malfeasance when it occurs. As long as staff are fearful of reprisals, victimisation or losing their jobs they are highly unlikely to come forward with information that would assist investigations or reforms. This is why every firm must have confidential channels where potential whistleblowers could provide information anonymously. Maintaining anonymity also helps protect the integrity of the information provided – since no direct benefits would accrue.

5.2. **Strategies to promote business ethics outside the firm**

Initiatives that could help promote business ethics outside the firm could include:

- efforts to strengthen the formulation and application of international law,
- efforts to enhance the effectiveness of international standards,
- collective action strategies,
- strategies to involve and empower host communities and
- programmes to broaden and deepen capacity building and sensitisation.

1) **Strengthening international laws and regulations.** Business laws and regulations provide the foundational framework upon which strong business ethics can be built. These laws and regulations hold firms accountable for its business practices, omissions and negative externalities (including those that are unintended). Regulations that could relate to environmental, social and labour issues are also foundational and could help build the foundation for business ethics.

Examples of relevant laws and regulations could include national and international law (e.g. contract, property, tort and company law) and regulations like the US Foreign Corrupt Practices Act.
However, a number of factors could limit their effectiveness. These include inadequate knowledge and/or skills in some firms, the costs of implementation, weak and/or unwilling judicial systems and perceived erosion of competitiveness (if competitors do not comply). Strengthening laws and regulations would involve a number of things, including:

- capacity-building and sensitisation (especially among medium-scaled and emerging firms), incentives to address loss of competitiveness (actual or perceived) and

- programmes that more fully integrate local communities and non-governmental organisations in the design, sensitisation, implementation and monitoring of laws and regulations that promote business ethics.

2) Enhancing international standards. International standards could be enhanced in four main ways.

- First, attempts should be made to link them to existing laws where necessary. For example, anti-corruption standards could be linked to existing provisions in international or domestic law to make the standards more meaningful and effective. This would introduce an element of explicit sanctions for non-compliance.

- Second, attempts could be made to incorporate implicit sanctions for non-compliance. A recent example would be the case of ratings agencies rewarding companies that sign up to international ethical standards. This is a de facto implicit sanction that could be replicated in many domestic and international processes.

- Third, efforts should be made to standardise and harmonise standards that appear to have proliferated in recent years. Too many duplicative (and sometimes contradictory) standards could be frustrating and counterproductive.

- Fourth, programmes should be introduced to monitor compliance and provide comprehensive and easily understandable reports for use by all stakeholders.

3) Collective action strategies. Recent evidence suggests that companies could help prevent unethical practices (like corruption) by using a collaborative strategy involving various stakeholders. Such collective action could promote ethical behaviour in a number of ways.

- First, it could help to level the playing field since all participating entities would commit themselves to adhere to prescribed standards.
• Second, firms could join forces in order to ensure transparency via peer monitoring and pressure.

• Third, collective action strategies constitute an important (and unified) bargaining position for the firms in discussions with the government.

• Fourth, this approach promotes transparency for investors by facilitating the flow of market information (such as quality, price, innovation and service) and by minimising the possibility of market distortions resulting from unethical practices and ensuring that firms with ethical practices are not disadvantaged.

4) Empowering host communities. Host communities usually bear the brunt of unethical practices by foreign and domestic firms. Furthermore, in many developing and emerging economies, governments do not have the resources (and sometimes lack the will) to monitor business behaviour effectively and enforce rules and regulations. There is clearly a role for host communities to play in this regard. Individuals and organisations in host communities could play invaluable roles by providing input in the design phase of programmes/rules to promote business ethics. With some training they could also perform crucial monitoring and reporting tasks.

5) Capacity-building and sensitisation. Programmes should be introduced to ensure that all stakeholders fully understand the standards and appreciate their respective roles in design, implementation and monitoring/reporting. A good place to start would be educational institutions (at all levels). Business schools must strive to institutionalise ethics courses in their core curricula to ensure that the next generations of entrepreneurs and business managers are adequately prepared. Both research and teaching should be adequately resourced.

5.3. Conclusion

There should be a link between a firm's efforts to conduct profitable business and its stance on ethical matters. Business ethics brings these two worlds together. Profitable business and good ethics could be mutually reinforcing. Strong ethical principles that go beyond upholding the law by doing the right thing can enhance the firm's image and secure/expand market share. This is particularly true in today's globalised market and information-driven society. On the contrary, firms that engage in unethical behaviour damage the firm's brand and cause social, socio-cultural, economic, environmental and political distress with dire consequences. This is why all stakeholders must strategise to design and introduce new strategies within and outside firms to promote good business ethics. This is not just the right thing to do. It is also good for business.