

A Preliminary Research Note on:

Dynamics of Social Responsibility in

Small and Medium Enterprises (SMEs)

& SME Clusters



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Part I: A Conceptual Review

The very notion of Social Responsibility of Business in Small & Medium Enterprise (SME) centres around concepts that have proven very hard to define. With regard to SMEs, Wilkinson¹ observes, 'if what constitutes 'smallness' is contextual and possibly subjective and interpretational, then we need to examine what factors combine to explain patterns of 'small' business behaviour, rather than assume one particular type'. Similarly, attempts to understand Corporate Social Responsibility (CSR) have led to numerous definitions ranging from 'CSR being about capacity building for sustainable livelihoods; CSR meaning simply to give back to society; or CSR being about how companies manage the business processes to produce an overall positive impact on society'².

Another option of looking at CSR is from the UN Global Compact's view that encourages businesses to stand by the universal principles in the areas of human rights, labour, environment and anti-corruption. However, the ideology behind this remains all-encompassing and broad, and therefore those signing on to it may enjoy operational flexibility.

In the absence of universally accepted definitions, any research is open to criticism and varying interpretations. The purpose of this note is therefore not to establish any 'one-size-fits-all' approach, but simply to explore some underlying dynamics and drivers, and thereby to provide an indicative list of factors to identify strategies to further involve small businesses in socially responsible initiatives.

Social Responsibility: Is it a new concept?

A good deal of academic and development works see the idea of social responsibility (SR) as nothing particularly new to SMEs. A paper by SME Key³ states that social responsibility is just a new way to describe something SMEs already do: investing in broader social values whose benefits go beyond profit. In practical terms, a study by the European Union shows that half of the European SMEs are involved to different degrees in external socially responsible causes⁴. Similarly, research in context of Asian and Indian businesses also found that 'corporate citizenship maybe a new term, but is not a new concept. Nor is it alien to developing countries'⁵.

Almost all researchers accept that **philanthropy** is at the basis of much that SME's think and do in terms of social responsibility. Thus it may be inappropriate to ignore this aspect as a part of CSR in order to literally abide by Milton Friedman's conception that corporate executives as individuals may donate some of their earnings and time to charitable causes, but this should not, on any account, be merged with their responsibilities as managers of shareholder's investment, funds and trust⁶. This particularly holds irrelevant in case of small businesses that operate in an owner-manager scenario.

A communication from the EU commission on CSR observes that 'SMEs often manage their societal impact in a more intuitive and informal way than large companies. In fact, many SMEs are already implementing socially and environmentally responsible practices without being familiar with the CSR

¹ Wilkinson, A., 'Employment Relations in SMEs', *Employee Relations*, 21, No.3, 1999, pp.206-217. Goss, D., *Small Business & Society*, London: Routledge, 1991

² "CSR: Making good business sense" - Report by World Business Council for Sustainable Development (WBCSD), Jan 2000: Section 2

³ 'The business case for social responsibility in SMEs' - Report published by www.smekey.org with support of the European Commission, Employment and Social Affairs Directorate. The SME Key is a part of the European Business Campaign on CSR (www.csrcampaign.org). SME Key is managed by CSR Europe

⁴ Observatory report No 7, 2002, 'European SMEs & Social & Environmental Responsibility', European Commission Directorate-General for Enterprise, 2001 ENSR Survey of over 7000 SMEs

⁵ Corporate Social Responsibility: Perceptions of Indian Business by Centre for Social Markets (2001)

⁶ Essay entitled 'Social Responsibility of Business', Nobel Laureate Milton Friedman 1987

concept or communicating their activities⁷. Such a conclusion does not however imply that philanthropy ought to be considered as a substitute to business ethics⁸. While it is important to check that charitable work is never used as a cover up to non-compliance to law, at the same time it is also crucial to not to underrate the social good that is already being done by small-scale philanthropists.

A **definition** given by the World Business Council for Sustainable Development (WBCSD)⁹ states that "CSR is the commitment of business to contribute to sustainable economic development, working with employees, their families, the local community and society at large to improve their quality of life." This definition clearly brings out the view that any involvement by the businesses that leads to improvements for society at large should be recognized as a component of CSR.

There are by now innumerable examples of enterprises, especially large corporations that publicise extensively their work on community/social issues in their annual reports. Some of these firms clearly link their community activities within their business processes, especially supply chains. This is as true, for example, in the case of IKEA¹⁰, Shell International Ltd¹¹ as also for ITC India¹². Many firms, among other things, more simply indicate external social causes that they simply wish to support as in the case of Adidas Salomon for community service¹³ or Tata Consultancy for literacy programme¹⁴. The various foundations set up by business corporations also adopt this approach¹⁵. Very much like many larger enterprises that cannot directly link their community involvement with their main line of businesses, so is the case with the SMEs. The EU Survey¹⁶ revealed that only 28% of the European SMEs currently see their SR activities as integrated components of their general business.

Given different **social and cultural conditions** across societies, perceptions may differ as to what actually constitute CSR behaviour in different countries¹⁷. For example, in societies that strongly emphasise philanthropy, an entrepreneur may perceive philanthropic behaviour as an inextricable component of responsible behaviour and indeed as an investment in gaining social goodwill. This may not however be equally true in other countries or in other cultural groups.

In any context, however, firms consciously investing in the community where they live are more likely to benefit from it than firms that "do good" for its own sake. For this reason, it would be advisable for SMEs to voice their 'silent' social and environmental responsibility¹⁸. In other words, small businesses have an opportunity to benefit the wider community by consolidating their current SR activities and communicating effectively about what they are doing¹⁹.

Many researchers suggest that it is possible to practise philanthropy, while keeping the latter seriously integrated with business strategy. Claire Gaudiani in her book, "The Greater Good: How philanthropy drives the American economy and can save capitalism?", makes a distinction between charity, which is

⁷ 'CSR: A business contribution to sustainable development' - Communication from the Commission of the European Communities, July 2002, COM (2002) 347 final

⁸ Pg23-25, 'Ethics Incorporated: Top Priority & Bottom Line', Dipankar Gupta, KPMG 2004

⁹ WBCSD Publication 'Meeting Changing Expectations: CSR' 1999

¹⁰ IKEA Social & Environmental Responsibility Report 2004

¹¹ Location development initiatives - The Shell report 2003 (7th in the Series of Sustainable Reporting)

¹² Refer to Case Study given on http://www.indiapartnershipforum.org/social_partner.htm (A forum by Confederation of Indian Industries - CII and UNDP)

¹³ Adidas-Salomon's Social & Environmental Report 2004 (Pg51)

¹⁴ *ibid* - Case Study given on India Partnership Forum

¹⁵ Refer publications "Business as a social partner: A Compendium of Case Studies" by Social Development Council, CII 2005 & 'Meeting changing expectation: CSR', WBCSD 1999

¹⁶ Survey of SMEs by European Commission, Observatory of European SMEs, No.4, 2002

¹⁷ UNIDO Working Paper No 13, "CSR & The development agenda: Should SMEs Care?"

¹⁸ UNIDO Report - CSR: Implications for SMEs in Developing Countries 2002

¹⁹ CSR Magazine, Europe Oct 2002, 'Special Report: Starting Small: A growing concern (Pg 4)

about easing symptoms of distress, and philanthropy, which is about investing in solutions to the underlying problems²⁰.

The words like '**social investment**', '**venture philanthropy**' and '**social entrepreneurship**' are being used to suggest how to integrate the strategic mindset to donating. In developing countries especially, corporations feel the need to support local communities for health care, education etc. Nestlé, for example, invests in building a decent community infrastructure, which it terms as 'milk-production systems' and feels that it is needed to ensure a reliable supply. Many companies also view their social cause-related philanthropy, as an investment to create a favourable relationship with Governments.

Moreover, a better alignment of socially responsible behaviour with business strategy would provide further incentives to keep up the former even in periods of economic downturn, where philanthropy vulnerable to cost cutting²¹. This latter line of reasoning is increasingly referred to the second generation of CSR development²².

Business Reality: Survival First!

The issue of social responsibility cannot be viewed in isolation to business competitiveness. The first priority for any business, whether it is small or large, is its survival. Adidas Salomon puts 'sustainability as a company' as the first core value that drives its strategies²³, even the ones for social development.

For this reason, and even more so for SMEs in developing countries, improving technology, management and marketing practices remain key concerns that need to be addressed in parallel with social and environmental impact, if they are to compete in the global markets²⁴. In fact, unless an enterprise results are in line with the financial priorities of its shareholders, its ability to venture into areas of social responsibility is seriously reduced. It is for this reason, for example, that Ineke Zeldenrust of The Clean Clothes Campaign points out that the business case for making improvements in management systems, facilities and training is much stronger than the business case for achieving more equitable industrial relations²⁵.

One of the crucial observations made by the communication from the EU Commission (*ibid*) to foster CSR among SMEs sees a positive correlation between SMEs strategic focus and their socially responsible activities: SMEs focusing on innovation, quality and growth also score higher on current or future social engagement. This relationship works the other way too: pursuing responsible practices makes companies more competitive and thus enhance enthusiasm, innovation and self-confidence²⁶. It is noted that 'SMEs that claim to be involved in SR activities for purely philanthropic reasons have shown to experience bottom line improvements and owner managers that engage only for public relations benefits, experience a degree of personal satisfaction'²⁷.

²⁰ 'A survey of wealth and philanthropy', An article in "The Economist", Feb-Mar 2006

²¹ *ibid* – UNIDO Report on Implications of CSR for SMEs

²² Zadek, S (2001) The Civil Corporation. The New Economy of Corporate Citizenship

²³ Adidas-Salomon's Social & Environmental Report 2004, 'Living our Values' - Pg 8

²⁴ *ibid* – UNIDO report on 'Implications of CSR for SMEs'

²⁵ Refer to <http://www.cleanclothes.org>

²⁶ *ibid* - SME Key

²⁷ Ella Joseph, 2000, 'A Welcome Engagement: SMEs & Social Inclusion', Southampton Institute of Public Policy Research

The Actual Drivers

a) Business Case: How good is it?

A key reason sighted for SMEs to get involved in socially responsible initiatives is the business-benefit they can obtain from doing so. SMEs can benefit from their involvement for social and environmental causes as this can improve reputation, employee morale or skills, relationships with local community, reduce risk profile and thus improve access to capital. The 'Sustainable Business Value Matrix' developed jointly by SustainAbility Ltd. (www.sustainability.com) and UNEP²⁸ provides an interesting method to measure the impact of sustainable development issues on traditional measures of business success. Business may use this matrix to assess the business case for sustainable development, but varying contexts of operations as well as local environments will lead to varying results.

These differences were demonstrated through a series of global stakeholder dialogues²⁹, convened in eight countries by a WBCSD working group. On the question of whether CSR fits into the business agenda, stakeholders in Thailand felt that 'owing to the economic vulnerability of the private sector, business was forced to be concerned solely with the survival of the enterprise and that social responsibility was more of a luxury item'. Whereas those in USA or Philippines were of the view that CSR forms a major priority issue for businesses. In Brazil, the participants felt that only multinationals were promoting the business concept of social responsibility, which had not yet reached local SMEs.

While such statements may be too much general to represent national views they do give idea of the different priorities and expectations of stakeholders. For example, while some people believe that gaining publicity and brand advantage is rarely a priority for SMEs when engaging in socially responsible activities³⁰, others observe see SMEs as personally related in their community, and thus holding a different sense of responsibility³¹. The EU survey³² reveals that not many SMEs (just about 20%) formally report their social or environmental initiatives to the outside world. Another survey undertaken by Business Community Connections³³ in the UK, showed that 91% of SME respondents involved in the community causes did not monitor or evaluate the effectiveness of their involvement. These figures show that, while some enterprises do find value in communicating their involvement in socially responsible activities chiefly to safeguard their business interest, the same business case might not be relevant to others.

The word '**innovation**' may hold the final answer to building a business case for CSR. There are an increasing number of businesses people, who although beginning supporting social causes (like giving employment to disabled people or bridging the rural digital divide), ended up benefiting from these initiatives in terms of dedicated work force, through the former, and a new market/trade opportunity, through the latter.

There is enough evidence that environmental efficiencies generate significant cost savings and that improved labor standards result in improved productivity through better management, motivation and retention of staff, and higher skill and quality levels thus creating a business case for all companies, of whatever size, to improve³⁴. However, UNIDO report on CSR implications for SMEs (*ibid*) infers that the **business case needs to be carefully developed according to the product, industry and/or service** in question as a standard list of benefits will never be significant for all.

²⁸ Sourced from 'Sustainable Development Reporting: Striking the balance' WBCSD, March 2004, Pg 13

²⁹ *ibid* - 'CSR: Making Good Business Sense', Section 2, Pg 13

³⁰ *ibid* - SME Key

³¹ CSR Magazine, Europe Oct 2002, 'Special Report: Starting Small': Understanding SMEs (Pg 6)

³² European Commission, SMEs in Europe; Observatory of European SMEs; Report No 8 submitted to the Enterprise Directorate-General by KPMG Special Services, EIM Business & Policy Research, and ENSR; Brussels, 2002

³³ Research report on the Involvement of SMEs in community causes: 1999 www.bconnections.org.uk

³⁴ 'Responsible Trade & Market Access' (Pg 47) - Report by UNIDO's SME Branch, Vienna, 2005

b) Stakeholder pressure:

This driver arises from stakeholder theory³⁵ that centres on the idea that corporations have stakeholders, be individuals or groups, who can affect or be affected by the working of the corporation. A Stakeholder Matrix provided by WBCSD³⁶ is a simple model to assist business in positioning the level of efforts towards each of its stakeholders. It displays how a firm's efforts on reporting SR to its stakeholder ranges between 'responding to requests', 'keep informed', 'keep satisfied' and 'focus efforts', according to the variable combinations of influence and interest parameters of different stakeholders.

In other words, a business's domain of economic influence will determine its priorities. This explains how the following three forms of SMEs response to social responsibility.

- i- The SMEs that operate as **sub-contractors to multinational corporations** (MNCs) feel greater pressure to report social compliance as per the codes of conducts prescribed by their buyers. 'As more and more large companies take up ethical codes of practice, so there is greater pressure for demonstrably responsible behaviour in all spheres of business activity'³⁷.

The driver in this case is purely 'economic'. The large company faces investors and customers that demand socially responsible behaviour and therefore require the same from the smaller players in its supply chain. This continues to be the case as long as MNCs are being pressurized to be accountable and transparent to their Governments and civil society organizations. As Philip Watts of Royal Dutch/Shell puts it "we need to open up the books, reports with greater transparency than ever before, especially in this environment in which business is faced. We need to maintain an ongoing dialogue with an ever broader range of stakeholders, not just employees and shareholders, but also neighbourhood communities"³⁸.

However, the pressure on the whole supply chain isn't fool proof as it is limited, both in its reach beyond the first tier of SMEs as well as in its real effectiveness. A briefing from the International Institute for Sustainable Development states that 'Supply chain standards and other tools of the current SR agenda are shaped to suit the interests and capacities of large enterprises, with little recognition of the barriers to implementation that SMEs face. Even when these barriers can be overcome, there is often little direct financial incentive for SMEs to comply, as many of the drivers that make up the conventional business case for SR are more likely to apply to larger enterprises'³⁹.

Recognizing this shortfall, the current discussion in multi-stakeholder initiatives such as ETI⁴⁰ and FLA⁴¹ is increasingly questioning if the traditional methods to audit compliance to codes of conducts, developed mainly by European and American corporations, have actually brought about the desired change in their supply chains. As a positive result of these discussions, more and more companies are taking interest in understanding the values and priorities at the supply end so that some mutual compliance levels could be agreed upon.

³⁵ Donaldson, T & Preston, L.E., 'The Stakeholder Theory of the Corporation: Concepts, Evidence and Implications', *Academy of Management Review*, 20, No.1, 1995. Quoted in 'A Critique of Conventional CSR Theory', *Journal of General Management*, Vol 29 No.4, Summer 2004

³⁶ 'Sustainable Development Reporting: Striking the balance' WBCSD, March 2004, Pg 17

³⁷ Business & Society- Corporate Social Responsibility report 2002, Department of Trade & Industry, UK- Quoted in CSR Magazine, Oct 2002, 'Special Report: Starting Small'

³⁸ Philip Watts Chairman of the Committee of Managing Directors, Royal Dutch/Shell Group of Companies. Quote in WBCSD publication

'Sustainable Development Reporting: Striking the balance'-ibid

³⁹ ibid – Quoted from UNIDO report 'Responsible Trade & Market Access'

⁴⁰ Ethical Trading Initiative www.ethicaltrade.org

⁴¹ Fair Labor Association www.fairlabor.org

Moreover, the 'liberal' CSR agenda centred on a 'win-win' paradigm is increasingly being debated. It is noted that 'the government and corporate action on CSR is not simply a technical issue of know-how, resource availability, "win-win" situations or even greater environmental awareness on key decision makers, rather it is a political process involving power struggles between different actors and stakeholders'⁴². Thus implying that power-dynamics continue to operate even while engaging with stakeholders, which makes the whole process selective and 'the only constituency that is guaranteed a voice is shareholders'⁴³.

This is even truer for SMEs and the model to truly engage them at the negotiating table. Even though there are many supporters of the multi-stakeholder initiatives yet many, including political leaders⁴⁴ and SMEs⁴⁵ fear that this might just be a further burden to exports from developing countries.

- ii- The second group of SMEs are those vertically integrated into national value chains. In this case the driver would work just as in case of the global supply chains, if the large firm operates in sensitive markets. Otherwise the pressure to exhibit social compliance is limited.
- iii- The third group of SMEs operate exclusively in local markets. Normally, they produce for non-branded or extremely price sensitive consumer segments where pressures on social and environmental performance are much lower⁴⁶. Here social compliance would be tagged according to the minimum acceptable standards in the national laws and would be subjected to various local dynamics such as the bargaining power of unions, the effectiveness of civil societies, the regional social systems, the enforcement capacity of regulatory bodies etc.

c) Ethical Values:

The third line of reasoning is related to the ethical consideration of the owner/manager⁴⁷. The ENSR Survey indeed reveals that voluntary CSR among European small businesses is motivated mostly by the entrepreneur's personal sense of responsibility and embedded-ness in the community⁴⁸. Also the top two reasons for community involvement among the BCC survey⁴⁹ respondents were; to give something back to the community (59%); and wishes of senior management (47%).

Needless to say, identifying what constitutes **voluntary responsible behaviour** in different value systems is the real challenge faced at the moment. Presently, the debate over business engagement with the community is skewed towards the involvement of a handful of large multi-national companies⁵⁰, who promote the universal principles adopted by ILO on labour standards. However, in the publication on Decent Work⁵¹, ILO itself accepts that 'parallel to economic and social considerations, there is a strongly implied ethical dimension in labour standards (...) and that the key to successful application is the right mix of the universal principle and the ways in which those directly concerned can gain ownership over it (...) This, it says, shall entail looking at different contexts, including the philosophical and spiritual ones too'.

⁴² Utting 2002:2007 – Quoted in IDS Working Paper 227 (below) Pg5

⁴³ IDS Working Paper 227: Corporate Accountability to the poor? Assessing the effectiveness of community-based strategies, Niamh Garvey and Peter Newell, Oct 2004

⁴⁴ Refer to Nelson Mandela's Speech to the WTO, Geneva, May 1998

⁴⁵ UNRISD Report 'Corporate Codes of Conduct. Self regulation in a global economy', Jenkins, R (2000)- Quoted in UNIDO report on 'Implications of CSR for SMEs' (ibid)

⁴⁶ ibid –UNIDO report 'Responsible Trade & Market Access' -Pg48

⁴⁷ ibid- Communication from the EU Commission 2002, Pg11

⁴⁸ ibid- ENSR Survey of European SMEs, As quoted in CSR Magazine, Oct 2002, Pg4

⁴⁹ ibid- Business Community Connections UK

⁵⁰ ibid- Ella Joseph, 2000

⁵¹ Peccoud, D, 'Philosophical & Spiritual Perspectives on Decent Work', ILO Publication, Geneva, 2004

For example, in countries where labour supply is abundant and enforcement of labour laws is not too tight, there is hardly any business case for managers to address worker's right violations⁵². In these cases, entrepreneurs who endorse the core labour ILO standards or provide for health or education of their workers could be doing it primarily because of the individual values.

In this sense, the clearer one is about reference values in any context, the easier it will be to identify forms of enterprise behaviour that are socially responsible. Presently, the debate in management strategy⁵³ seems to be centred on the personal qualities of entrepreneurs (such as attitudes, mindsets, open-mindedness etc) that are pre-requisites for building CSR related competence in a business organization. A great deal of emphasis is thus placed on popularizing ethical leadership. An interesting example is that of Universities in Canada⁵⁴, which invite white-collar offenders to teach management students about the importance of making ethical decisions.

Perhaps an equally important step is that proposed by the WBCSD working group⁵⁵ namely that 'the companies should speak openly and directly about their social values and conduct', instead of using tentative language that leads to obscure objectives.

Part II: The SME Cluster Approach for CSR

After recognizing the different viewpoints on drivers and limitations of CSR for SMEs in general, this section looks at the scope for CSR in SME clusters. The simplest definition of a SME cluster could be a group of firms dealing with similar products and located in a specific region or in geographical proximity to each other. From the product point of view, a cluster could be industrial, agro, artisanal or even service based, whereas from the standpoint of its formation, a cluster can be categorized as a natural or induced.

Global research undertaken over the last two decades reflects that besides macro economic framework, local socio-economic and institutional dimensions of clusters have a strong bearing on their potential⁵⁶. The success of a cluster is shaped not only by the economic relationships between its actors but also by the social norms and mutual trust levels prevailing among the different stakeholders. It is now well accepted that clustering leads to collective efficiency gains that individual firms can hardly achieve outside the clusters.

This section is an attempt to explore the linkages between a SME cluster and CSR. In view of the innovativeness of the concepts, it is deliberately kept broad and open for further inputs to be incorporated, as more on-field action-research results are drawn⁵⁷.

Following the structure presented in the previous section, the implications of the three drivers is explored in order to investigate their relevance for SME cluster development.

⁵² *ibid*- UNIDO report 'Responsible Trade & Market Access' - Ineke Zeldenrust, Pg47

⁵³ Working Document 'Competence Building to mainstream CSR across business' - CSR Europe 2004

⁵⁴ An example of this is University of California Berkeley's Haas Schools of Business <http://haas.berkeley.edu/news/20020903.ethics.html>

⁵⁵ *ibid*- 'Making good business sense', 2000

⁵⁶ "Industrial Clusters in India", A note by Mukesh Gulati, UNIDO Cluster Development Programme, April 2006

⁵⁷ Reference to on going project between UNIDO and Swiss Agency for Development and Cooperation in the area of SME cluster development and Corporate Social Responsibility: (2005-2008)

a) The Business Case:

The fact that the SMEs benefit by reconsidering their management and streamlining their production system is well established, and is probably the key reason behind the increasing number of small firms opting for certifications. However, as noted in the first section, the business case for CSR is very much specific to a particular industry and it involves issues such as **the production process, the location of the firm, its competing environment and target markets** before a list of expected benefits is laid out.

For example, it is possible that spending on clean fuel or environment-friendly raw material might be feasible for a small firm only when its competitors also agree on using it. Similarly, while improved energy management might generate great savings to a firm that has a great deal of mechanised operations, all that a more labour intensive units may need could be as simple as a more comfortable sitting posture of workers.

The location of a firm is equally important to assess the feasibility of following good labour practices. For example, a small European firm may need to ensure first-rated labour standards simply in order to attract suitably skilled and motivated work-force. The very same standards would probably appear as an unsustainable addition to cost of operation for an equally small firm in South Asia. The availability of abundant cheap labour and also the readiness of labour to put in extra hours of work, makes it all the more viable for manufacturing units here, to ignore the working standards. Such inconsistencies are often also the outcome of the nature of the markets that the firms cater to. For example, in case of Jalandhar Football manufacturers (India)⁵⁸, it has been noticed that the firms that are exporting to some high-end European or American brands are much more inclined towards formal compliance norms than those selling only in the domestic markets.

It is within such product-, process-, location- and market-dependent scenarios that we develop an **argument for cluster support**. Inside a cluster, many firms have in common a great proportion of the characteristics described in the above heads and as a result face **similar challenges**. For example, the entrepreneurs may all face the same pressure to enforce labour or environmental standards that may demand a change in the production technology. For example, in the case of the Ambur Leather cluster, small firms got together to purchase 'chrome-recovery plant', which not only led to a reduction in pollution levels of underground water but also brought significant cost savings to firms, as they could now re-use the chrome for leather tanning⁵⁹.

As a result of being in such similar situation and being physically very close to each other, there is **greater chance of learning and replication** of better practices among the SMEs in the cluster. If a firm is able to benefit from internalizing any CSR practice, this provides a good and visible reason for others to follow.

However, like in any cluster development initiative, a key challenge is to identify who should be **taking the first step**. This is often a very difficult task for firms that have a short-term view of their operations and markets, as tackling their CSR agenda implies costs in the short run. Within clusters it may be admittedly easier to gather a group of leading businesspeople that take a joint initiative, and thereby set a visible example. However, the costs of setting such lead group into motion should not be under-estimated, especially if this requires breaking free from old habits or misconceptions.

Dissemination of good practice can also pose significant problems. Experience shows that the positive learnings tend to remain limited to a small group, while the negative ones spread faster,

⁵⁸ The SME Cluster selected under UNIDO -SDC project- *ibid*

⁵⁹ Ambur Cluster End of Project Report, UNIDO Cluster Development Programme, India

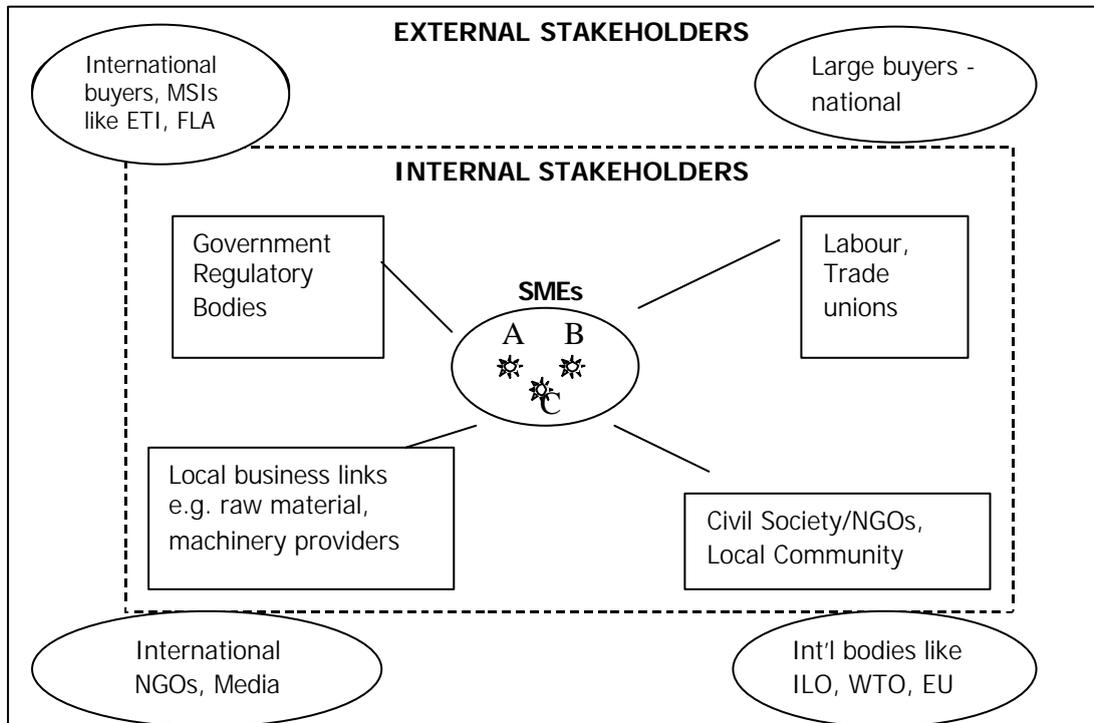
cautioning others from trying out new initiatives. A discussion paper by IIED⁶⁰ observes that ‘SME associations tend to focus on lobbying to resist stricter social and environmental controls, and are reluctant to engage in CSR initiatives that they would regard as adding to the burdens their members already face.’

In this sense, a developmental institution can play an important role in the cluster by demonstrating the advantages of sharing good practices and of adopting a joint approach to CSR mainstreaming. This could be done through **collective activities** like joint sourcing of environmentally friendly raw material, group hiring of social auditors, joint training of managers/workers or maybe by standardising labour practices throughout the cluster. UNIDO’s past intervention in the Ludhiana knitwear cluster shows that as the water and energy efficiency measures were experimented with a few firms and shared with the rest, a good number of firms were willing to adopt the same⁶¹.

Pro-active initiatives taken by cluster actors can even provide the cluster SMEs with **competitive advantages and access to niche markets**. An example of this is the Oaxaca State Coffee Producers Network, Mexico⁶² that through cooperative action had encouraged clean supply chain amongst its members, and also partnered with a number of reputed organizations to gain access to international markets for sales through fair-trade coffee. The region has seen a voluminous increase in sales since then. However, there is still a lack of quantitative evidence on how far would ‘fair-trade’ as an agenda go, to provide a cluster with proactive competitive advantages.

b) Stakeholder pressure

The following stakeholder diagram is a helpful reference point to understand the linkages and pressures that may work in a SME cluster.



⁶⁰ Discussion paper on SMEs and CSR, Written by Tom Fox of IIED, June 2005

⁶¹ UNIDO Cluster Development Programme Hosiery & Knitwear cluster of Ludhiana, End of Project Report, www.smeclusters.org

⁶² UNIDO Commissioned study on SME Clusters & Responsible Competitiveness in Developing Countries, By AccountAbility (UK), December 2005

As discussed in section 1, the extent to which each of the above stakeholders can exercise pressure on SMEs to adopt social codes of conducts, depends on the formers' bargaining power, which in turn is determined largely by the market forces. The SMEs in a cluster may be of one, two or all three types, denoted in the diagram by:

- 'A' as part of the global value chain and supplying to large MNCs/brands,
- 'B' as suppliers to one or two large domestic enterprises,
- and 'C' as not linked to any big enterprises.

When faced with pressures from external stakeholders like international NGOs or MNCs, there are good many examples of category 'A' firms in a cluster to join hands and work together to address challenges. Some of the most popular examples of such joint actions is the elimination of child labour in the carpet⁶³ and the sports goods industry⁶⁴ in Northern India and Pakistan⁶⁵. These projects were successful because the **concentration of the affected firms** in the same geographical space helped the enterprises to collaborate and also made implementation more practical for the developmental agencies involved in the above, such as ILO, FIFA and GTZ.

Furthermore, **monitoring compliance within a cluster is more efficient** and less expensive than simply expect a large number of scattered individual suppliers to comply. Further examples of such a group-based assistance is being tested by the Ethical Trade Initiative⁶⁶ to improve working conditions in the South African wine industry, the horticulture industry in Kenya and garment industry in Sri Lanka among others.

The above initiatives mainly focus on **building the capacities** of the participating supplier firms that are mostly located in clusters, through their associations so that they are able to either adopt a specific code of conduct or build a customized one for their industry like the one made to uphold the health and safety standards in the Vietnam footwear industry⁶⁷. This initiative is a truly multi-stakeholder one as it involves not only the cluster representatives of manufacturing firms but also national and international research and developmental institutions besides the international buyer groups.

For type 'B' firms in the cluster, namely those that are **vertically integrated** with one or two large firm(s) in their vicinity, the influence of the latter has repeatedly been a major force for bringing social and environmental concerns to the SME suppliers. Companies like Unilever, BP, Shell, Rio Tinto and B&Q have done extensive work to raise the labour standards in their respective industry clusters across South America, Chile and Bolivia⁶⁸. Similarly there are examples of the TATA, Maruti Udyog in India that because of a stronghold on their suppliers are able to force the implementation of certain codes and norms through their supply chains.

What appears as the most significant challenge is to involve type 'C' firms, namely those that cater exclusively the local market. A conference in Beijing between EU and Chinese Government last year showcased the fact that CSR in China was to a large extent dependent on the Governments interventions, and thus 'would not become a significant force unless China's legal system matures and media is allowed to report the dealings of the state-run enterprises'⁶⁹. In other words, it would depend entirely on the effectiveness and transparency of the local law implementing systems to ensure a

⁶³ Ref to RUGMARK project, www.rugmark.org

⁶⁴ Ref to Sports Goods Foundation of India, www.sqfi.org

⁶⁵ ILO-IPEC project (<http://www.ilo.org/public/english/standards/ipec/about/factsheet/expls-98/exempl5.htm>)

⁶⁶ www.ethicaltrade.org, www.wieta.org.za,

⁶⁷ Vietnam Business Linkage initiative <http://vcci.com.vn/sub/vbli/default.htm>

⁶⁸ "Giving Corporate Responsibility a Latin beat", Article by Oliver Balch, Ethical Corporation Nov 2005

⁶⁹ "A Chinese definition of CSR"- Report by Tim Miller, Ethical Corporation Nov 2005

socially responsible behaviour of the businesses. There are cases, where cluster SMEs have been able to fulfil the demands made by the local stakeholders simply by the virtue of collective business perspective. For example, the introduction of cleaner production technologies and training programmes in the Tirupur Knitwear cluster⁷⁰ helped identify pollution control as a business decision for dyeing units, which otherwise would have shut down their establishments in view of orders from local authorities.

Such consortia responses to environmental regulations have also been identified in the industrialized countries, like for example in the Ceramics cluster of Nove and the leather cluster of Arzigano⁷¹. Another point in case is that of the collective action initiated by the SDC-TERI⁷² partnership for the Indian Foundry clusters to improve the latter's socio-environmental status in face of stringent ruling by the Supreme Court of India in the year 1995. Informal reports also exist of Indian SME clusters taking up collective projects in the field of education, health or water conservation in their local communities, due to incitation by local NGOs.

c) Ethical Values

The third driver, namely the ethical inclination of entrepreneurs, certainly cuts across the subject. Unless there is a real commitment towards the socio-economic welfare or environmental sustainability on part of all the private actors, true development may never emerge in a cluster. Given below are a few ways, where an ethical inclination may assume a beneficial role to foster socially responsible behaviour in a SME cluster.

i) Ethical Leadership

A key aspect in fortifying the movement of businesses towards true social responsibility is the role of ethical leadership at all levels, whether it is for the SME associations, the Government local regulatory authorities or in individual dealings between buyers and suppliers.

It has been observed by various cluster development experts⁷³ that many times in a cluster, one finds one or two leading entrepreneurs, who based on their personal value-sets, invest a considerable amount of resource for facilitating a collective action within a group. Such active players are capable of instigating a common opinion, which easily becomes the socially responsible decision for the cluster as a whole, in view of the rapid spread of information and the opportunities for mutual benchmarking. Such well-intended leaderships have also lead to faster results, especially when they arise from important office bearers of the industry associations in a cluster.

ii) Commitment from the large buying firms:

While SMEs in the supply chains are expected to be honest in their dealings with their labour, large buyers should also be transparent in their procurement procedures. Unless the small firms are assured of strategic gains, they may never find a business case to invest into social or environmental performances. It wasn't for nothing that Nike's online disclosure of contractor factory details was appreciated worldwide! Any large enterprise that gets into a long-term strategic partnership with its suppliers will not only ensure that the latter are compliant but will also help in making them that way. However, if large firms find it unmanageable to get into such contracts with small individual firms, then a cluster may provide an ideal way to go about it.

⁷⁰ Tirupur Cotton Hosiery Cluster End of Project Report, UNIDO Cluster Development Programme, India

⁷¹ Case study on 'Effluent Treatment Plants, Nove and Arzigano - leather and ceramics', By Michele Clara, April 1998

⁷² 'Igniting Change' -a film on project of Swiss Agency for Development & Cooperation (SDC) & Tata Energy Research Institute (TERI)

⁷³ Based on discussions with UNIDO Cluster Development Programme team, New Delhi, India

A cluster provides ready-grounds for the requirements of buyers to converge towards shared development projects and also involve the beneficiaries. One of the most recent of such projects is a collaboration initiative between six international organizations, led by buyer representatives, to enhance the effectiveness of multi-stakeholder approach to improve the working conditions in the garment factories of Turkey⁷⁴.

iii) Shared values provide a platform for collective action

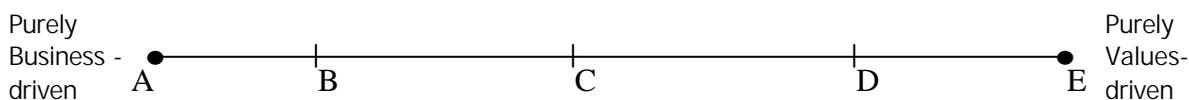
It is rightly noted that, “corporations are bound by a social contract to contribute to the fabric and welfare to the societies in which they operate”⁷⁵. This is especially true for cluster SMEs that are a part and parcel of the community that they thrive in. Ethical values are often shared in a cluster, which provides a platform for group-based philanthropic work. These common value sets seem to arise mainly from a sense of belongingness to a particular place or a culture, which in itself may serve as a long-term driver.

There are some interesting partnership models emerging globally, where the local industry has in fact joined hands with the local communities, NGOs and Government departments in order to solve issues affecting their communities. In fact, the Melbourne model⁷⁶ on which the Cities programme of the UN Global compact is based, rides entirely on this voluntary willingness of private sector to partner with the public institutions for the betterment of their local societies.

Marcela Manubens, vice president of global human rights and social responsibility at Phillips Van Heusen, stresses that ‘moving the industry beyond simple monitoring, toward real change, will take collaboration at even simplest of levels’⁷⁷. Such models seem to be much more sustainable as they intend to drive all stakeholders towards a common vision rather than pulling them into a game of ‘fault-finding’. An improved dialogue based on common philanthropic inclinations of the cluster actors, may lead to identification of better social projects, which then may trigger a greater quantitative and qualitative philanthropy.

A Strategic Challenge

Looking from a realistic viewpoint, the motive behind any socially responsible action by an entrepreneur will vary on the below illustrated scale of A to E i.e. from **‘purely business-driven’ to ‘purely values-driven’**.



Most of the small firms that are extensively dependent on their value chain for survival, are individually not in a position to bring about changes in the business environment, based on their value sets, and so prefer to be somewhere around point B. On the other hand, most of the stakeholders, both external and internal, would expect a firm to be closer to point E, while keeping the business demands unchanged. This may lead to a constant tussle situation.

The challenge for cluster development initiatives is therefore how to reconcile the stakeholder pressures with the activities taken up voluntarily by the private sector. At first sight, this is an ideal

⁷⁴ Joint initiative on corporate accountability & workers right - <http://www.io-in.org/pub/turkey.shtml>

⁷⁵ “Giving Corporate Responsibility a Latin beat”, Article by Oliver Balch, Ethical Corporation Nov 2005

⁷⁶ http://www.citiesprogramme.org/the_melbourne_model.php

⁷⁷ “Moving beyond monitoring” – Article by Lisa Roner, Ethical Corporation, Jan 2006

scenario for confrontation to emerge: civil society (e.g. an NGO or a citizens group concerned with worsening of social or environmental standards) and the private sector (individual entrepreneurs or producers associations) accusing each other to be stubborn and insensitive, while local government simply being unable to reconcile apparently diverging interests. There is no doubt that a strong cluster governance framework may indeed facilitate dialogue among all the cluster stakeholders and eventually lead to the identification of win-win scenarios. What remains to be empirically tested is if such governance framework can emerge more easily or promptly, when triggered by a confrontation that the private sector may perceive as a threat to its economic viability?

PART III: Concluding Remarks

The beginning of this paper hinted the existence of a large variety in enterprises that could be clubbed as SMEs. However, the one thing that almost all SME experts world-over would agree with, is that just as majority of small entrepreneurs run their businesses on short-sight and informal procedures, so do they engage in socially responsible activities. In order to make this engagement more organized and formal, the following summary is drawn from the full range of concepts and observations detailed above.

- It is first important to recognize that the involvement of small firms in philanthropic activities is a crucial aspect of operation in local communities and thus should be duly acknowledged. As a study by the Inter-American Development Bank (IADB) summarizes that 'for smaller firms in developing countries, the promotion of responsible practices must be built on the ethical/religious motivation already existing to make the business case, wherever possible, which in turn will help to ensure sustainability...'⁷⁸.
- Stakeholder pressures that are enforced on SMEs may result in a temporary facelift of the businesses, however they will not lead to sustainability unless there is a long-term commitment from all fronts. The different stakeholders, especially the large buying firms have to accept that the compliance in the supply chains entails a good deal of costs and risks that should be shared by all those involved. Even to explore and build a business-case for CSR activities may require investment in industry-specific research and fostering of skills & capacities of small businesses through investments in human capital. This is development process and therefore demands a strategic partnership.
- Clusters may provide a rich platform for joint action, for SMEs as well as the other stakeholders interested in improving the CSR profile of any industry. For SMEs, the clusters provide a 'support system' of institutions and like-minded entrepreneurs that facilitate sharing of experiences and resources based on shared values, and also give an impetus to take on certain activities that might have been individually unfeasible. For other stakeholders, the clusters provide a practical entry point as well as a useful ground to test the effectiveness of collective engagement models.
- Finally, locally active multi-stakeholder groups should not try to force down a pre-conceived agenda but instead let the local needs devise the most effective models for CSR development in SMEs. Given the present market pressures that demand ever-lowering product prices and delivery timelines, the business case of CSR would fail unless changes in attitudes and values are catalysed through collective engagements.

⁷⁸ "Social and Environmental Responsibility in Small and Medium Enterprises in Latin America" - IADB, September 2005