SMEs: Using CSR to Achieve Sustainability
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SUMMARY:
Corporate Social Responsibility has emerged from the fringes of business and civil society engagement, and is now viewed as a framework for simultaneously promoting business competitiveness and environmental and social sustainability (the “triple bottom line”). This paper will argue that Small and Medium Size Enterprises\(^1\) are the key to the success of any effort to improve global sustainability through Corporate Social Responsibility. SMEs produce 65% of global GDP and also comprise an important part of transnational corporations’ CSR efforts. Furthermore, many SMEs have strengths — flexibility, the ability to innovate, strong ties to their communities — which allow them to embed CSR deeply in their businesses.

Transnational corporations must understand that practicing CSR also means working closely with the SMEs in their supply chains. When promoting CSR in their supply chains, such corporations should ensure that the SMEs are supported in their efforts to meet higher standards of performance in quality and in CSR. This includes adequate and fair compensation for the costs they incur in complying with global standards and pursuing their own CSR. This will allow SMEs to be dependable business partners, and contribute to CSR practices of the entire industry.

\(^1\) There is no consistent operational definition of “SME”. Most countries use a combination of number of employees — ranging between 100 and 500 — and annual business revenues. The most commonly cited definition is that used by the European Commission: employing fewer than 250 workers. For further discussion, including categories of “micro”, “small” and “medium” enterprises, see the SME user guide: European Commission Enterprise and Industry Publications: “The New SME Definition: User Guide and Model Declaration” (2005)

SMEs: NECESSARY PARTNERS IN CSR FOR GLOBAL SUSTAINABILITY

Businesses, like people, routinely organize themselves around goals of short-term survival and concrete measures of achievement. Promoting long-term sustainability requires identifying a variety of ways to shift expectations of “business as usual”, so that increasing numbers of businesses and individuals factor in the impact of their actions on others when they make their economic decisions. A UN Convention for Corporate Social Responsibility and Accountability, proposed as an outcome of the RIO + 20 Summit, approaches the question of sustainability through CSR implementation by focusing on actions and accountability of large and trans-national corporations. But the small and medium size businesses, which collectively employ millions of workers worldwide (estimated at 90% of the global workforce), and account for approximately 65% of global GDP\(^2\), need to be involved in order to ensure that the impact of CSR is felt in communities around the world.

Just a few years ago, the idea of SMEs practicing CSR was often dismissed as impractical. Justifications for such dismissals included arguments such as these: “there are too many SMEs, they are too loosely organized, they are difficult to regulate, they participate in the informal economy, they have too small a profit margin to spend on CSR “frills”, their owners/operators are not comfortable with the aspirations and formal language of many laws and standards”. Recently, however, the global economic downturn, among other major events, has brought into focus the extent to which productive, entrepreneurial SMEs contribute to economic activity through their role in innovation, flexibility, and ability to provide employment for family and community members. Maintaining a healthy SME sector has been correlated with national economic stability and growth opportunities\(^3\). Through application of key elements of CSR, SMEs can benefit the same way larger corporations can, for example through improving the quality and reliability of their products and services, better meeting needs of customers and workers, improving community relations and reducing risks. In some areas of CSR, SMEs are better positioned than larger corporations to implement CSR initiatives due to their existing ties to their communities. Many heads of SMEs, especially entrepreneurial founder/owners, already have much of the “CSR spirit” – the instinctive understanding of the importance of responsibility and reciprocity in their business dealings - and have the capacity to join the CSR movement when they become aware that its goals and methods apply to them.


\(^3\) Concerning the European Union, “SMEs’ contribution to employment growth between 2002 and 2007 (84%) has been much larger than could be expected from their share in total employment (67%)”. Source: [http://ec.europa.eu/enterprise/policies/sme/files/craft/sme_perf_review/doc_08/spr08_annual_report_en.pdf](http://ec.europa.eu/enterprise/policies/sme/files/craft/sme_perf_review/doc_08/spr08_annual_report_en.pdf)
HOW SMALL AND MEDIUM ENTERPRISES CAN EMBED CSR PRACTICES IN THEIR ACTIVITIES

SMEs can embed CSR in their business practices by adapting some of the same tools as those available to large corporations, including stakeholder engagement, demonstrating accountability through public reporting, and using the voluntary global guidance standard ISO 26000. Key among these is stakeholder engagement, which can start on an informal basis and lead to increasing accountability. Stakeholders are usually defined as those people and groups that are affected by the actions of a particular business. These can include workers, suppliers, community residents, consumers, and investors. Communicating with them is one of the best ways a business can identify its strengths, weaknesses, and areas of potential risk. However, stakeholder engagement can be difficult for many small business owners, who are often used to making their decisions on their own. Opening to “two way communication”, which is the heart of stakeholder engagement, can be made easier by keeping initial meetings informal and exploratory, and by following up on some of the first small and practical suggestions. Although many founder/entrepreneurs take a paternalistic approach to dealing with their workers and staff, they usually are genuinely motivated to improve their business competitiveness and morale. Therefore, we have found assistance by third parties in setting up discussions and ground rules can help steer clear of defensiveness and personality conflicts, and focus stakeholder engagement on improvements.

Another accessible route to CSR for SMEs is using the ISO 26000 Seven Core Subjects to identify areas of strength, and areas in need of improvement. The Seven Core Subjects are: organizational governance, human rights, labor relations, environment, fair operating practices, consumer issues, and community development and involvement. Taking advantage of the flexibility of ISO 26000, each core subject can be defined in a way that is relevant and accessible to SMEs. This is especially beneficial for SMEs since, unlike large corporations, they do not often have the resources (finances, staff, time) to undertake extensive CSR initiatives across all areas at once. Hence, for SMEs to succeed in implementing CSR, it is essential for them to set priorities at first and aim for continuous improvement over time. Furthermore, the Seven Core Subjects of ISO 26000 introduce SMEs to an overview of global expectations for CSR. Such expectations are often surprising for SMEs, as they are more comprehensive than many business owners’ prior definition of CSR, which tend to center around philanthropy and sustainability initiatives. Once exposed, many SME executives notice that they have done something (albeit small) in each category and start describing the initiatives. This recognition process is crucial; as they see that parts of their business have already evolved to incorporate some aspects of CSR, they become more willing to identify and act on gaps between their current practices and the CSR goals of the Seven Core Subjects. In another advantage for SMEs implementing CSR, their more flexible management structure allows them to implement substantial CSR initiatives quickly without seeking approvals of boards and investors.

To demonstrate the benefits of these approaches to CSR for SMEs, this paper will present the story of how one Chinese factory has used some of the above tools, leading to significant changes and benefits for the business.

The Alashan Yulian factory, located in Inner Mongolia, processes raw cashmere goat and Bactrian camel fibers. The company developed a reputation for quality and reliability, and established itself as a source for high-end fashion buyers on the international market. At the start of the 21st century, regional environmental degradation (desertification related to over-grazing of goats) started to affect Inner Mongolia’s topography (sandstorms, movement of dunes) and thus the lives of the herders of the region. Understanding, and experiencing, the damage done by a disproportionate number of goats, Liu Xiaoyong, the entrepreneurial founder/owner of Alashan Yulian, found a way to add value to camel fiber, thus encouraging herders to raise more camels as an alternative to goats. Mr. Liu successfully developed and marketed “camel quilts” — fashionable quilts stuffed with “downy baby camel fiber” — to the Chinese domestic market. This new product is marketed as “eco-friendly” for consumers, because the camels and their fiber are not exposed to man-made chemicals in their food or processing.

Mr. Liu has offered some herders’ cooperatives a “sustainability premium” price in exchange for their work to manage grazing more sustainably. He has his eye both on a long-lasting sustainable supply of fiber, economically viable sources of supply, and on customers who may be intrigued by the connection of their purchase with protection of the land and the herders’ livelihood. His use of CSR has benefitted him by: diversifying his product lines; obtaining more added value by producing and marketing a finished product, and increasing his business competitiveness because he is now selling more domestically, becoming less dependent on a fluctuating global market price for his fibers.

In terms of tools for implementing CSR, Mr. Liu practices stakeholder engagement both “upstream” with the herders, and “downstream” with the wholesale buyers and retail customers, whom he needed to engage to develop his new product successfully. He has sought various certifications and attestations to provide third party assurance that his products are of the quality that he claims. He pays above-average wages and provides training so that workers can develop new skills. He pays attention to the traditional values of the factory workers, the majority of whom are ethnic Mongolians, by including a traditional Mongolian obos (shrine) and its rituals near the entrance to the factory. He is motivated to document and improve his performance in the Seven Core Subjects, with the goal of achieving recognition as a local factory which practices CSR in a way that is accepted globally.

CHALLENGES FOR SMEs IN THE CONTEXT OF IMPLEMENTING CSR AND GATHERING/DISCLOSING SUSTAINABILITY INFORMATION

While CSR implementation brings benefits to SMEs, there are also challenges specific to SMEs. For SMEs selling under contract to larger corporations, those corporate buyers can demonstrate their own responsibility by providing the SMEs in their supply chain with guidelines and resources, and by publicly acknowledging their own stake in the SMEs’ impacts on their workers and communities.
Public reporting is an expansion of stakeholder engagement, and a more formal way to communicate with customers, community and suppliers. Barriers to public reporting for SMEs include the costs (in money and in staff time and expertise) of preparing and presenting reports, and the formal nature of such reporting which may be alien to many SMEs. Reluctance to admit to problem areas in a public report can diminish the credibility of a business, and actually hurt its reputation with its stakeholders. However, public reporting is an important part of accountability; the very fact of accepting the requirement of a public report helps to alert the SME’s owners to their obligations to stakeholders. Those who work with SMEs on their CSR (for example, local governments and Chambers of Commerce, buyers in their supply chains, and consultants or NGOs) can work to develop simple templates for organizing reports, methods of keeping reports brief and to the point and keeping production and distribution costs down.

Gathering sustainability information (even documenting something as basic as paper consumption or percentage of waste that is recycled, for example) takes staff time and effort, and requires management commitment, communication and follow-through. When these become too burdensome, or when information gathering becomes an exercise without a clear benefit to the company, SMEs are likely to opt out. Similarly, disclosure of such information carries costs and also risks. Business partners, customers, buyers, government officials and other stakeholders who are interested in such information need to communicate clearly with the SME why the information is important and valuable, and how it will be used.

Especially for SMEs, long checklists of requirements for information disclosure can create too much of a burden to make the reporting feasible. Deciding what information should be disclosed and discussed is best done by linking it to specifics of stakeholder engagement. For example, what issues are relevant for the community? (pollution, job opportunities, community development, health issues related to use of the company’s products, etc.) Disclosing some types of information can lead to business problems related to specifics and confidentiality concerning sources, ingredients and processes. Using third parties and non-disclosure agreements to protect proprietary information can be a partial solution. International buyers who require this information from SMEs should contribute to the cost of collecting the information. Time and effort invested in measuring/reporting needs to be put in the context of payback and usefulness to the SME, and be affordable for them, or it will not be done in a meaningful or useful way.

A severe set of challenges arises when SMEs, especially though not exclusively those in developing country contexts, operate at least partly in the informal sector. In these cases, SMEs are avoiding such formal and visible actions as registration, compliance with government safety and environmental regulations and/or collection and payment of taxes. Movement toward more legal compliance can be very difficult, especially when the SMEs are severely undercapitalized or operating in a climate of corruption. Problems with “shadow factories” and double bookkeeping occur when SMEs are pressured to keep their prices so low that they cannot operate legally and still make any profit. In such situations, SMEs can be encouraged to take steps toward legal operations, when their community provides consistent enforcement of laws, support services for SMEs (collection of over-due payments owed them by purchasers, for example) and in the long term the ability and willingness of their customers to pay a
“living price” for their products. Participation in the supply chains of larger corporations – if those corporations themselves practice CSR - can be an important factor leading to improvement in these cases.

LARGER CORPORATIONS AS ‘DRIVERS’ OF CSR AMONG SMES

One large study\(^6\) examined CSR and working conditions in apparel and footwear factories in countries including Guatemala, Vietnam, Thailand, China, and Sri Lanka. It provides evidence that industry-wide standards, when explained and enforced by their multinational purchasers, can indeed bring about improvements in working conditions even among workers who lack key skills such as literacy. The improvements in workers’ situations also benefit the companies. For example, many low-wage workers rely on overtime to reach an acceptable level of income. But long working hours can lead to lower productivity and more injuries, as well as worker dissatisfaction and high turnover. Implementing the International Labour Organization (ILO) limit of a 60-hour workweek can lead to increased productivity so the company comes out ahead even though workers need to receive a higher base pay in exchange for the drop in hours.\(^7\)

Another source\(^8\) discusses the same labor codes implemented by the apparel and footwear industries, from the viewpoint of the transnationals’ own self-interests: “‘Generally, the motivation behind the codes was legal and reputational risk management’, said Gare Smith, the former Levi’s executive who is now a lawyer at Foley Hoat. ‘I’d say about eighty to eighty-five percent of the time legal and reputational risk management was the motivational driver, and about fifteen to twenty percent of the time brand enhancement was the motivating driver’.” The large apparel and footwear MNCs perceived the benefit to themselves of actually implementing their codes of conduct, and thus made this a priority, contributing their own resources, investing in and working with their conscientious suppliers over time, and enforcing their codes by dropping suppliers who did not show progress in correcting violations.\(^9\)

On the other hand, a recent report about one multi-national’s lack of implementation of promised CSR improvements in China included the point that in order for its “sustainability ideal...to become reality, it needed to become part of buyers’ day-to-day decision making, a criterion on which they were evaluated. For instance, would the buyers be encouraged to choose a T-shirt that costs a half cent more apiece because it used safer chemicals or was dyed at an environmentally friendly mill? ...that’s when sustainability is really embedded.”\(^10\)

The link between CSR and purchasing policies is crucial to the involvement of SMEs. CSR must be a partnership involving producers, retailers, and consumers. Corporate and institutional buyers must

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\(^10\) Andy Kroll, “Walmart’s Shadow Factories”, Mother Jones March/April 2012 p. 43.
include CSR elements when making buying decisions; otherwise they create a major “disconnect” between their talk and their actions. When this disconnect occurs, CSR is reduced to “greenwashing” and public relations, and has limited impact on sustainability. This aspect was recognized by ISO 26000, as an outcome of several years of heated discussions:

“to promote social responsibility in its value chain, an organization should…. Promote fair and practical treatment of the costs and benefits of implementing socially responsibly practices throughout the value chain, including, where possible, enhancing the capacity of organizations in the value chain to meet socially responsible objectives. This includes adequate purchasing practices, such as ensuring that fair prices are paid and that there are adequate delivery times and stable contracts.”

Thus, promoting CSR throughout the supply chain is of direct relevance to SMEs. Key points are illustrated by the experiences of Bao Jijun, the founder/president of Shandong Lejia Home Textiles Company. Bao owns and operates a factory that produces shower curtains. Over the past five years, the company has expanded from 35 to 150 full time employees. They source their materials from other Chinese provinces, manufacture and package the shower curtains in the factory in Shandong, and sell primarily to large European and Japanese customers. Through selling to international customers, Bao became familiar with corporate codes of conduct, and working to standards. He was proud to meet their requirements, but after Bao had made the necessary investments to improve his factory’s working conditions, his only major customer, a transnational corporation, asked him to cut his prices to them. How could he stay in business if his profit margin was going to be reduced year after year? Especially galling to Bao was the fact that the multinational marketed itself as a “sustainable” and “socially responsible” corporation. His purchaser was obtaining a marketing advantage from the CSR improvements that Bao’s company had paid for. Fortunately Bao was empowered by learning that there are advocates for fairness in the application of CSR worldwide; he broke ties with the original transnational, and found other transnational purchasers who saw his documented CSR achievements as indicators of a good business partner.

Bao has found that, over time, his CSR efforts have led to greater worker motivation, increases in productivity and quality, a higher worker retention rate, and more international buyers. A successful businessman, he appreciates the competitive edge that he gained through his CSR. To further distinguish himself, and to maintain his appeal to international buyers, he is rising to the challenge of implementing the guidance of ISO 26000 and its Seven Core Subjects. He is now confronting the ironic truth that he needs to engage his own suppliers and consider their impact on workers and the environment, just as his buyers have engaged him. Bao is genuinely committed to “continuous improvement” in his CSR. But he is counting on the marketplace to support those efforts; wholesale buyers, and ultimately their retail customers, need to “vote with their money” to make CSR economically sustainable.

ISO 26000 Clause 6.6.6.2
Bao’s example ultimately illustrates the positive dimension of multinational CSR: supporting local-level suppliers in their own efforts. However, the reverse side shows how multinationals’ behavior can negatively impact SMEs around the world, especially in developing countries. Recent examples of child labor in Burkina Faso, in the organic cotton supply chain, indicate the complexity of supply chain issues, and the harms that can result when SMEs either do not understand or are not supported sufficiently to incorporate responsible behavior in their business practices. In Burkina Faso, cotton farmers apparently used forced labor by foster children, giving as a reason that they did not have enough money to buy plows. Inspectors verified that the cotton met organic standards, but did not examine the issue of whose labor was actually doing the field work. Multinationals’ acceptance of responsibilities towards their supply chains (ideally through voluntary CSR decisions driven by their own core business practices, or else through regulation to enforce protective laws if voluntary actions are not sufficient), should ensure that purchasers provide adequate financial and training support for their upstream producers.

In conclusion, when procurement and purchasing departments send a message (ever cheaper) that contradicts the CSR and sustainability departments’ goals, SMEs may not be able to afford the added costs of truly implementing CSR. SMEs may be compelled to cut corners on product quality, worker safety, and environmental impact mitigation. If CSR and sustainability programs are limited to eco-efficiency initiatives with short term or immediate payback, the core business model reflected in the supply chain continues to be focused on price reduction at any price. When consumers are encouraged to think only about price, they are not engaged as partners in social responsibility. Using CSR to contribute to global sustainability requires all the “stakeholders” – not just producers, but buyers and consumers - to respect the lives of other people and the future of the planet, and to act responsibly within their own spheres.

HOW SMEs CAN ENGAGE AND PLAY A ROLE IN THE CONSOLIDATION OF CSR BEYOND RIO +20

As this paper has argued, CSR is definitely applicable to SMEs. In order to encourage more CSR-aspiring SMEs, they need to be involved as “stakeholders” in the process of creating the Convention on Corporate Responsibility and Accountability. Such a UN Convention should be developed through an inclusive and participative process that engages SMEs, even if the main focus of the document is on large multi-national corporations. SME networks (peer and sector organizations) could send representatives starting in the early stages of the Convention; individual corporations could involve exemplary members of their own supply chains. In

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addition, NGOs and consultants with experience advocating for SMEs in their negotiations with buyers and with government officials could add insights.

Following the spirit of stakeholder engagement and accountability, this paper will close with feedback from an early and sincere SME user of ISO 26000. He made these suggestions voluntarily, demonstrating his comfort level with engaging with the issues. While his references are specifically to ISO 26000, they apply just as readily to any systematic CSR effort:

1. International buyers need to respect ISO 26000 (need to practice it themselves)
2. Establish a website or other accessible reporting system – post information on who claims to use ISO 26000, get public feedback from stakeholders.
3. Establish some “hard indicators” (minimal achievements in each Core Subject) to ensure that irresponsible businesses don’t destroy the reputation (“brand”) of ISO 26000
4. ISO 26000 should hold regional meetings and workshops to tell SMEs, government officials, etc. about CSR, its purpose and how to get started.

As these ideas demonstrate, committed SMEs want to preserve the integrity of global guidance standards on CSR, and do not fear a high bar. In fact a high bar rewards their efforts. If this attitude, and the tools to implement CSR, spreads along supply chains and into different communities, global sustainability may well prevail.

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