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CORPORATE HARMONY AND CONFIDENCE BUILDING SPHERES ON THE FINANCIAL MARKET

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Abstract: As the last financial crisis was caused by abuse of trust on the part of the financial institutions, this paper describes a proposed structure integrating sustainability and ethics based on trust and confidence. The author describes relations between business ethics and some theories of corporate governance and presents a possible answer to the question of whether trust can be measured. Then, he sketches a square of rules and regulations in which the financial market with its regulations is immersed, split into four overlapping sectors of financial market law, company law, codes of best practices and corporate governance principles. Interactions between these sectors lead to the creation of an inner circle describing the integration sphere where all the areas merge together in harmony. Last, the author formulates a proposal for the broadest understanding of corporate governance – corporate harmony.

Keywords: corporate governance, corporate harmony, rules and regulations square, business ethics, financial institutions

The last financial crisis has already been named as a crisis of trust that came about as a result of financial institutions abusing the trust of their clients and shareholders on an unprecedented scale. It disrupted a process of sustainable development of financial institutions, largely due to unethical behavior on the part of their managers. We can now find strong declarations at the highest levels that *"in a context of crisis, authorities must consider how to safeguard competition principles without hampering policy measures to avoid a slump or the erosion of trust in the financial sector"* (OECD, 2009a, p. 11). However, when we get down to more specific documents, such as another OECD report (2009b) that provides recommendations for some improvements in corporate governance, what we see, surprisingly, is that the words "trust" or "confidence" disappear completely. Several issues are discussed there that require mutual trust and confidence, but those words never appear in the report.

It might seem like corporate governance had nothing in common with business ethics, which obviously is not true. In a recent study, Nordberg (2010) examines three main theories: agency theory, stewardship theory, and stakeholder theory. Then he analyzes the role of ethics in corporate governance, discussing three ways in which it can be approached: as teleological, deontological, or virtue ethics. He concludes that *"the link to the ethics of corporate governance comes in what directors aspire to achieve"* (Nordberg, 2010, p. 185) and compares the implications those three theoretical perspectives may have on such a practical outcome as behavior of individual directors and of whole corporations.

If we define the stewardship theory as a model in which managers are *"motivated by a need to achieve, to gain intrinsic satisfaction through successfully performing inherently challenging work, to exercise responsibility and authority, and thereby to gain recognition from peers and bosses"* (Donaldson and Davis, 1991, p. 51), we can derive from Nordberg's conclusions that virtue ethics expresses itself in the stewardship approach to doing business. Trust and confidence play a crucial role, and satisfied managers earn esteem by creating long-term value of "their" company. As he explains, *"in a virtue-based system, individual and collective aims seem to be self-reinforcing"* (Nordberg, 2010, p. 187). However, mechanisms have to be implemented to support such an approach and prevent would-be stewards from becoming frustrated and turning into unfettered agents. Therefore, I set out an integrated corporate governance model based on a well-balanced equilibrium between all regulation and self-regulation spheres. I develop here an idea of a rules and regulations square specified earlier (Grabowski, 2010) that leads to a concept of corporate harmony built on trust and confidence. This specific square is constructed for the financial market case, but may be easily applied to any branch or business area.

How Trust Can Be Measured?

In the whole variety of financial institutions, there is one thing in common: we entrust them with our financial assets that we earn during our lifetimes in the hope that these will be reasonably managed to assure our future profits. We entrust them with our fortunes in the confidence that they will not be lost. We entrust them with trust...

One question that naturally arises is how trust can be measured, if at all. Of considerable interest in this regard is a study in which a Corporate Governance Index (CGI) designed on the basis of OECD Principles (OECD, 2004) was plotted against the market-to-book ratio of companies listed on the Hong Kong Stock Exchange (Cheung, 2007). A positive relation was proved, and further conclusions were presented by Cheung, Connely, Limpaphayom, and Jiang (2008). They explained that in 2003-2006 corporate governance practices measured by CGI were improving continuously. More interesting, however, were the next results that showed *"an asymmetric response between stock returns and changes in corporate governance practice."* In the language of trust, it means that trust is built slowly but may be lost very quickly.

Confidence Building Spheres

The issue is well-known from the point of view of customers who should trust financial institutions but are afraid that their trust might be abused. However, almost all big banks in Poland (and in several other countries) are listed on the stock exchange, and their shares may be bought by everybody, even by the same clients mentioned above, who enter into quite another relation with the banks. Clients may become shareholders with their direct investments or indirectly through investment or pension funds or insurance companies that reinvest their money. So, even without their full knowledge of that fact, they enter into an inevitable conflict of interest, as they are to have an interest not only in their personal profits as customers but also in the long-term value of banks as their shareholders. As listed banks function under financial regulations and also under company law and other corporate regulations, we can specify two distinct areas where financial regulations are devised to protect clients from financial institutions, and corporate regulations are devised to protect shareholders.

On the other hand, we can look at those areas of regulation from the point of view of their authors, so that we obtain another classification – legally binding regulations (hard law) and self-regulations (soft law). Such overlapping categories prompted me to draft the diagram below and to consider how their mutual interactions may influence the trust building process on the financial markets.

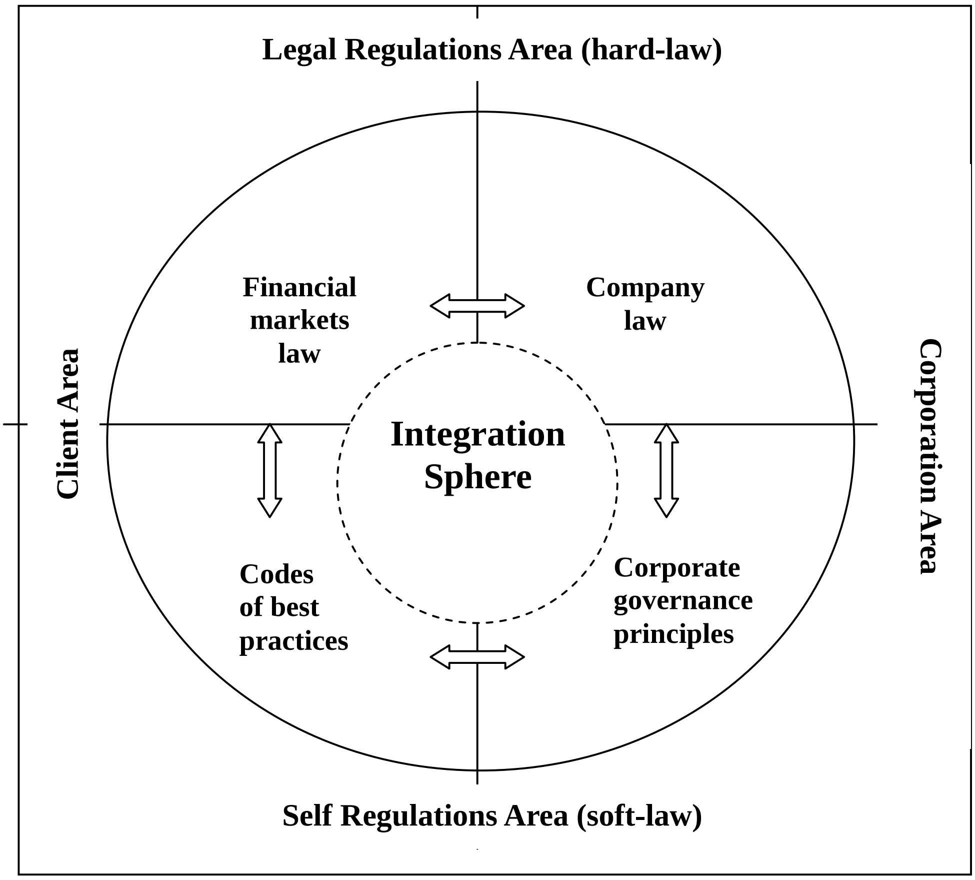

Figure 1. Rules and Regulation Square

We can identify three regulation layers there: the first, basic layer represented by the rules and regulations square depicting the system of law in a given jurisdiction, the second layer sketched as an outer circle of regulations for a given field of activities with four specific sectors, and the third layer with an inner circle representing the integration sphere where all four sectors merge in harmony.

The financial market works within the rules and regulation area sketched as an external square cut into four smaller areas delimited by two perpendicular lines crossing in the centre. The vertical line splits the square into two main areas – the client area on the left-hand side with external relations between market institutions and their clients and the corporate area on the right-hand side with internal relations between those institutions and their shareholders. The horizontal line splits the square into two other main areas – the hard law area on top with the entire body of law regulations, and the soft law area below with the broad spectrum of self-regulations.

The whole regulation system for financial institutions and their stakeholders is immersed in the external rules and regulation square. This is represented by an outer circle just inside the square, divided between four sectors according to the primary division described above. On the top left-hand side, we can see the financial market law sector where the hard law area and the client area intersect, and below we can find the codes of best practices sector where the soft law area and the client area intersect. On the right-hand side, there are two remaining sectors: the company law sector on top, where the hard law area and the corporation area intersect, and the corporate governance principles sector below, where the soft law area and the corporation area intersect. The most interesting part of that diagram is the two-directional arrows that symbolize a mutual penetration of boundaries. It becomes more intensive in the central part of the diagram, finally leading to the creation of an integration sphere represented by the inner circle. A dotted line emphasizes its flexibility, as it surrounds an area where all the regulation fields merge together. The deeper and more harmonious this integration sphere is, the better conditions exist for building trust between financial institutions and their stakeholders.

Interactions Leading to Integration

Interactions Between Client Area And Corporation Area

The mutual penetration of boundaries between these two areas is the easiest to identify, as several financial institutions are organized as stock companies. They consequently fall both under company law regulations and under regulations appropriate for specific branches of financial law. The more those two areas are consistent, the more effective they are. Such a clarity and uniformity of law promotes the protection of its "consumers," which, in this context, we can refer to as being both financial institutions and their clients.

These interesting relations can be observed in the self-regulation area at the lower part of the diagram, as the clients of a bank may at the same time be its shareholders. They are, therefore, interested in the lowest level of all fees for the services the bank is providing to them, even if that comes at the cost of lower protection of the bank's interests as such. On the other hand, as shareholders of that bank, they are interested in the highest earnings and the easiest way of creating earnings is to make the fees as high as possible. However, those are the same fees for services that their bank offers them as clients. The conflict of interests is obvious and may be resolved only when we consider the company interest in the holistic and long-term context, as in the short-term period the most important factor is quick profit only. By contrast, when we consider the long-time perspective we easily discover that security and the bank's development become much more important, as they ensure a constant grow of client numbers and also the security of their deposits. The conscious clients-shareholders will, therefore, tend to favor the equilibrium between the needs of "their" bank and its clients, leading them to the conclusion that the company interest should be understood as a mutual interest of all shareholders that understand and take into account the interests of all other stakeholders, including clients (which is the main motive of modern stakeholder theory). Such reasonable client-shareholder relations will, therefore, be very careful to ensure that the self-regulations applied by the bank take into account all those complex interdependences, promoting sustainable development and building long-term ties between the bank and its clients based on mutual trust.

Interactions between Hard Law Area And Soft Law Area

Let us start with the right-hand side of the diagram, namely with the corporation area. I have already analyzed (Grabowski, 2006) some examples of interrelations between law regulations and self-regulations with corporate governance understood as a splice of all regulation levels. In some models, the regulation crux is shifted to provisions of codified law; in others, more emphasis is put on corporate governance codes that are developed on a more voluntary basis. The boundary is dynamic, and we can identify its constant flow in both directions. The most typical movement is the "hardening" of the law by absorption of particular principles of corporate governance in company law, but we can also observe some softening moves in the opposite direction. An interesting approach could be seen in the shareholders rights directive (Directive, 2007). It introduced a set of universal regulations for all Member States of the European Union, but left them a great deal of freedom in a choice as to the area (hard law or soft law) in which they should be applied. In my earlier paper (Grabowski, 2008, p. 486), I discussed an interesting example of that approach with the possibility of casting votes by correspondence. It is specified as follows: *"while the timing of disclosure (...) of votes cast in advance of the general meeting electronically or by correspondence is an important matter of corporate governance, it can be determined by Member States"* (Directive, 2007, motive 12).

One of the characteristics of self-regulations in the corporate area is their high centralization – on a given market only one document with a corporate governance code exists that is directed to all listed companies, and only in some exceptional cases may a few codes co-exist in one country. As corporate governance is an important issue for all enterprises, a centralized set of guidance directed specifically to unlisted companies was developed lately by the European Confederation of Directors' Association (ecoDa, 2010).

A much more complex situation appears in the client area on the left-hand side of the diagram. The hard law area is highly centralized here, as apart from the set of acts of law mentioned earlier another set exists that deals with consumer protection. Quite the opposite situation may be observed in the soft law area, as the granulation in the codes of best practices sector is really extensive. Over twenty sets of such codes were developed by different branch organizations in Poland. An attempt was, therefore, made to prepare a Canon of Good Practices on the Financial Market (KNF, 2008), which sets out the principles common to all financial institutions. This is a nice example of co-existence and infiltration of both areas, as the Canon was worked out together by thirty organizations that represented all types of financial institutions and consumer protection organizations and, also, some governmental agencies, including the Polish Financial Supervision Authority (KNF).

Crossing the Boundaries

The works of the European Commission are a good example how the boundaries of the four sectors described above could be crossed. Let us begin with four recommendations (European Commission, 2004, 2005, 2009a, 2009b) that create a set of complementary documents touching on some crucial problems of corporate governance in financial institutions and listed companies. Later on, the European Commission (2010) issued a green paper on corporate governance in financial institutions and remuneration policies. All those documents are about specific regulations concerning both the client area and the corporate area. The green paper points out the overlapping interests of financial institutions' clients and shareholders, leading to the conclusion that *"the supervisory authorities, whose mission to maintain financial stability coincides with the interests of depositors and other creditors to control risk-taking by the financial sector, have an important role to play in shaping best practices for governance in financial institutions"* (European Commission, 2010, p. 4).

In all the above documents, we can see a deep infiltration of the area of legal regulations and that of self-regulations. The European Commission (2005, motive 4) also invited Member States *"to take the* *steps necessary to introduce at national level a set of provisions based on the principles set out in this Recommendation, to be used by listed companies either on the basis of the 'comply or explain' approach or pursuant to legislation."* Some conclusions were then converted into hard law directives addressed to the financial institutions, but others concerning listed companies are still being examined. Finally, the European Commission (2011) issued another green paper on the governance framework with a clearly stated intention to leave ample maneuvering room for self-regulation. The boundaries between particular sectors are floating and are delimited variously in different Member States.

Integration Sphere

Finally, we reach the inner circle in the centre of the square that delimits an integration sphere where all four specific sectors co-exist in harmony. The better all the areas are coordinated, the more this sphere is homogenous. In the deep integration sphere, all regulations are consistent, and no small-print provisions are hidden. Only such a system creates a level playing field free of suspicions and fears of being cheated. Only then may an atmosphere of true co-operation and mutual trust be built effectively.

In that internal sphere some new initiatives may appear, among which the so-called stewardship code is worth mentioning as a set of self-regulations for institutional investors who play a dual role in both the corporation and client spheres. On the one hand, they are shareholders exercising their corporate rights, but on the other, they earn those rights through individual investors entrusting them with their financial assets to be invested. Those institutional investors, therefore, should exercise their corporate rights in such a way that the interests of the beneficial owners are respected so as to promote relations built on trust and confidence.

The OECD Principles of Corporate Governance (OECD, 2004) should also be placed in this sphere together with another document that supplements the Principles with methodology for assessing their implementation (OECD, 2007). The methodology identifies the company law (corporation area) and the securities regulation system (client area). The document is based on the assumption that it is not enough to examine the regulations only, as their assignment to specific regulation areas is less important than their effectiveness. That is why another factor is also studied there, namely what recourse mechanisms are open to stakeholders when their rights are breached. Even the best regulation system cannot be assessed positively if court procedures are too slow or ineffective. Here, too, the soft law area might be useful, as *"enforcement and redress might be handled by special courts and institutions such as arbitration tribunals. In forming a judgment, the reviewer should examine the effectiveness of such institutions and their achievements"* (OECD, 2007, p. 74).

Corporate Harmony

All the above considerations lead me to make a proposal of a new definition of corporate governance understood very broadly as a whole set of relations between the company and its stakeholders built on mutual trust and confidence. It takes into account not only the company itself, but also all the external spheres, both legal regulations and self-regulations together with local corporate culture and tradition. As it seems to integrate not only the three main theories of corporate governance, namely agency theory, stakeholders theory, and stewardship theory, but also the most basic notions of business ethics, the name "corporate governance integrated" looks like the best one. This is even more adequate as it incorporates also "integrity" that is crucial to describe a very good manager. However, another name appears even better, which takes its source from the Polish name for corporate governance: "Ład korporacyjny." The Polish word "Ład" (It should be pronounced something like "wad" or "wa:d) means "beauty", but also "order" and "harmony." I strongly believe that "harmony" constitutes the best characteristics of really good corporate governance in its broadest sense, and therefore propose the name "corporate harmony."

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SUBSIDIARITY IN ASIA

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Abstract: The principle of subsidiarity is a principle of social organization. In recent years, the application of this principle has been found in areas as diverse as international law (especially European Union law), the social teaching of the Catholic Church, and in the structuring of organizations, such as credit unions and co-operatives, and it is influential in a variety of political debates. The key elements of the principle are its perspective from the lowest level to higher levels and its insistence that the purpose of higher levels includes help or support to lower levels. As the principle becomes better known in Asia, there is potential for its application to assist co-operative development of disputed resources and to assist in the growth of globalized professional and business ethics.

Keywords: subsidiarity; European Union; South China Sea; social teaching of the Catholic Church; global ethics; professional ethics

Introduction

The principle of subsidiarity has attracted the interest of scholars in Asia and deserves to be better known among policy-makers. It is a principle of the organization of society. The meaning of the principle is to some extent dependent on the context, especially as it has been used in law, in social teaching, in cooperatives and other organisations, and in political discourse. The meaning of the principle is evolving along with experience of its implementation.

Understanding of the principle of subsidiarity, not in isolation but in its interaction with other principles, may be helpful in social organisation in Asia. Some Asian societies have historically been very complex, with a wide variety of forms of organization. However, subsidiarity may help a new generation to work effectively together, especially in international cooperation. Subsidiarity may also provide insights into the appropriate level of responsibility in the ethics of globalizing business and professions.

Translation and Definition

In English, the word "subsidiarity" is unfamiliar. You can read many discussions where you will find that the definition and meaning of subsidiarity is contested. Some dictionaries do not even recognize the word, even though subsidiarity is a recognised concept in European law and is used at the highest level of treaties, and it is a recognized concept in social teaching. (Even the Microsoft spell-check function on my computer refuses to recognize the word and wants me to substitute "subsidiarily.")

A few years ago, I gave a lecture on subsidiarity to an audience in China. One difficulty became apparent when I wanted to translate my lecture into Chinese. There doesn't seem to be an agreed upon translation of subsidiarity. My academic friends, who were specialists in legal English, puzzled over this word. Since then, I have collected different translations: 基层化原则 (jiceng huayuanze), 辅助性原理

(fuzhuxing yuanli), 自主权原则 (zizhuquanyuanze), 权利自主原则 (quanlizizhuyuanze), 从属原则 (congshu yuanze), and 权力下放原则 (quanlixiafangyuanze). Perhaps the most frequently used is 辅助性原则 (fuzhuxing yuanze). I understand that there may be similar difficulties of translation into other languages.

My difficulties with translation alerted me to the issue that "subsidiarity" is not originally an English word. I understand that its roots are in Latin. The meaning of the word is contested and depends on the context in which it is used. We should use the word with some care, both because of different views about the core meaning of the term and because of the problems in translation of the original Latin and then other languages.

Nearly a decade ago, Chinese political scientist Liu Junning pointed out that one of the defining features of the principle of subsidiarity is that governments at all levels should not be engaged in any work that can be done by the next lower level of government. All things which can be done by civil society organizations should not be done by the government. All things which can be done by individuals or families should not be done by government or civil society organizations (Liu 2003). However, Lui's observation reflects only part of the definition and, perhaps, the less important part. More important is the concept that higher levels of society (when seen as an organic whole) are meant to support or assist the levels below them. The original Latin meaning of "subsidium" carries this meaning of help, support, or assistance (Ross, 1993). Only later has the related English word "subsidiary" come to have a meaning of "subordinate to" as in the usage of “subsidiary companies” within a group of companies, and this can cause confusion for readers. Some writers suggest a third element to the principle, which is the respective competencies of the different levels should be clearly defined.

The Oxford English Dictionary definition of "subsidiarity" reads: “(in politics) the principle that a central authority should have a subsidiary function, performing only those tasks which cannot be performed at a more local level.” This definition is only partial in that it fails to include the meaning of support or assistance and does not include definition of competencies.

Uses of Principle of Subsidiarity

This principle has a variety of applications, and four main areas are in international law (especially European Community Law), in Catholic Social Teaching, in economic organisation of credit unions, co-operatives, and similar organisations, and in contemporary political discourse. This list is not exhaustive. Each of these is worth some discussion, but I will exclude the topic of economic organization of credit unions and co-operatives because this will be dealt with by another author. I will also focus on the modern development of the principle of subsidiarity, rather than its historical origins (Jiang, 2011).

International Law

The countries of Europe are slowly and resolutely moving towards an increasing degree of cooperation. What began as the European Iron and Steel Community has slowly expanded into the European Union. Understandably, this movement is very cautious. It takes place against a background in which localism is also powerful. We have seen the former nation of Czechoslovakia divide to become the Czech Republic and the Slovak Republic. The former Yugoslavia has splintered into many parts, and the process is not complete. At the same time, without nations breaking up, there is a movement towards the devolution of greater power at local levels. Thus, a local parliament has been formed in Scotland, a component of the United Kingdom of Great Britain and Northern Island. Yet, at the same time, as localism is powerful, there is also a constant increase in the degree of cooperation in Europe. The process of increasing cooperation has been uneven, and the recent history of the Euro shows how the limits of cooperation are constantly being tested. It is a process, and there will be many stages in the future.

Subsidiarity as a principle of international law has been written into international agreements, creating what is now the European Union (Lei, 2007). It allows the implementation of two political imperatives. One imperative is to avoid the centralization of all political and economic power in the Union headquarters in Brussels by protecting other levels of government, including national, regional, and local. The European people are not ready for full union and may never be. The second imperative is to provide a test whereby the validity of centralized legislation or action can be measured, and, thus, disputes can be settled through the European courts, rather than through armed conflict.

Article 5 of the Treaty on European Union contains the definition of the principle of subsidiarity. It ensures that decisions are taken as closely as possible to the citizen and that constant checks are made to verify that action at Union level is justified in light of the possibilities available at national, regional, or local levels. Specifically, it is the principle whereby the Union does not take action (except in the areas that fall within its exclusive competence) unless it is more effective than action taken at national, regional, or local level. It is closely bound up with the principle of proportionality, which requires that any action by the Union should not go beyond what is necessary to achieve the objectives of the Treaties.

As a legal principle, subsidiarity could also be of assistance among the nations of Asia. Perhaps even more slowly than the nations of Europe, Asian nations are learning to work together and build cooperative structures. Not surprisingly, the nations of Asia are very cautious about this process. In Asia, as in Europe, there is a history of wars, large and small, political, colonial, and hegemonic domination, and religious division. Some countries in Asia and Europe are new and not yet stable. There are powerful regionalisms and even rebellions in both Asia and Europe. However, clearly Europe has been able to move forward more rapidly than Asia. The application of the principle of subsidiarity helps each nation to make the cautious steps towards peaceful international cooperation.

Let us take an example. In the 1960s, European countries had only a few years earlier concluded a major war. Yet these nations were able to conclude a cooperative regime on boundaries and licensing of the petroleum resources of the North Sea. Perhaps this could be a model for Asian countries in areas such as the South China Sea. Professor Shen Dingli of Fudan University has suggested the co-management and development of disputed areas, waters, and resources (Shen, 2012). The application of the principle of subsidiarity could enable Asian parties to see the value of working, as far as possible, at the lowest national or sub-national level and to accept that higher structures that were to aid or assist the lower levels. This would assist a movement to co-management.

When considering the place of subsidiarity in international law, it should be emphasised that the principle of subsidiarity cannot be considered in isolation. It must take its place along with other principles of international law, and in the application of the principle of subsidiarity in the European Union, it is closely bound up with the principle of proportionality, which requires that any action by the Union should not go beyond what is necessary to achieve the objectives of the Treaties. Other principles of international law include respect for sovereignty, equality, and reciprocity, principles relating to treaties, and principles relating to human rights and dignity.

Catholic Social Teaching

Catholic Social Teaching understands human society as a complex network of relationships in which individuals participate in a wide variety of groups, including economic, social, cultural, sporting, recreational, professional, and political. The principle was first expressed in negative form in 1931: "Just as it is gravely wrong to take from individuals what they can accomplish by their own initiative and industry and give it to the community, so also it is an injustice and at the same time a grave evil and disturbance of right order to assign to a greater and higher association what lesser and subordinate organisations can do. For every social activity ought of its very nature to furnish help to the members of the body social, and never destroy and absorb them" (Pontifical, 2005). The forms of help (Latin *subsidium*) can include support, promotion, and development.

The principle of subsidiarity gives us a standpoint to analyse social and economic organs through the way in which they relate to the individual and to the social communities to which the individual belongs. Thus, subsidiarity has been used to critique unregulated and unrestrained market capitalism, which reduces the individual to an economic pawn, largely deprived of means of production. In the twentieth century, the principle of subsidiarity has influenced the distributivist movement, which has as its focus the distribution of the means of production to the lowest possible level. The principle continues to influence anti-trust legislation and anti-trust regulators, providing a basis for resisting monopolies and cartels and allowing the distribution of market power.

When considering the place of subsidiarity in Catholic Social Teaching, it should be emphasised that the principle of subsidiarity cannot be considered in isolation. Catholic Social Teaching is grounded in the human dignity of each individual, and subsidiarity is one of three pillars. The other two are the Common Good and Solidarity.

Political Discourse

We have seen that the principle of subsidiarity has influenced distributivisim and anti-trust. Perhaps it also has an influence on federalism. A version of subsidiarity is also part of discourse among conservative or libertarian thought, particularly as that is emerging in the United States of America. In this discourse, subsidiarity is sometimes equated with small government and limits to the function of government.

However, it should be noted that the principle of subsidiarity is neutral as to big government or small government. It simply relates to the appropriateness of taking decisions and action at the lowest possible level. It also sets out the function of higher levels to support or assist lower levels. Catholic Social Teaching articulates situations where it is necessary for the state to act directly in the economy and other aspects of society, at least on an exceptional basis. Also, some thinkers emphasize the importance of subsidiarity without balancing this with other principles. Catholic Social Teaching has three pillars: the common good, solidarity, and subsidiarity. Without these balancing principles, over-emphasis on subsidiarity has led away from social justice and towards an individualist conception of the public order.

Mencius and Subsidiarity

I sought to find some guidance in the Asian philosophical and spiritual traditions. I turned to the classical Chinese philosopher Mencius 孟子 (circa 372 to 289BC), who taught in the Confucian tradition. Mencius wrote on a variety of topics, but it is his teaching on social organisation that interests me in this context. Mencius was not afraid to challenge the rulers of his time, and his words have been kept for us. Mencius (14.14) said: "Of the first importance are the people, next comes the god of land and grains, and of the least importance is the ruler" (Zhao, 1999).

This text turns upside down the conventional thinking of the time. Conventionally, the people had to serve the spirits and to serve the ruler. Mencius makes us realize that the higher levels in a hierarchy are to be at the service of the lower levels. Also, the authority of the higher levels is subsidiary because its purpose is to undertake tasks that could not be practicably undertaken by lower levels alone. This can come as a surprise to those who think that subsidiarity stresses the subordinate role of lower levels. In fact, subsidiarity stresses the primacy of lower levels: higher levels can only be justified insofar as they support or subsidize the lower levels that are closer to the grass-roots. The text from Mencius is often quoted on a variety of issues, but I suggest that it also provides us with the insight into subsidiarity. Of course, Mencius is only one of many classical thinkers. Yet, his influence continues to resonate today. His wisdom may be uncomfortable for rulers or leaders in higher levels of organization, but his wisdom should not be forgotten.

Subsidiarity in Business and Professional Ethics

Subsidiarity is a principle of social organization. We know that none of us is an island, and even the smallest business requires some higher-level organisation. A sole proprietor running a small store cannot exist without complex services to supply the goods that he or she sells. A sole practitioner in medicine or law cannot exist without the complex arrangements and traditions that enable practice.

In fact, we are experiencing new levels of complexity in the globalization of business and of the professions. For example, recently, two law firms in China and Australia entered a new business relationship, forming one of the largest legal service organizations in Asia. When such unions bring together very different ethical traditions, the principle of subsidiarity can help us to enable appropriate ethical decision making within the new body. The principle of subsidiarity is not just about efficiency but has important moral or ethical consequences. It is not just about gaining popular support by devolving power to the grass-roots. Its basis is personalistic: that is, a conviction that each human person has a unique human dignity. The value of the person is ontologically and morally prior to organizations in society, even the family.

Part of that human dignity is also responsibility: not only does power belong to the lowest practicable level, but also the matching responsibility to act belongs at the lowest practicable level. Thus, there are two ethical issues here: the first issue is the ethical duty to order society in accordance with the unique human dignity of the person, and the second issue is the ethical duty of each person to act in accordance with their dignity and the responsibility it carries. It is the application of this principle that is the special task of ethicists in fields of applied ethics, such as business ethics or professional ethics. Philosophers might make their contribution, but practical ethicists have the task of finding the ways of applying the principle of subsidiarity in their own fields.

Another area of application for the principle of subsidiarity is in evaluating the work of professional organizations and business organizations. Do these organisations work to help, support, and assist the lowest level in the profession or business, giving emphasis to the development of all individual members? Or has the organisation been dominated by an outside group or a small clique within the profession or business? In Asia, business and professional organizations are growing in number and in maturity, and the application of the principle of subsidiarity can help to keep them rooted in the mass of members.

Subsidiarity and Its Contrasts

It may be useful to distinguish the principle of subsidiarity and its application from some other principles or practices that have some similar features.

Devolution or Delegation

Some modern business or management theories emphasise the importance of devolution of power and authority to lower levels in an organization, such as a corporation. This is sometimes called empowerment. Such a management practice should not be confused with subsidiarity. Delegation or empowerment relies on the delegation of power from higher levels to lower levels (for example, from a management office to the shop floor). By contrast, subsidiarity takes as its premise that power already belongs to the lowest possible level and is granted to higher levels only when necessary. Of course, the other side of the coin is that responsibility also belongs as far as possible to the lowest levels, starting from the individual human being and then moving into more complex sectors of society.

Centralization

Centralizing doctrines argue that the most efficient level of government is the central level because the centre has the maximum information or knowledge and the maximum power or leverage. Therefore, all resources should be best subordinated to centralized decision and control. According to centralizing doctrines, power and responsibility properly belongs to the centre, though it may in practice be delegated to subordinate organs. This is in contrast with subsidiarity as it is defined in this paper.

Federalism

Federalism, with its divisions of power and responsibility at different levels and with its clarification of respective competencies, can seem close to subsidiarity. However, they are not the same. Federalism is based on the unification of previously independent units into a single mega-unit while reserving certain competencies to the smaller units. Subsidiarity as a social philosophy applies as much in a unitary state as in a federal state. The European example reminds us that subsidiarity is also applicable in co-operative structures that encompass a number of states or other units.

Complementarity

The principle of complementarity has been applied in the establishment of the International Criminal Court. It is intended to emphasize that the court does not function in a national or international hierarchy of courts. It is not superior to or inferior to national courts. Rather, the International Criminal Court is intended to serve as a complement to existing national courts, having jurisdiction only when national courts are unwilling or unable to act (El Zeidy, 2008).

Conclusion

The principle of subsidiarity is grounded in the dignity of each human person and has a variety of applications: first, it is one of three pillars of Catholic Social Teaching; second, it has an important place in international law, especially in the development of European international structures; and third, it is a principle of societal and organisational arrangement. However, the principle has many definitions or applications. It has evolved in history, and the meaning of the principles has been amplified by experience. Like its companion pillars, solidarity and the common good, subsidiarity is complex. The principle has important ethical consequences in its approach to both responsibility and power.

The principle of subsidiarity is not magical. The application of the principle requires consistency and perseverance. However, it may be a useful principle for policy-makers in Asia to enable development in accordance with the human dignity of each person and to enable development in growing cooperation. For business and professional ethics, the principle of subsidiarity assists in promoting the growth of ethical individuals and enterprises that accept responsibility at every appropriate level of society. For governments, the application of the principle of subsidiarity may assist in cautious but ever-deepening peaceful cooperation.

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THE CONTRIBUTION OF EMMANUEL LEVINAS TO CORPORATE SOCIAL RESPONSIBILITY AND BUSINESS ETHICS IN THE POST-MODERN ERA

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Abstract: Emmanuel Levinas developed an ethics of inter-subjectivity and responsibility. According to the phenomenology of Levinas, moral impulse and intuition are elicited by the encounter with the Other. Encounter with the Other, particularly the face and the voice of the Other, gives rise to a sense of responsibility for that Other. Business leaders are challenged by Levinas' approach, to move from a way of doing business that insulates the corporations and its constituent members from customers and other stakeholders to engagement with the other(s) in ways that enhance their wellbeing, by creating positive social effects from the work of the corporation and engagement with corporate stakeholders.

Keywords: alterity, business ethics, corporate social responsibility, ethics of responsibility, inter-subjectivity, Emmanuel Levinas, Levinas, the Other (Autrie), phenomenology, stakeholder, stakeholders

Introduction

We live in the Post-Modern era.[1] Post-Modernism is a philosophy developed in reaction to the experience of World War II. Those who reflect on the human condition, namely philosophers, were disillusioned by the experience of World War II. Immanuel Kant's reliance on human reason and rationality became distrusted. Rule-based imperatives were discredited with the rise of Phenomenology and Existentialism.[2] Most of these intellectual developments occurred in Europe, the grounds of World War II. Phenomenologists and Existentialists were profoundly affected by the fact that Germany, one of the most intellectually and industrially developed nations, a home of the industrial revolution and of the development of bureaucracy, committed the human atrocities of the Holocaust. Emmanuel Levinas emerged in that context. Levinas was a Jewish Philosopher who was born in Russia (now Lithuania) and who migrated to France. Levinas was a student of Martin Heidegger, a leading philosopher of Phenomenology. Although Levinas was fully engaged intellectually with the philosophy of Heidegger, Levinas became disillusioned with Heidegger because of the latter's affiliation with the Nazis: Heidegger served as chancellor of Freiburg University under Hitler's ruling National Socialist German Worker's Party, the Nazis. In Levinas' view, Heidegger's cooperation with the Nazis demonstrated his lack of authenticity and the failure of metaphysics, an intellectual concern for Being (Dasein) divorced from ethics.[3] Levinas developed an approach based on encounter with the Other (Autrie) and responsibility for the Other.

Levinas' Ethics of Inter-Subjectivity and Responsibility

Emmanuel Levinas developed an approach wherein he rejected a Heideggerian analysis of being, or a subject-object analysis as "first philosophy." In "Is Ontology Fundamental?" Levinas understands that he breaks with "the theoretical structure of Western thought" when he articulates that "[t]o think is no longer to contemplate, but to be engaged. Launched—the dramatic event of being-in-the-world…[4] Levinas considered ethics to be "first philosophy." Ethics is concerned with the relationship of the self to the other (autrui), but ethics is other than knowledge. The Other ("autrui") is not an object of one's comprehension, and the fundamental being-ness of the Other is not reducible to one's comprehension.[5] Levinas was particularly concerned that the otherness (alterity) of the other (autrui) would be diminished through intellectual comprehension of the universal human condition.[6] Levinas understands that categorization and generalization, an inquiry of ontology and epistemology, whereby being and objects are classified as "the same," contains the risk that the ego seeks to reduce all alterity/ otherness to itself.[7]

Furthermore, and a reason that Levinas argues that ethics is "first philosophy" is that moral impulse and intuition are pre-rational and are elicited by the encounter with the Other.[8] The encounter with the Face of the other elicits a sense of responsibility of the self for the Other.[9] The encounter with the Other is alternatively cast as an encounter with the Other's voice, or touch/ caress, and is based on proximity to the other. The meaning of being is presented in a face to face relationship. However the relationship to the other is fundamentally a "speaking" relationship.[10] "I" means "here I am," present to the Other in vulnerability.[11] To Levinas, language is proximity to or contact with the other, not communication of information. The response to the alterity of the Other is responsibility and "putting oneself in the place of the other." "Putting oneself in the place of the other" is called "substitution" by Levinas.[12] The responsibility for the Other is not based on transactional symmetry or reciprocity.

Although Levinas' language is abstract, his approach appeals to and is verified in experience, particularly the experience of parenthood, as in the encounter of a mother with her newborn child. Some language of the ethics of responsibility is also couched in erotic love, but the imagery of silent appeal and asymmetry of relationship resonates more in the parental relationship. Although an intuitive understanding of the asymmetrical responsibility for the other can be grasped through the experience of parenthood or erotic love, Levinas extends the responsibility for the other beyond these relationships into an infinite responsibility for all others, although the content and specifics of the responsibility of the self for the Other(s) depends on the proximity to the other(s).[13]

Fulfillment of the self's responsibility to the other must acquire content to be meaningful. To do that, one must listen to the voice of the other, to determine his or her specific needs. However, there is a risk in identifying the other's needs, because the responsible self may seek to dominate the other in a well-intentioned effort to best serve the needs of the other. The voice of the other must be heard, but the issue of "whose judgment should prevail" arises in the effort to meet the needs of the other, according to the ethic of responsibility. Rooted in the conviction that I understand the needs of the other better than he or she does, I might over-ride the other's voice. The ethics of inter-subjectivity thereby swings between duty- based norms about how to meet the needs of the other and spontaneously responding to the face and the voice of the other and the expression the other's needs in this encounter.

The relationship of the self to the other becomes complicated or, at least, modified by the recognition of The Third (other): that there are other Others, to whom responsibility is owed by the self, and which are Others to the Other, to whom the Other is himself or herself also responsible. The introduction or recognition of the presence of the Third must weigh in the self's actions relative to the Other, who is the Neighbor. The alterity of the Other commands my response to the fact that I am not alone in the world as justice.[14] The concern with justice becomes intensified as the self realizes that there are other Others, "the Third," and that the Other is also a self who relates to the other Others or the Third in responsibility. For example, what are the ethics of a mother devoting so much attention to a single, disabled child that the other children in the family and her spouse are neglected? Or, is it ethical for a hospital to expend so many resources on the care of a single patient or a few patients that the hospital goes from "running in the black" to "running in the red" with the result that the hospital is unable to serve others in the neighborhood?[15] Questions of justice thus arise from the presence of the Third to the self and the Neighbor.

The question arises, "Can Levinas' ethics of inter-subjectivity and responsibility enrich Corporate Social Responsibility and Business ethics in the Post-Modern Era?"[16] Emmanuel Levinas' approach is that a genuine encounter with the other would avert the injuries to others perpetrated by corporations and the managers who are their agents under the guise of shareholder capitalism, economic development, and the costs of doing business.[17]

Application of Emmanuel Levinas to Corporate Social Responsibility and Business Ethics Using A Stakeholder Approach

The phenomena of corporate wrong-doing, corporate culture grounded in individualism and greed,[18] and corporate criminal conduct weigh in favor of the notion, or at least the need for, of a business ethics based on the phenomenology of Emmanuel Levinas. The Other: The first Other for corporate managers is the Shareholder, according to Berle and Means' "Theory of Managerial Capitalism." The encounter of a corporate manager with the Other, who is a shareholder, gives rise to a fiduciary obligation of the managers to the shareholder(s) and duty of prudence. Managers must recognize the opportunity costs and expectation of reasonable return on part of shareholders in the management of corporate affairs. Equity capital is that resource most at risk, since returns to the other factors of production are guaranteed if a firm is to remain a going concern or protected if a firm declares bankruptcy. It is easy to lose a sense of proximity to the shareholder. The scandals of Robert Brennan with the securities fraud by First Jersey Securities led to the loss of lifetime savings of his investors.[19] Enron's collapse led to loss of savings for employees who had vested their 401K investments in Enron stock. Enron Officers fraudulently engaged in sham transactions blocking employee shareholders from selling stock in the Fall of 2001 while the Officers were selling off shares.[20] Kenneth Lay and Jeffrey Skilling were later convicted of insider trading and securities fraud.[21]

However I would argue that the first "others," the others most proximate to the corporation are the customers. Customers are the purpose of the corporation, the others who are the recipients or beneficiaries of the product of the producing organization. Acts like Ford Motor Company's, and Lee Iacocca's cost benefit analysis about whether to recall Ford Pintos or to pay damages to the burn victims would never be done if Levinas' encounter with the face and voice of the other, and his approach of Responsibility to the Other were used by managers. More recently, some company officials of Sanlu Dairy Company knowingly included toxic additives, which enhanced the perceived protein content of the infant formula but which led to kidney damage and even death among infants drinking the tainted formula.[22]

The Third: other stakeholders. Employees, suppliers, the environment, and communities where the firms operate constitute the Third. Levinas' approach profoundly challenges corporations to lose the anonymity of their encounters with their customers, in particular, and to regard the situation of the others, including their employees, their suppliers, and the communities in which the corporate plants are located. For example, the decision in Russia to construct Chernobyl and other nuclear power plants without a concrete dome to contain possible radioactive products of a nuclear accident, thereby shifting the risks and costs onto the surrounding community, would not be made. Totale and Unocal in a joint venture constructed a gas pipeline in Burma (Myanmar) under conditions in which the human rights of villagers were violated. Interestingly enough, the films of an extraordinary producer director, Milena Kaneva, bring face to the villagers affected by Totale and Unocal in Burma[23] and to the Ecuador villagers in the Amazon rain forest whose land and waters were polluted by the oil mining and disposal procedures of Texaco. Texaco and Chevron, which purchased Texaco, defended its actions on the basis that it conformed to the environmental law in Ecuador of the time. Corporate executive should re-consider the approach of hiding behind legalities when they know that the production standards in use in less economically developed countries are not permitted in more economically developed countries; prudence requires a re-examination of that approach, particularly as the courts in Ecuador rejected Texaco/Chevron's defense and held the company liable for eight billion dollars, now increased to about 19 billion dollars in clean-up costs and other penalties.[24]

Implications for organizations: insularity of wealth and power. Disturbingly, face-to-face encounters of prison guards in the Nazi concentration camps with the Jewish and other prisoners did not always lead to the encounter giving rise to responsibility for the other. The guards insulated themselves from the human face and voice of the other, the prisoners in the concentration camps. Insulating mechanisms, such as referencing the prisoners by number rather than name, were at work in the case of the guards in the Nazi concentration camps.[25] Likewise, mechanisms are at work to insulate corporate executives from their lower-level employees and their customers. Corporations blunt the sensitivity of the self to proximate others; particularly accounting can reduce the other to impersonal terms. Corporate executives within corporations tend toward egotistic/ narcissistic pre-occupation with themselves and concentrate on how they appear to powerful others.[26] In identifying such narcissism, Roberts warns of a risk of a "terminal moment for ethics" because bosses within corporations "encrust" themselves in the notion that they are independent of others, thereby cutting themselves off from the fundamental premise of Levinas' ethics, openness to the Other.[27] Roberts points out the distancing effect of accounting systems on corporate life.

The so-called "neutral mirror" of business activity embodied in the accounting statements disembodies the work of the corporation, causing abstraction, loss of proximity with the actual work done in the corporation, and, particularly, contact with the corporation's customers.[28] Even though there has been a surge in the development of corporate codes of ethics starting in the 1990s, these reflect an ethics of narcissus rather than a genuine concern for the Other; codes of ethics were a shield in cases of wrong-doing by employees of the corporation under the U.S. Federal Sentencing Guidelines.[29] Corporations should re-focus their efforts from being seen as ethical to activating real issues of sensibility to the Other, particularly concern for their customers, their employees, and environmental sustainability. Measures of CSR need to be developed to counteract purely financial performance embodied in accounting systems. The triple bottom line is a step in that direction. Moreover, actions of CEOs, such as Southwest Airlines former CEO Herb Kelleher, who took pride in spending one day a month at the airports working alongside SWA gate crews, establish a culture of responsibility to employees and customers.[30] In addition to measures of CSR, performance measures must be developed to incentivize executives to personal engagement of the corporation and its executives with its stakeholders, including, of course, shareholders/ investors.

Conclusion: Beyond Philosophy to Action

In terms of the implications of the phenomenology of Emmanuel Levinas for business organizations and their actions, business leaders are challenged to move from a way of doing business that insulates the corporations and its constituent members from customers and other stakeholders to engagement with the other(s) in ways that enhance their wellbeing by creating positive social effects from the work of the corporation and engagement with corporate stakeholders.

Appendix: Managerial Incentives for Stakeholder Engagement

A multifaceted measurement of the stakeholder engagement is required, including measurement of engagement with and effect on shareholders, bondholders, supply chain, employees, communities where the firm operates, and the environment. For each of the dimensions of stakeholder engagement, a behaviorally anchored rating system (BARS)[31] should be developed. The rating system should include both harms and goods to the particular stakeholder. Executive compensation should be tied to the rating system. A compensation system should be developed that includes diminishment of compensation and claw backs for longer term consequences that come to light. For example, a stakeholder lawsuit would be counted negatively, with consequential reduction of executive compensation. Furthermore, prosecution and settlement with the SEC would be indicative of negative long-term relations with some stakeholders, including shareholders, bondholders, and insurers. Goldman Sachs settled its prosecution by the SEC for both selling and short-selling its CDOs.[32] Under this methodology, the executives of Goldman Sachs would return compensation as a consequence of the settlement with the SEC. Instead, the reality was that the CEO of Goldman Sachs, Lloyd Blankfein, received an increase in compensation in 2010, the same year as the settlement with the SEC.[33] Compensation plans need to be developed that evaluate CEO performance over time and with respect to multiple indicants of performance, as suggested herein.

Notes

1 Jean-François Léotard, La Condition postmoderne: rapport sur le savoir (Paris: Minuit, 1979). Translated by Geoff Bennington and Brian Massumi in The Postmodern Condition: A Report on Knowledge (Manchester: Manchester University Press, 1984).

2 Although Levinas' doctoral dissertation was on Husserl's Phenomenology and his theory of intuition, Levinas's development of the ethics of responsibility is based on and develops phenomenology, as interaction between abstract and concrete. Levinas came to consider Ethics rather than Ontology as First Philosophy, based on his life experience and his reflections on those experiences.

3 Martin Heidegger, Sein und Zeit, (Tubingen: Max Neimeyer Verlag 1927. See also, Martin

Heidegger, Being and Time, trans. by John Macquarrie and Edward Robinson (London: SCM Press, 1962) Martin Heidegger was the successor at the University of Freiburg to Husserl, who founded the philosophical school of Phenomenology. Heidegger was elected Rector of the University of Freiburg by the faculty in April 1933, when Adolf Hitler had been elected Chancellor of Germany; Heidegger joined the Nazi Party within a month of his becoming Rector of Freiburg. Heidegger gave several addresses which indicated his support of Nazism in Germany. See for example. "German Men and Women!", a speech delivered on 10 November 1933 at Freiburg university; printed in the *Freiburger Studentenzeitung*, November 10, 1933. English translation in R. Wolin, ed., *The Heidegger Controversy* (MIT Press, 1993), chapter 2.

[4] “Is Ontology Fundamental?” is an essay written in 1951, and serves as chapter 1 in *Entre Nous,* a collection of essays published by Levinas, translated by Michael B. Smith and Barbara Horshav (New York: Columbia University Press, 1998). Citation to p. 3.

[5] Emmanuel Levinas in *Entre Nous*, “Alterity and Diachrony, at p. 166.

[6] See Emmanuel Levinas in *Otherwise than Being*, at p. 131-132.

[7] Emmanuel Levinas in *Totality and Infinity*, at pp. 47- 48: “For the philosophical tradition the *conflicts* between the same and the other are resolved by theory whereby the other is reduced to the same…”

[8] Emmanuel Levinas, *Autrement qu'être ou au-delà de l'essence, 1974.* Published in translation as *Otherwise than Being or Beyond Essence* (Pittsburgh: Duquesne University Press, 1998)

[9] See also Zygmunt Bauman, *Postmodern Ethics* (Malden, MA, Blackwell Publishing,:1993)

[10] Some other philosophers understand the relationship of the self to the other as a “speaking relationship.” See for example, Martin Buber, I and Thou. See also Harold Stahmer, “Speak that I may see Thee,” and John M. Oesterreicher, “The Unfinished Dialogue.” For Levinas on Buber, see *The Philosophy of Martin Buber: Library of Living Philosophers Vol. 12* (Open Court Publishing: 1991).

[11] Emmanuel Levinas, “Substitution” in The Levinas Reader at p. 104.

[12] In substitution the self (moi) puts itself “in place of the other by taking responsibility for the other’s responsibilities.” Critchley and Bernasconi at p. 239. Levinas frames substitution as the passage of the “identical” subject to the other in sacrifice. This act of the subject is prior to consciousness and fundamental to the being of the self. See Levinas, *Otherwise than Being, or Beyond Essence* at p. 114*:* “The word *I* means *here I am,* answering for everything and for everyone” and at footnote 22: “Substitution is the communication of the one to the other and the other to the one…”

[13] See Levinas, *Otherwise than Being, or Beyond Essence* at footnote 22: “It is the proximity of the third party that introduces… justice…Being will be non-indifferent....because…space belongs to the sense of my responsibility for the other. The everywhere of space is from the everywhere of faces that concern me…” The extension of the responsibility for the Other is reminiscent of “Six Degrees of Separation,” wherein the hypothesis is that everyone in the world is connected to every other via a network of six persons, hence six degrees of separation.

[14] See *The Levinas Reader*, on Substitution at p. 117 – 118.

[15] This is a real life example, conveyed to the author in a private communication. It is likely, moreover, that such a dilemma is encountered by many other hospitals.

[16] See Jean-François Léotard, in La Condition postmoderne: rapport sur le savoir (Paris: Minuit, 1979). Translated by Geoff Bennington and Brian Massumi in The Postmodern Condition: A Report on

Knowledge (Manchester: Manchester University Press, 1984) distinguished post-modern as philosophy and as economic production. Thus, the Post-Modern Era is the Post-Industrial Era, a phrase coined by Daniel Bell, in economic history. The post-industrial revolution is also called the Third Wave by Alvin Toffler.

[17] In the business context, the "other" or others are stakeholders. The primary or most proximate stakeholder is the customer, not as finance would have it, shareholders of a corporation.

[18] http://www.nytimes.com/2012/03/14/opinion/why-i-am-leaving-goldman-sachs.html?pagewanted=all

[19] http://en.wikipedia.org/wiki/Robert_E._Brennan

[20] Tittle v. Enron, 463 F.3d 410 (5th Cir., 2006). See also, Ruling Lets Enron Workers Sue Lay, Northern Trust Over Lost Savings, Wall Street Journal, October 2, 2003.

[21] http://www.usdoj.gov/opa/pr/2006/October/06_crm_723.html

[22] See http://www.nytimes.com/2009/01/22/world/asia/22iht-milk.2.19593612.html?_r=0

[23] Milena Kaneva's documentary about the pipeline in Burma, Total Denial, received international recognition. See http://www.totaldenialfilm.com/

[24] http://www.businessweek.com/articles/2012-10-09/chevron-fails-to-squelch-19-billion-ecuador-verdict

[25] See Luna Kaufman, *Luna's Life: A Journey of Forgiveness and Triumph* (ComteQ Publishing: 2009).

[26] John Roberts, "Corporate Governance and the Ethics of Narcissus," in Business Ethics Quarterly (2001), Vol. 11, Issue 1, pp 109-127.

[27] Ibid. at p. 110.

[28] Ibid. at p. 117.

[29] See Henry Amoroso, *The Federal Sentencing Guidelines Endorsement of Corporate-Level Restitution: Furtherance of Public Policy or Discrimination on the Basis of Entity Capitalization?,* 18 Campbell L. Rev. 225 (1996).

[30] See *Flying High with Herb Kelleher: A Profile in Charismatic Leadership*, in the Journal of Leadership Studies, June 22, 1999, by Jane Whitney Gibson.

[31] Schwab, D. P., Henemen, H. G. and DeCotiis, T. A. (1975), *Behaviorally Anchore Rating Scales: A Review of the Literature*. Personnel Psychology, 28: 549–562.

[32] http://www.sec.gov/news/press/2010/2010-123.htm

[33] http://www.guardian.co.uk/business/2011/apr/02/lloyd-blankfein-executive-pay-bonuses

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RATING AGENCIES AND THE EUROPEAN UNION SOVEREIGN DEBT CRISIS: AN ETHICAL APPROACH

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Abstract: Credit ratings have become a key factor in today's financial markets. Their importance influence not only private finances but, also, they influence a country's finances, budget, economic policies, politics, and, in the case of Europe, credit ratings are modeling the whole EU structure and institutional development. Today, credit ratings are affecting the wealth and welfare of entire populations. The possibility of "*inside*" credit ratings has important economic and social implications and deserves study from an ethical point of view. In the present paper, we analyze the role Credit Rating Agencies (CRAs) in the European Union Sovereign Debt Crisis and its ethical implication. Using a historical, descriptive, and comparative methodology, this paper first presents 1) the development of the European Union sovereign debt crisis, then compares 2) the levels of debt in relevant developed countries, 3) presents the relevance of Rating Agencies in the financial markets, 4) analyzes their role in the European Union Sovereign Debt Crisis, 5) assesses the updating of CRAs regulation, 6) reviews the feedback from governments and other Institutions and 7) draws some conclusions and recommendations.

Keywords: credit rating; European Union; debt crisis

European Union Sovereign Debt Crisis Development

The European Union Sovereign Debt Crisis has been one of the hottest topics debated in news and financial analysis. We aim to study, from an ethical perspective, this subject, and, more specifically, the role that rating agencies play in the development of the events. Let us begin with a brief review of the main events. European countries' debt was not considered an issue until 2010 when came reports indicated that total Eurozone sovereign debt was €7,862 billion. However, most economists "trace the beginning of the European sovereign debt crisis to 5 November 2009, when Greece revealed that its budget deficit was (…) more than twice what the country had previously disclosed " (Voss, 2011). The deep causes of this crisis can be traced to the very structures and players that govern European institutions.[1]

The debt crisis revealed fundamental economic differences between northern and southern European countries. Some Southern European countries have had increasingly high debt levels, higher unemployment, and a loss of competitiveness. Northern Europeans tend to have lower debt levels and don't think they should compensate other countries' wrongdoings. However, there is a consensus among countries in the EU to continue the Union, and all together have to find the solutions. Below is a condensed timeline of the sovereign debt crisis development in Europe.

European Sovereign Debt Crisis Timeline

- **1992--**The Maastricht Treaty was signed, creating the European Union (EU). Its members are required to: keep low and stable inflation; keep low deficits and debt and have pro-growth policies; have stable exchange rates. The most important factor with regard to the European sovereign debt crisis will prove to be the fiscal requirements.

- **2004**--November 22: Greece admits that it manipulated the government's fiscal convergence criteria in order to gain admittance to the Eurozone.
- **2009**--November 5: Greek Prime Minister announces that Greece's annual budget deficit will be 12.7% of GDP — more than twice the previously announced figure.
  --December 8-22: Fitch and S&P ratings cut Greece's sovereign credit rating to BBB+ from A- with a "negative outlook." Moody's cut it from A2 to A1.
- **2010**--Greece initiates three different austerity packages.
  --Jean-Claude Trichet, President of the European Central Bank (ECB), extends less-restrictive collateral rules.
  --Credit ratings downgraded: Portugal down 2 levels, Spain and Ireland down 1 level, and Greece downgraded to Ba1=junk status.
  --Eurozone nations and the IMF agree to a €110 billion bailout plan. Eurozone nations must provide €80 billion and the IMF €30 billion to help bail out Greece.
  --The Eurozone nations create the European Financial Stability Facility (EFSF) and initially fund it with €440 billion in capital. It is designed to prop up faltering Eurozone economies. The EFSF provided loans to financially needy countries within the Eurozone, recapitalized banks, and bought sovereign debt.[1]
  --Greece, Spain, Italy, and Germany agree to austerity packages.
  --Hungary's Prime Minister announces that it is probable that they will default on their sovereign debt obligations.
  --November 28: Ireland agrees with the IMF and Eurozone members on a €85 billion bailout package.
  --December- Permanent bail-out mechanism established and stronger sanctions agreed upon by the European Council as an amendment to the EU Lisbon Treaty.
- **2011**
  --Strict fiscal rules enforced across the EU.
  --Emergency funding program established-the European Financial Stabilization Mechanism (EFSM).
  --May: Portugal agrees with the IMF and Eurozone members on a €78 billion bailout package.
  --Debt yields across the Eurozone rise dramatically as investors become increasingly skittish about Europe's prospects for resolving its crisis.
- **2012**
  --March 12: The IMF and Eurozone members agree on a €130 billion bailout package for Greece.
  --European Stability Mechanism (ESM) replaces the EFSM and EFSF to become a permanent rescue-funding program.
  --European fiscal union proposes more integration throughout Europe as a central body, and that it has more control over each member state's budget.

--Eurobonds issued by 17 Euro nations, excluding the highly oppositional Germany, to help takeover the debt. Investors and economists support Eurobonds and think they are the best way to solve the EU debt crisis.

--November 15: Third quarter gross domestic product (GDP) shrinks 0.1% in the Eurozone. This result compares to a second quarter shrinking of 0.2%. Countries worst hit include: Greece, Italy, Spain, Portugal, Austria, and the Netherlands.

--December 13: After endless negotiations, EU finance ministers announce that they have reached an agreement to form a banking union. A single banking regulator — the ECB — is thought to be a key to resolving this three-year-old crisis. Authority is granted to force troubled banks to close their doors and for bank capital ratios to be raised.[2, 3, 4]

This chain of events that led up to the sovereign debt crisis in the EU are coupled with the downgrading ratings of several EU nations. The role of the three American-based credit rating agencies in the events is widely debated and is the subject of study of our paper. Currently, the integrity, the reliability and the reputation of Moody's, Standard and Poor's, and Fitch are under debate.

Debt Crisis in Developed Countries

The causes of the sovereign debt crisis of the last years are a combination of multiple factors that evolved over time. To summarize, we can enumerate the following:

- The globalization of finances
- Easy credit conditions in the US during the 2002–2008 period encouraged high-risk lending practices.
- Easy credit conditions in the EU countries. The adoption of the euro led to many Eurozone countries of different credit worthiness receiving similar and very low interest rates for their bonds during years preceding the crisis. High-risk lending practices became widespread in some countries among consumers, as well as governments.
- The 2007–2008 US generated global financial crisis
- The 2008–2012 global recession
- International trade imbalances
- The bursting of real-estate bubbles
- Government over-expansive fiscal policy choices (revenues and expenses)
- National bail-outs of troubled banking and private bondholders. That meant nations assuming private debt and socializing losses

When talking about sovereign debt, we have to distinguish it from household debt and financial institutions debt. Due to high-risk lending practices, the last two were also spiraling and later, due to socialization of losses, accelerated the first. However, even if we are used to hearing about the European Sovereign Debt Crisis and the southern European economies as being the "culprits" of the situation, it is important to note two facts: first, the Sovereign Debt is not reduced to European countries, but is well spread in most OECD economies. Second, inside the EU, high levels of debt are prevalent among most of the economies, including the ones perceived as strong or risk free economies. Let us explain the first point: in effect, according even to The Economist Intelligence Unit, the position of the euro area looked no worse and, in some respects, better than that of the US or the UK. We can state that

- The budget deficit for the euro area as a whole (see graph) is much lower.
- The euro area's government debt/GDP ratio of 86% in 2010 was about the same level as that of the US.
- Between 2000 and 2012* The euro area's general government financial balances have been consistently over the UK and markedly over the US. (see Figure 1 Figure 2)
- Private-sector indebtedness across the euro area is markedly lower than in the US and UK

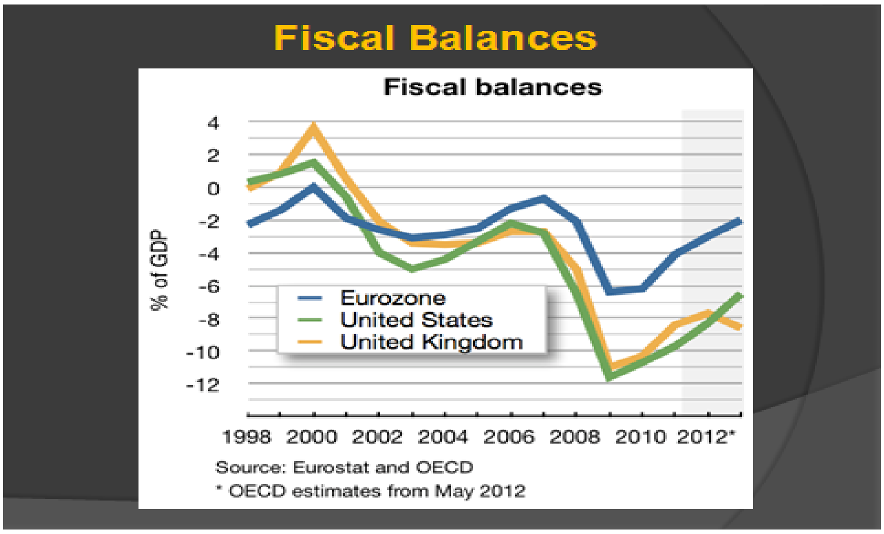

Figure 1. Fiscal Balances

Sources: Wikipedia, European Sovereign Debt Crisis. http://en.wikipedia.org/wiki/European_sovereign-debt_crisis

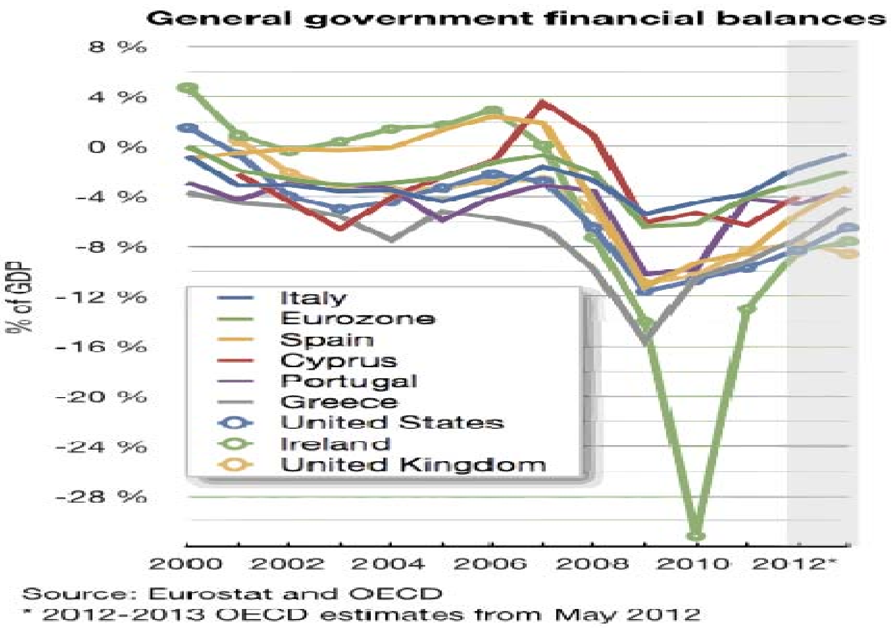

Figure 2. General Government Financial Balances

Source: Wikipedia, European Sovereign Debt Crisis. http://en.wikipedia.org/wiki/European_sovereign-debt_crisis

In absolute terms, the ten main debtor countries in the world are the United States, the United Kingdom, France, Germany, Japan, Italy, Netherlands Spain, Ireland, and Luxembourg. The biggest Eurozone debtors on the ranking are France and Germany, in the third and fourth place, both with around US$ 5.6 trillions each, the two "core" Eurozone economies. Ahead in the ranking is the UK in second place with US$ 9,8 trillions, and in the first place is the US with US$ 16 trillions. The UK is almost double the German or French one, and US debt is triple them. We can conclude that the crisis is extended to all the developed economies. The so called "Eurozone Sovereign Debt Crisis" could probably be more accurately renamed as the "Eurozone Sovereign Rating Crisis," as we will see as the present study develops.

Table 1. Ranking of Countries by External Debt

		Unit: Millions US $	Unit US $		
Rank	**Country**	**External Debt**	**Per Capita**	**% of GDP**	**Date**
1	United States	16,053,420	51,626	103	10-Nov-12
2	United Kingdom	9,836,000	156,126	390	30-Jun-11
3	France	5,633,000	74,619	182	30-Jun-11
4	Germany	5,624,000	57,755	142	30-Jun-11
5	Japan	2,719,000	19,148	45	30-Jun-11
6	Italy	2,684,000	36,841	108	30 June 2011 est.
7	Netherlands	2,655,489	226,503	344	30-Jun-11
8	Spain	2,570,000	18,260	84	30-Jun-11
9	Ireland	2,352,000	26,820	108.2	30-Sep-11
10	Luxembourg	2,146,000	3,696,467	3,443	30-Jun-11

(Source: Wikipedia, List of countries by external debt.
http://en.wikipedia.org/wiki/List_of_countries_by_external_debt)

Regarding the second fact, in effect, as we can see in Graphic 4, until 2010, the main total debtors in the EU were, in order, Germany, Italy, France, and the UK, the four economies considered to be the core EU countries. The so called "peripheral" European countries' debt seems not to be so peripheral. In terms of debt percentage over GDP, the situation does not depict a two-Europe clear divide. If we except Greece and Iceland, the main debtor as a percentage over is Italy. Portugal and Ireland are slightly over Germany, France and the UK and Spain as the best positioned of the 10 countries reflected. Noteworthy, is the case of the Netherlands which has one of the highest OECD countries debt percentages over GDP (see Table 1). The debt of the so called PIGS (Portugal, Ireland, Greece, and Spain) amounts to only to 6% of the overall Eurozone debt. We cannot endorse the 2-tier vision of the European debt and less the consideration that the debt crisis is confined to Europe.

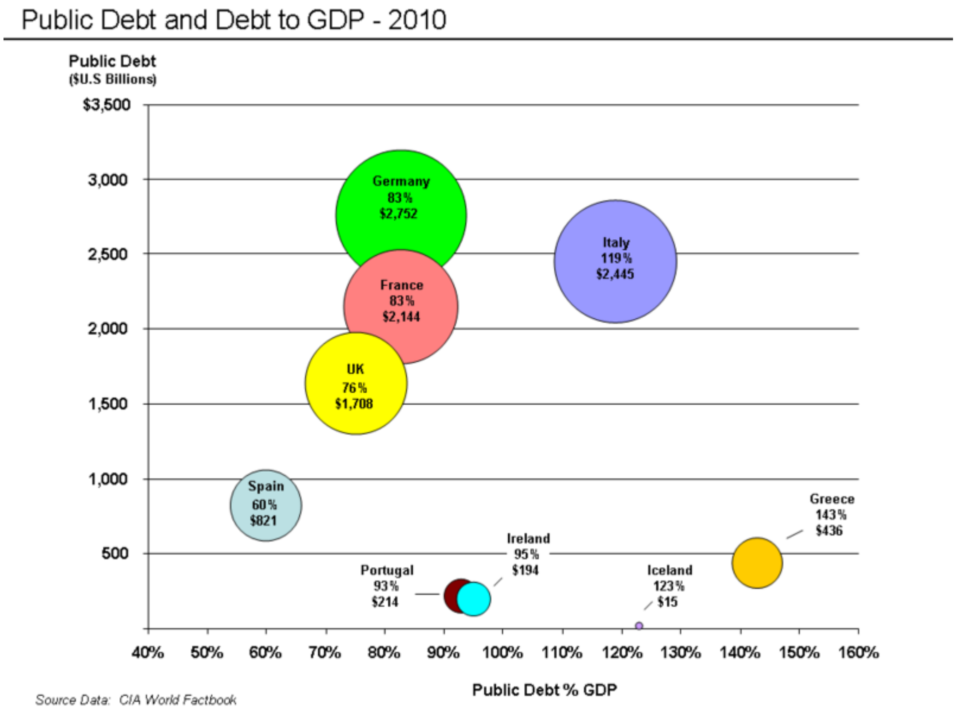

Figure 3. Selected Eurozone Countries 2010 Public Debt

Source: Wikipedia, European Sovereign Debt Crisis. http://en.wikipedia.org/wiki/European_sovereign-debt_crisis

The Rating Agencies Relevance in European Financial Markets

Rating agencies play a crucial role in financial markets because they are the reference to know about the reliability of bonds and securities. Ratings importance has grown over the years, not only because markets widespread use them, but because in the last few years, regulation has made them mandatory. That is the case of the EU regulatory reliance on credit ratings. The EU adopted in 2005 of the Basel II recommendations and transposed them in European Union law through the Capital Requirements Directive (CRD), which was effective since 2008. This force European banks and, more importantly, the European Central Bank to rely heavily on the assessments of credit risk marketed by the main CRAs. The problem derives from the fact these CRAs are practically reduced to two: the US firms, Moody's, and S&P. In this aspect, the EU Capital Requirements Directive is strengthening anti-competitive duopolistic practices akin to exclusive dealing. European governments surrendered most of their rating regulatory authority in favor of a private cartel non-European and lax regulated.[5]

The Role of the Rating Agencies and the European Union Sovereign Debt Crisis

During and after the Asian Crisis in the late 90s, the role of the credit rating agencies and the effects of their ratings was very controversial. Some authors, such as Ferri, Liu, and Stiglitz (1999)[6], have claimed that excessive downgrades on ratings took place then, leading the already struggling national economies into a deeper hole. The 2008 US generated global economic crisis has once again revealed the important role on the economy of the ratings provided by the CRAs and their inaccuracies. As a consequence of rating flaws, whole economies could suffer its effects. When analyzing the causes and effects of the European Sovereign Debt Crisis, with the background of the mentioned experience in Asia, but mainly due to the global economic crisis, the same questions are again, case of study. What if because of a wrong rating an innocent economy is seriously harmed? Since CRAs are not prone to reveal the real methodology they use to generate their ratings, Gärtner, Griesbach, and Jung (2011)[7] from University of St. Gallen, made a thorough econometric analysis on the effect of CRAs´ ratings on government spreads, based on annual data for 27 OECD countries between 1999 and 2010. Using variables, such as rating, GDP growth, GDP per capita, government surplus, government primary surplus, government debt, government bond yield (10-year), credit spread, and inflation, they obtained different models, all of them robust enough, to represent how sovereign debt ratings are formed through the estimation of relationships between ratings and macroeconomic and structural variables.

Then they decomposed actual ratings in two parts: a systematic and an arbitrary part; this one was unexplained by observed previous procedures of CRAs. The third step was the quantification of the effect of each of those two parts of a country´s sovereign debt rating on its bond yields in order to evaluate both the endogenous and the discretionary impact of CRAs on the market during the European debt crisis, especially concerning the PIGS (Portugal, Ireland, Greece and Spain) countries. Among the findings of the study are the following:

- Government effectiveness has a significant impact on sovereign debt ratings, while corruption has no explanatory power.
- Income growth has a statistically significant negative impact on sovereign debt ratings, which is strange because higher income by itself should bring lower debt ratio in the future.
- CRAs claim that their ratings are not affected by changes in the business cycle, but in the case of PIGS, the study does not support those claims. It seems that some developing counties not included in the study got over-ratings at the expense of PIGS under-ratings.
- There was no consequence of being a PIGS country before 2009, but after it, they were rated 2.30 notches lower than another country with the same economic fundamentals.
- Modified models are still consistent. About 80% of the predicted sovereign debt ratings are similar to those provided by the CRAs.
- The results suggest that PIGS suffered an excessive downgrade of their rating during the crisis.

The overall conclusion is that the PIGS were rated relatively worse during the crisis than all the other OECD countries of the sample. This flawed rating meant higher spreads on government bonds, further aggravating some European governments' financial situation and creating the so called "European Debt Crisis." Gärtner, Griesbach, and Jung (2011)[8] acknowledge that the PIGS were facing severe, home-originated economic problems, but just because they were targeted as a group, the PIGS group, got lower than neutral ratings and suffered unjustified financial damage that became a self-fulfilling prophecy.

The Impact of Rating on Credit Spreads

After separating actual ratings into a predicted part due to economic and structural variables, and an unexplained part, and after estimating each influence on the credit spread, it may be seen that markets respond to the unexplained part, which means that CRAs may have a discretionary effect on the interest rates that governments have to pay for credit. From new econometric analysis, the hypothesis that the credit spread is caused by the rating spread cannot be rejected. In fact, the rating spread of 2 of the 4 PIGS was not caused by the credit spread. This sustains that ratings are a relevant variable when obtaining credit spreads. The results insinuate that CRAs, through increased ratings that may not be assigned to economic fundamentals, may influence interest rates. Both the systematic and the unexplained part are highly significant.

The study has proven that markets and CRAs interpret economic variables in a different way. As the market does, it does not explain the increased credit spread of the PIGS countries, but the unexplained or arbitrary information could explain it. This concludes that CRAs may lead countries with an important debt ratio into serious problems. However, the excessive downgrade is not the only issue concerning CRAs and Europe. The precise moment in which CRAs have divulged the change of ratings has been extremely disruptive some times. As the EU Commissioner for Internal Market and Services, Michel Barnier said, "I have also been surprised by the timings of some sovereign ratings -- for example, ratings announced in the middle of negotiations on an international aid program for a country." “We can't let ratings increase market volatility further." Barnier claims that any agency that "infringes, intentionally or with gross negligence, the CRA Regulation, thereby causing damage to an investor having relied on the rating," should be taken to the courts.[9]

CRAS And Regulation

Due to the responsibility CRA´s have since investors, borrowers, issuers and governments worldwide rely on the ratings they provide, and in order to protect investors, governments have realized that tight regulation in the industry is a must, and some measures have been undertaken in the USA and EU. Let us review the main regulatory concerns that have been regulated. In 2006, The US Congress´ Credit Rating Agency Reform Act (CRARA) empowered the SEC to regulate CRAs in several aspects, except for their rating methodology. This law required the SEC to establish clear guidelines for determining which credit rating agencies qualify as NRSROs (Nationally Recognized Statistical Rating Agencies). This measure opened up competition to the industry. Concerning transparency and disclosure about CRA´s methodologies, conflicts of interest, use of confidential data, performance and commitment to issuers, the International Organization of Securities Commissions launched the 2008 IOSCO CRA Code, of voluntary implementation.

The Dodd–Frank Wall Street Reform and Consumer Protection Act, passed on July 21st, 2010, in its Title IX, known as the "Investor Protections and Improvements to the Regulation of Securities" in the Subtitle C, orders the SEC to create an Office of Credit Ratings (OCR), to supervise NRSROs, and regulate them. Its policies seek transparency and eradication of conflicts of interest. Regulation includes the requirement that rating agencies must, among others document an effective internal control over the implementation and adherence to policies, procedures, and methodologies for determining credit ratings,

(1) Submit an annual internal control report,
(2) Adhere to rules, policies, and procedures to avoid conflicts of interest,
(3) Notify users of identified significant errors,
(4) Report to authorities valid allegations of illicit conduct by issuers of securities.

It also establishes guidelines for corporate governance, organizational control, and management of conflict of interest. The Commission has authority to suspend or invalidate an NRSRO concerning a particular class of securities if the NRSRO cannot produce ratings with integrity. The OCR must examine each NRSRO at least once a year and must write a public inspection report. The European Union has passed three regulations concerning CRA´s since 2009. They are known as CRA1, CRA2 and CRA3

(November 2011). CRA3 changes significantly the CRA Regulation on issues including the dependence of companies on external credit ratings, sovereign debt ratings, competition within the industry, independence, and civil liability of credit rating agencies. Several proposals have been issued: a mandatory rotation rule that forces financial instruments´ issuers to switch the CRA every four years to get their ratings; this is not applicable to small CRAs; issuers of structured finance instruments should engage a minimum of two different CRAs for their ratings. To lessen the probabilities of conflicts of interest, CRAs should make public a shareholder with 25% or above of the capital or voting rights owns at least 25% of the rated entity.

In order to assure the independence of CRAs and their opinions, there would exist the prohibition of having more than 25% or more of the capital or the voting rights in more than one CRA. Furthermore, if a shareholder had at least 5% of the capital or the voting rights in more than one CRA, he would have to divulge publicly his ownership in each other. If investors or issuers suffered damage due to an infringement committed by the CRA, either intentionally or with negligence, they could claim damages from the CRA. Sovereign ratings should be reviewed a minimum of every six months (instead of every 12 months as it is now under general rules).

ESMA (European Securities and Market Authority) took over the supervision of CRAs in the EU i July, 2011. It is the regulator of CRAs in the EU, exclusively responsible for the registration and ongoing supervision of CRAs. ESMA is responsible for the registration of CRAs that operate in the EU; the supervision of registered CRAs, that is monitoring of CRA compliance with the CRA Regulation; taking supervisory measures and imposing fines in CRA Regulation infringement; submitting draft regulatory technical standards for endorsement by the European Commission; and assessing of third country regimes under the endorsement and certification provisions.

After a long period of lax regulations and enforcement, it is apparent the CRAs regulation reforms are on the fast track. Regulations are considering enforcement and legal liabilities in case of wrongdoings. At the same time, implementation --or explanation of non-compliance-- with the IOSCO Code of Conduct in CRAs own code is expected. Supervision Entities or Committees have been created or assigned, although at the present time we cannot yet extract any assessment regarding their efficiency on real performance due to lack of relevant data.

We do assess that US and EU regulation reforms are taking divergent orientations. Although both enforce transparency and organizational requirements to prevent conflicts of interest and corporate governance, the EU is much stricter in the sense that it encourages strict supervision of methodologies and rating results and stresses detailed CRAs civil liability penalizations and the agencies' registration requirements. The US SEC cannot “interfere” with ratings and methodologies. The US framework seems less advanced, is less regulated, and operates through market competence.

The big effort that is being made on regulatory issues must be recognized. The fact of being behind the CRAs activities helped the sub-prime crisis to arise. After 2008, both legislators and markets realized tougher regulation and supervision is a must. However, we shall recall that even with regulation and enforcement, law infringements cannot be fully prevented. Codes of conduct, encouragement of best practices, and having an ethical mindset are also needed in the professionals in the industry to prevent harmful practices.

The main objective of the IOSCO Code Fundamentals is to guarantee investor protection by assuring the integrity of the rating process. It is divided in four sections: The Quality and Integrity of the Rating Process, CRA Independence and the Avoidance of Conflicts of Interest, CRA Responsibilities to the Investing Public and Issuers, and Disclosure of the Code of Conduct and Communication with Market Participants.[10] Regarding each of the sections, the following need to be considered:

The Quality and Integrity of the Rating Process requires, among other things, that procedures (1) be written based on a thorough analysis of relevant data; (2) have rigorous methodologies; (3) have qualified personnel; (4) CRAs should keep internal records and have enough resources to carry out high-quality credit assessments; (5) there should be periodical review of methodologies and models; (6) there need to be monitoring and updates of the ratings; (7) CRA's analysts should be held to high standards of integrity.

CRA Independence and the Avoidance of Conflicts of Interest, for example says that, "A *CRA should separate, operationally and legally, its credit rating business and CRA analysts from any other businesses of the CRA, including consulting businesses, that may present a conflict of interest."*

CRA Responsibilities to the Investing Public and Issuers deals with transparency ("*A CRA should publish sufficient information about its procedures, methodologies and assumptions so that outside parties can understand how a rating was arrived at by the CRA.")* and the treatment of confidential information.

Disclosure of the Code of Conduct and Communication with Market Participants. "*A CRA should publish in a prominent position on its home webpage links to (1) the CRA's code of conduct; (2) a description of the methodologies it uses; and (3) information about the CRA's historic performance data."*

The Feedback from Government and Other Institutions

The influence that sovereign debt ratings have had over sovereign bond interests, the bulk of the sovereign debt amount, and its repercussion on some European government financial expenditures have prompted a widespread response among European governments. Policy makers have criticized ratings agencies for acting politically, accusing the Big Three of bias towards European assets and fueling speculation. Moody's decision to downgrade Portugal's foreign debt to the category Ba2 "junk" infuriated officials from the EU, especially Portugal. [11] State-owned utility and infrastructure companies in energy, airports and highways were also downgraded despite claims to having solid financial profiles and significant foreign revenue.

French central bank chief Christian Noyer criticized the decision of Standard & Poor's to lower the rating of France but not that of the United Kingdom, which "has more deficits, as much debt, more inflation, less growth than us." Similar comments were made by high-ranking politicians in Germany. Michael Fuchs, deputy leader of the leading Christian Democrats, said: "Standard and Poor's must stop playing politics. Why doesn't it act on the highly indebted United States or highly indebted Britain?" adding that the latter's collective private and public sector debts are the largest in Europe. He further added: "If the agency downgrades France, it should also downgrade Britain in order to be consistent."[12] Credit rating agencies were also accused of bullying politicians by systematically downgrading Eurozone countries just before important European Council meetings. One EU source noted that downgrading timings coincided the weeks of summits.[13]

Initial criticism has turned into action directed to create new alternative rating agencies. Those initiatives range from government-sponsored, private market initiatives and people-backed initiatives. In Europe in 2010, Germany's foreign minister called for an "independent" European ratings agency, which could avoid the conflicts of interest that he claimed US-based agencies faced.[14] European leaders are studying the possibility of setting up a European ratings agency in order that the private U.S.-based ratings agencies have less influence on European financial markets.[15, 16] The German consultant company Roland Berger is collecting funds to set up an independent, non-profit ratings agency by mid 2012. According to the company, setting up a new ratings agency would cost €300 million.[17] Another group, Bertelsmann Stiftung, presented a plan for establishing an international non-profit credit rating agency (INCRA) for sovereign debt.[18]

China bolstered the activity of a locally based rating agency, the Dagong Global Credit Rating (大公国际资信评估有限公司). Dagong become notorious in 2010 and 2011 for giving the US debt lower credit ratings than those given by the three traditional rating agencies, Moody's, Standard and Poor's and Fitch.[19] The ratings assigned by Dagong to the U.S., the UK, France, Belgium, Italy, and Spain were significantly lower than those the given by the three traditional rating agencies, but the major emerging countries ratings were significantly higher.[20] It is interesting to point that the U.S. Securities and Exchange Commission has refused to recognize Dagong's ratings.

Dagong is currently tying up with US and Russian partners to form a new group. The Chinese firm will set up the joint venture with Egan-Jones Ratings Co. (EJR), based in Pennsylvania, and Russia's RusRating JSC. The joint venture, called Universal Credit Rating Group, will engage in global ratings affairs.[21]

Other initiatives started in developing regions. Three of them, Global Credit Rating Co. (Africa), Pacific Credit Rating Co. (Latin America) and JCR/VIS Credit Rating Co. (Asia), are joining efforts to create the International Ratings Group, with the goal to create a single agency covering all the emerging markets: Africa, Middle East, Eastern Europe, South America and Asia.[22] Another innovative initiative is a web collaborative rating agency based on transparence, participation, and the concept of collective intelligence, called Wikirating. The contents are based on participation, and it diffuses its methodology and sources of information. Wikirating conducts ratings through cyber-polls and also elaborates its own index, The Sovereign Wikirating Index (SWI) is based on a formal methodology.[23]

Wikirating results show big disparities with traditional ratings. In the case of the US, while S & P rates it AA +, Wikirating grades the US BBB - (the last step before the "non-investment grade"); however, a country like Bolivia is rated above the US. Many of the new agencies are in compliance with the IOSCO CRA Code or intend to be so in the near future[24]. The International Organization of Securities Commissions (2009) point out that a number of factors that may have contributed to this, including the proposed EU regulations.

Conclusion and Recommendations

The role of credit ratings agencies (CRAs) in the latest financial crisis has been very controversial. After some evidence of wrongdoings in the 1997 Asian Financial Crisis, the role of (CRAs) in the US generated 2008 World Financial Crisis has been widely studied and analyzed. The studies highlighted flagrant conflict of interests and the lack of proper regulation and government control, resulting in an urge for a regulatory reform and control enhancement that has been taking place since 2010, especially with the passing of the US Dodd-Frank Wall Street Reform and Consumer Protection Act.

Since the end of 2010, we have been witnessing another financial crisis, the European Union Sovereign Debt Crisis that started at the end of 2010 and it is yet unfolding. This is a new phenomenon much less studied from the CRAs point of view. Parallelism and differences between both crises can be established. In both crises, CRAs were involved and had an important role, but while in 2008 the financial products that caused the crisis were private CDOs (Collateralized Debt Obligations) created and commercialized by investment banks that had previously paid CRAs to rate it in an unethical situation of conflict of interests, in the 2010 crisis the rated were sovereign bonds and the sovereign countries that issued them. In 2008, the problem was over-rating (Lehman Brothers was rated AAA almost until a few days before its bankruptcy); in 2010 the problem may very well be under-rating.

In the first case issuers, investment banking institution were ordering the ratings. It was in their interest that ratings were as high as possible in order to market the financial products they created. In the European case, it is just the opposite; financial institutions are the creditors and are direct beneficiaries of low credit ratings. The lower the ratings are, the higher the yields are. Given that new regulation and its implementation were focused at addressing former problems, we are tempted to suspect that a new form of conflict of interest may have evolved, also concerning CRAs and financial institutions, that tend to produce ratings lower than reality.

Rating results are a key factor in Europe Sovereign Debt Crisis. They are important not only in private finances, but they influence a country's finances, budget, economic policies, and politics and are modeling the whole EU structure and institutional development. Europe Sovereign Debt rating is affecting the wealth and welfare of entire populations. The slight possibility of conflict of interest or, to use another term, "*inside*" credit ratings, deserves to devote resources to conduct through technical research on the subject. Technical conclusions may pave the way not only for new regulation but also for a new ethical evaluation and understanding of the phenomenon. The conclusions and recommendations can be summarized as follows:

- Regulation of CRA's is a crucial factor for the accountability of CRAs. Governments and lawmakers understood the need and reacted, although it seems that the pace and extent of changes goes behind the evolution of markets.
- Regulation change is always a response to evolving situations. No regulation can be effective if there is no deep understanding of the market mechanism and its flaws. No deep understanding can be achieved if governments don't conduct thorough technical research to spot the flaws.
- Establish a '*supranational'* body of regulation. Although CRAs may be located and accredited in a particular country, the products rated may be issued in one or more different countries, and investors may probably be scattered all over the world. Rating is no longer just an in-country activity but a global one. National regulation and enforcement will lose its efficacy if it is issued by individual countries. An agreement between the main player nations will be needed in order to establish a supranational body of regulation.
- The Importance of enforcement and supervision can never be neglected. No matter what, regulations need to be enforced and supervised.
- It is important that the methodology used to issue the ratings is included in the regulation and supervision. According to US Law, there is an obligation to report the methods and procedures, but this doesn't mean that methods and procedures are regulated. Given the evolving nature of the science, the computation algorithms used in ratings are constantly progressing. That makes methodology regulation a difficult task. Regulation should be considered an ongoing activity, hand in hand with advanced research.
- In case of proven responsibility, liabilities provisions should be included and specified. EU legislation is more evolved in this aspect. Liabilities evidence is, again, the need of a

supranational law frame and supervisory institutions.
- Promote application of best practices in the industry as a complement to regulation and as a necessary bridge between regulation and ethical values.
- The promotion of ethical values is important to prevent and avoid injustice. Most rating agencies have already adopted a code of ethics, but their implementation is left to themselves. Transparency and supervision will be fundamental for sound implementation.
- Empower financial customers and their associations to pressure 1) law enforcement, 2) best practices, and 3) ethics codes implementation and accountability

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REVIEW AND REVISION: THEORY AND PRACTICE OF CORPORATE PHILANTHROPY IN CHINA

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Abstract: Corporate philanthropy has played an indispensable role in public welfare areas [1] in China since its emergence in the 1990s. As an "emerging philanthropic market" (Michon & Tandon, 2012) where entrepreneurship or corporate citizenship is still to be entrenched in the society, the progress of corporate philanthropy in China is crucial for cultivating the philanthropic spirit of society and fostering the growth of civil society. Therefore, it is worthwhile to pay more attention and make more investigation into the theory and practice of corporate philanthropy in China (Lu, 2002; Ge, 2007). The present paper aims to make a general review of the state of this particular area and to discuss potential ways to optimize current frameworks.

Keywords: corporate philanthropy, civil society, institutional constrains, resources

The Emergence of the Theory and Practice of Corporate Philanthropy in China

The spirit of benevolence has been practiced by the merchant elite in China since the late 17th century (Tsu, 1912; Yang, 1963; Smith, 1987, 1998; Shue, 1998; Shah & Chen, 2010). Budding capitalism and emergent merchant gentry in the late Ming and the early Qing periods fostered merchant philanthropy, foundling homes, and benevolent societies, and other welfare sponsoring institutions grew large and abundant. In the early 20th century, there appeared nascent entrepreneurship which promoted a retrieval of charitable enterprise in China (Tsu, 1912; Xin & Zhang, 1999). Charitable spirit and practice seem to rise concurrently with societal transitions in China. This may explain some of the characteristics of the beneficent tradition in China, such as liable to society, economic constraints of the transitional society, apt to be retarded by social instability and disintegration, as well as fugitive political agendas, and the tradition has kept being reconstructed in the changing context.

Corporate philanthropy has become a new version of the tradition. Corporate charitable activities started to increase in the early 1990s in China. In 1993, the first symposium on "corporation and commonwealth" was held in Beijing [2] representing the primary collaboration among the government, corporations, academia, and the media and aiming to promote benevolent enterprises and to make favorable policies available to corporate charitable donations. In 1994, Provisional Regulations on Enterprises Income Tax was promulgated by the State Counci l[3]. It stipulated for the first time fiscal incentives for corporate charitable giving. The severe flood in 1998 in China gave rise to a surge of corporate philanthropy to disaster relief [4], which led to the adoption of the Public Welfare Donations Law in 1999[5], further authorized tax breaks, and prescribed rules on the management and protection of donated assets.

The burgeoning corporate philanthropy reflected drastic changes of the social and economic landscape in China in the 1990s. Due to economic reforms and the open-door policy launched in 1978, the economic structure had undergone decentralization and diversification via the surging private business and foreign investment. As a result, the government's share of fiscal revenue dropped from one third of national income in 1978 to about one tenth in late 1990s (Xin & Zhang, 1999, p. 89) [6], and the non-public sector's [7] contribution to the gross domestic production (GDP) increased from less than 1% in 1978 to 55% in 1999 [8] with the accommodation of the employment up to 90% of the labor market (Zhang, 1998; Gu et. al., 2006). With the erosion of the government's capacity to deal with social needs, it had to transform its role from monopolizing the conduct of affairs to turning to more market-oriented modes. Corporate philanthropy thus turned to be a resource applicable for the public welfare enterprises.

Along with the process of reconstructing the social-economic resources, civil society emerged as public agenda in China since the late 1980s (Shen, 1986, 1990; Huang, 1988; Liu & Wang, 1988; Wakeman, 1993; Ma, 1994). The Party Central Committee issued a resolution in 1986 [9], aiming to promote legal knowledge among the people and strengthen socialist civic awareness. The government published a *Handbook for Citizens* in 1988 [10] to expound on civic concepts, such as democracy, rule-of-law, citizens' rights and duties, public ethics, social discipline, right protection, etc., although universal suffrage, parliamentarianism, multi-party system, and so forth were still labeled as capitalistic ideas. Nevertheless, such promotions and discussions played consciousness-raising roles towards corporate citizenship in the society and illustrated that there did not necessarily exist confrontation between civic power and the Chinese state (Wakeman, 1992; Duara, 1992)[11].

Following the civil society discourses, corporate social responsibility (CSR) issues started to become concerns (Lu, 1997; Wu, 1999). Since the early 1990s, a critical strand in CSR for multinational corporations (MNCs) in China has been a focus on environment and labor conditions in the supply chain. MNCs and domestic corporations in global supply chains started to report their codes of conduct and performance on CSR since 1997 (Wang & Juslin, 2011; Zadek, 2012). It has been increasingly recognized since then that the answer to this challenge could only be reached by building the management capacity of the corporations and the enforcement capacity of public institutions. This cognition turned to pressure on Chinese enterprises both from the government and from the public for pursuit of better behavior, including engagement in philanthropy. The pressure from the public existed as people tended to compare Chinese corporations with MNCs in China in respect of CSR performance and charitable practice, and they often conceived the former as much less satisfactory than the latter, although the former did donate more (Lu, 2002; Ge, 2007). This may show the impact of foreign direct investment on local perception and practice of CSR and philanthropy (Chapple & Moon, 2005), and show that CSR must evolve beyond its roots in philanthropy and compliance. However, for many domestic corporations, philanthropic engagement might be an easier way to establish more positive public images.

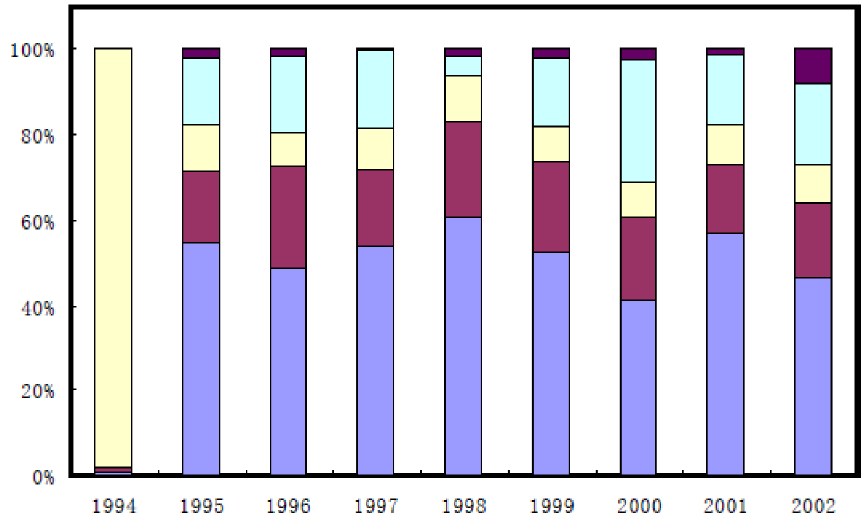
Chinese corporations, especially the privately owned, had to face another reality -- the accelerating development of the market economy during the 1990s shattered the old egalitarian socialism and dealt a fatal blow to its simple social structure, which boosted economic prosperity on the one hand and led to social and political problems on the other hand (Xia, 1999). Among the people who rapidly became rich, private entrepreneurs were beneficiaries of the government-dominated reallocation of social and economic resources. Their participation in social and charitable enterprises was sometimes interpreted as a means to maximize their economic and political interests or be legitimized from the society (Bian &

Qiu, 2000; Su & He, 2010; Gao, 2011).

In brief, the emergent corporate philanthropy in the 1990s was as an outgrowth of the economic reforms. On the one hand, Chinese corporations were becoming increasingly autonomous from the state. On the other hand, they were also under tremendous social, economic, ideological, and ethical pressures. Corporate philanthropy at this stage was, thus, characterized by all these factors and started to become part of a new paradigm of conducts for Chinese enterprises. Although it has been recognized that corporate volunteerism and donations started to play critical roles in aiding the poor, improving education, providing disaster relief, etc. in the 1990s (Shue, 1998; Lu, 2002; Ge, 2007), research and firsthand data accounts of corporate charitable activities are far from adequate.

Shue (1998) categorized four Chinese philanthropic models: (1) state-initiated and managed activities at the national level, (2) state-initiated and managed charity drives and community-chest-like foundations at the provincial and local levels, (3) merchant- entrepreneurs and corporate giving, and (4) sporadic independent charity activists. Type 3 seemed to have failed her interest in sorting out horizontally organized and relatively autonomous associations of philanthropic undertakings, as she did not pay much attention to it. She drew the conclusion that the role merchant-entrepreneurs and corporate giving played reflected the government's attempt to impose a moral-social vision that comprehensively incorporates both official and nonofficial actions, which blurred the distinction between state welfare and private philanthropy (p. 351).

Nor did Este's (1998) investigation of Chinese foundations and private philanthropy in the 1990s contain much detailed information about corporate philanthropy, although he generally credited private and corporate donations as the main source of revenue of GONGOs. Xu et al (2005) exemplified this point with the case of the Shanghai Charitable Foundation (SCF, 上海市慈善基金会). The following chart indicates the sources of the funds received by SCF from 1994 to 2002:



Corporation/individual; Overseas; Government; Incremental; Others

SCF was set up by the Shanghai Committee of People's Political Consultative Conference in 1994. It is notable that since the second year, the government's fund was cut down sharply and corporate and individual donations became the main source of its funds. Here, the mixture of corporation and individual donations again reflected the lack of detailed, well-organized accounts of the source of donations [12]. Some researchers have pointed out the private or non-public corporations have played overwhelming roles in charitable enterprises compared to the state-owned or public corporations since the 1990s [13] (Lu, 2002; Xu et. al., 2005; Ge, 2007), and corporate donations are not only made indirectly (via the third part, e.g. foundations), but also directly to aiding the charitable programs initiated by the government, NGOs, or corporation themselves (Ma, 1994; Lu, 2002; Utting, 2003).

There were two investigations with a focus on private and corporate philanthropy in 1999 and 2000, sponsored respectively by the Ford Foundation and UNICEF. However, only the first research was published (Lu, 2002), which presented general observations about 456 corporations' charitable and voluntary actions in Shanghai. The followings are Ge's conclusions drawn from the findings of these two studies (Ge, 2007):

(1) Among 436 corporations in Beijing, Shanghai, Shenzhen, and Chengdu or 503 corporations including Shanghai, above 90% of which had donated money, products, other goods, and other forms of voluntary activities since they were set up.
(2) Domestic corporations[14] donated more than foreign or foreign-invested corporations in China. In 1999, there were 48% of the former and 42.3% of the latter in four cities that donated; the level of donation (sum of donation: total sales) of the former was 0.79% (private corporations: 0.87%, state joint stock corporations: 0.7%); the latter was 0.56% in Shanghai.
(3) In terms of the paradigms of the charitable donations, domestic corporations were more altruistic, pointing to disaster relief, aiding the poor, supporting isolated areas, and educational sponsorship; foreign or foreign invested corporations were more mutually benefitting, mainly pointing to areas where their products or brands had influence.[15]

What Ge tried to argue was a) the efforts of corporations, especially domestic private corporations' contributions made to charitable enterprises, had not been adequately recognized and respected; b) corporate philanthropy in China should adopt a cooperative model, i.e. government encouragement of corporations to participate in public welfare enterprises in reasonable ways, while heavy scot burden and hypercriticism from the public were main obstacles for the development of corporative philanthropy in China. While looking from the civil society perspective (Shue, 1998; Este, 1998), lack of independence /autonomy for pursuing social and public well-being substantially hindered the development of corporate philanthropy in China.

No matter how vexatious it is to define or circumscribe the role of corporate philanthropy in the 1990s, it is obvious that it had become one of the main resources of charitable enterprise in China. This, again, has reflected the characteristic of the transitional philanthropy in China. As Smith (1987, 1998) noted, in spite of government's domination, social, economic changes can have even greater impact on the development of philanthropy in China. For example, merchant philanthropy in the early Qing dynasty distinguished philanthropy in the late Ming dynasty in that the moral-based gentry or scholar-official initiative model was weakened, and the more commercialized institutional charitable model obtained popularity. The underlying reason is that with the collapse of the Ming Empire and the justification of moral standards of the society (Yang, 1963; Smith, 1987), philanthropic activities were practiced largely by successful merchants with more concern for their business resources and the market in the Qing dynasty.

Mark Sidel (1997) compared Vietnam and China with respect to corporate voluntary and philanthropy. While he recognized shared similarities of the two countries, he also pointed out that the former was more integrated into the government-dominated charitable enterprise and, thus, had slower but smooth growth; the latter was more defiant, sometimes oppositional to the government-dominated model, which had led to even more care and the exercise of more control from the government. In other words, corporate philanthropy in Vietnam had less institutional pressure than that in China. Given that the high level of institutional pressure should continue while the roles of entrepreneurship should keep rising in the society, it can be expected that corporate philanthropy in China will develop on a large scale and in more strategic ways.

Breakthrough and Obstacles of the Theory and Practice of Corporate Philanthropy in China

It is notable that corporate philanthropy in China emerged in a particular context, which was characterized as "Guo-tui min-jin" (state retreat and civic advance) in social and economic areas (Wang & Yin, 2001; Yu, 2011).[16] Although the situation has been different since 2000, the government reset its role in social and economic areas[17] aiming to rebalance social and economic development;[18] some have called this "Guo-jin min-tui" (state advance and civic retreat (Wu, 2009; Deng, 2010); it is generally recognized that philanthropic enterprise has substantially progressed in China in the 2000s.

A UBS-INSEAD study of 2011 reveals that 72% of Chinese philanthropic organizations have been formed since 2000 [19] According to "The Statistical Report of Social Services Development in 2010" (Shehui fuwu fazhan baogao/社会服务发展报告) by the Ministry of Civil Affairs (Guojia minzheng ju/国家民政局), the third sector's growth is on a steep rise. As of 2010, there were 444,000 social organizations registered as such, which does not include an estimate between 1 and 1.5 million of unregistered or under the corporate legal label; in 2001, they were 211,000. Moreover, the amount and the size of donations depict a decided upward trend, hitting a record high of RMB 76.22 billions (US$ 11.55 billion) in response to 2008 Earthquake in Sichuan Province [20].

According to the UBS-INSEAD study, Chinese donors prioritize the four sectors: education, health, development and poverty, and disaster relief. They cumulatively account for roughly 60% of the total donations. The finding is in line with the Asian region's trend. However, development and poverty in China receives proportionally fewer donations than in any other country, and it is eventually surpassed by culture and arts (*Philanthropy Management*, 2012). The Hurun yearly China Philanthropy List of 2012 [21] reveals universities are currently the largest recipients of donations. This might be imputable to their higher transparency, as well as to an alignment with the interest of the government in raising the bar in the higher education.

Interestingly enough, we can observe a structural change in the composition of philanthropic donations over the years, which favors an increase in the proportion of local contributions over foreign aid [22]. Wang Zhenyao, director of One Foundation Research Center at Beijing University, observes China is undergoing a "mind emancipation movement" (*China Daily*, 2011). Leaders of this movement are high net-worth individuals and officials who are contributing financial and intellectual capital to the third sector. The monetary wealth of these entrepreneurs allows them more room to get through the costly registration process of private foundations (*China Daily*, 2011). Besides, the Internet has contributed substantially to the increase in the public pressure to give (Zachary, 2012).

As strengthening evidence, Beijing Normal University's School of Social Development and Public Policy Report of 2011 have documented that private foundations have surpassed public ones for the first time [23]. Nevertheless, according to the report, public foundations keep receiving a comparatively higher number of donations, which suggests that the government's influence is still strong. Indeed, the Charity Law of 2004 prevents individual private foundations from fund-raising with the public [24]. A revision of the law is expected by December 2013 within the "five year charity plan." The updated provisions purport to establish a more favorable climate for NGOs and philanthropic activities. Something that has already occurred on a municipal basis, for instance, in Guangdong Province (*Philanthropy Management*, 2011).

The recent economic boom and the increased participation in the global dialogue have contributed to activate the interaction among the different levels of Chinese culture. This allows a thorough understanding of the "Mind emancipation movement" referred to by Wang Zhenyao in part one. Besides, the substantial national contributions to the Wenchuan Earthquake reinforce the argument in favor of the existence of the seeds of a systematic philanthropic effort at the outburst of the calamity in 2008.

Further, the high growth rates have attracted worldwide attention around the drivers and components of such an outstanding economic performance. Entrepreneurship, specifically social entrepreneurship, is an important dimension to be considered. In fact, it touches on fundamental issues, such as the space for individual initiatives and the role of the civil society (Lal, & Clement, 2005; Li et al., 2009). In a broader sense, social entrepreneurship addresses the issue of respect of human rights and disparity and inequality, which are among the most debated and controversial aspects of the China's growth (Bardhan, 2008; Wolf et. al., 2011). Thanks to its flexible forms and market-based solutions that generate employment opportunities, it is a powerful means to address the magnitude of problems of the Chinese case (*Philanthropy Management*, 2012). Social enterprises are, also, the most compatible with the new forms of philanthropy and impact investment discussed in the prior section of the paper. Indeed, being private-for-profit companies, they fall outside the scope of NGOs regulations about fund-raising. Thus, we believe the combination of the two phenomena will play a major role in the development of the third sector in China. To make this happen, however, present bottlenecks that hinder their interplay must be addressed.

However, true social enterprises have a great potential to exert a positive influence over the social and economic life of their community of origin, and they often face substantial management challenges. Attraction and retention of human resources, limited access to funding, and poor governance structures hinder their quest for sustainability, and they constrain a "scaling up" process, which could magnify their impact (Schoning et al., 2012). At the same time, philanthropists and investors lament the poor transparency of such entities. Although ready to give in principle, they do not trust the use of their resources. For these reasons, many attempts at professionalizing the sector have started in Western countries by private entities [25], as well as national governments[26], and Supranational Organizations. Measurement of social impact has emerged as a critical need of the enterprises both to understand the extent of the fulfillment of their mission and as a way to consolidate their business model (ICCR, 2011).

Given the local character of social entrepreneurship initiatives, field studies stress the role of contextual variables in their execution (Seelos et al, 2010). As a matter of fact, Cecilia Zhang from LGT Venture Philanthropy points to the inability of financial planning as unique to China. Chinese Social Entrepreneurs are often incapable of estimating their financial needs, and, instead of presenting budgets, they ask the funds to give them "*how much they can*" (FYSE, 2012). On the other hand, lack of clarity in the requirements for funding eligibility boosts criticisms towards Chinese investors (FYSE, 2012). This evidence supports the fact assessment methodologies crated for social enterprises operating in developed economies might not be suitable to the context of the Developing World. Nevertheless, on one side, due to the relative youth of the phenomenon, and on the other due to resource constraints, few local actors from Developing Countries have engaged in the creation of ad hoc models (Shahnaz & Tan Shu Ming, 2009).

Social impact measurement of regular business, PPP and BOT in China, is in its infancy (Zhao & Wang, 2010; CSD, 2010), which adds to the poor availability of trained personnel that could help social enterprises develop their own. The Social Impact Assessment (SIA) is, in fact, still subsumed into the Environmental Impact Assessment (EIA) (Tang et al., 2008; CSD, 2010). Barrow (2000) has outlined the main differences between SIA and EIA. He has held the former participatory in nature, whereas the latter rather technical. The revised Chinese EIA guidelines have made it mandatory for stakeholders' consultation (Xiao, et al., 2012). This, which goes into the direction of Barrow's understanding of SIA, is in line with the Chinese government's objective of achieving a harmonious "Xiao Kang" (well-off society) by 2020 (UNDP, 2006).

Although, traditionally, there was no lack of philanthropic roots in the culture, the transition of the economy towards a market economy since 1980's has cultivated entrepreneurship and corporate charitable culture gradually in China. Corporate philanthropy as a social enterprise is still immature and lagging behind China's economic growth (Zhao, 2007; Su & He, 2010; Jiang, 2010). While the complexities have been explored and analyzed by some of the researchers (Lee, 2009; Lan & Galaskiewicz, 2012), it might be still necessary to address some key issues.

The concept of civil society (*gongmin shehui*) in China began to emerge in the late 1970s (Hua, 1990)[27] mostly thanks to the open door policy introduced by Deng Xiaoping. Therefore, its understanding has to be contextualized on the grounds of political and ideological influences. Non-governmental organizations' (NGO) unclear status is a direct consequence of those influences. Gudrun Wacker of the EU Institute for Security Studies[27] points to two main aspects: on one hand, not all Chinese social groups would meet Western standards to be considered NGOs [28]; on the other hand, government organized non-governmental organizations (GONGOs) form a self-standing category.

A number of factors hinder a backing of the movement of private and corporate philanthropy by the Central Government. Among these, ideological control plays a major role, with the recent scandals involving private not-for-profit organizations adding to the list of deterrents[29]. One for all, Guo Mei Mei's lavish life-style cast serious doubts about the accountability of The Red Cross Society of China and, by extension, of other philanthropic bodies (Wong, 2011). The young lady claimed a title as commercial general manager at the Red Cross. Therefore, the pictures of expensive cars and exclusive parties on her blog generated heated reactions from the public due to the dissonance with the institution she represented (Wong, 2011).

Conclusion

Discussions about Chinese philanthropy are often full of ambivalence. To some, philanthropy is rooted in the culture and plays dynamic roles in various contemporary contexts (Tsu, 1912; Jacobs, Gao, & Herbig, 1995; Smith, 1998). For instance, Tsu laid the spirit of Chinese philanthropy in the Confucian philosophic root "benevolence is love of human." To him, Chinese philanthropy derived from benevolence as a personal virtue (almsgiving) and then extended to social virtue, such as institutional charity in late empire times, and turned to be part of the institutional design (i.e. practical democracy and local self-government) in modern China. However, to others, such spirit and practice may be just substitutes of philanthropy, as Shue (1998, p. 351) claimed in that these charitable undertakings are in no way "even remotely resembling the horizontally organized relatively autonomous associations of the civil society model."

In the particular area of corporate philanthropy, while criticisms seem quite popular, obscure motivation and goals, lack of accountability, and sustainability, etc. are frequent remarks towards the state of art of corporate philanthropy in China. There are also optimistic analyses that highlight the vigorousness and promising future of corporate philanthropy in China. For instance, in Michon and Tandon's research (2012) based on a "robust market screening methodology" and already successful fundraising operations taken from the World Value Survey, China, along with Canada, the US, Australia, Switzerland, etc. was located in the first quadrant of the philanthropic market map, indicating a high rank of for private and corporate donations and potential for a philanthropic market.

It's obvious that different views have derived from different approaches to corporate philanthropy in China, each of which might have offered some elements of the answer to the vexatious question: What is corporate philanthropy in China? However, the question that remains are, how should we construe these dichotomous analyses into a comprehensive understanding of the state of art of the subject in question? In order to approach such a comprehension, the first step is to establish a global view of corporate philanthropy like the following:

Dynamic-multiplied paradigm of corporate philanthropy in China

Economic paradigm:	State planned economy				Market Economy
Era:		1980s	1990s	2000s	
Social-Economic Transition:	Centralized Power	Market Establishment (domestic)	Economy Transformation (globalized)	Social-economic Reconstruction (rebalanced)	
Philanthropic Model:	Government-controlled philanthropic model		Cooperative model	Civil society model	
		Government Foundations	GONGOs, Private and corporate Philanthropy	GONGOs & NGOs Private and corporate Philanthropy	

The points of the above diagram include: 1) Other than approaching to corporate philanthropy in China in static, isolated fashions, the Dynamic-multiplied paradigm takes the progress of corporate philanthropy in China into a continuum in which each new advance makes some difference compared to the previous ones, and each new state of development is contextualized in its social-economic background. Thus, it can make us better informed about the characteristics of corporate philanthropy in China. The civil society model would only make some sense in understanding the dynamics of the progress of corporate philanthropy in China - since the progress would not have happened without discharging some elements of the old model and integrating into some new elements from the civil society model. 2) The implication of the Dynamic-multiplied paradigm also lies in the possibility to develop a new tool kit to observe, analyze, and measure the development of corporate philanthropy in China in both macro and micro views. For instance, by integrating economy, market, government, and corporate philanthropic practice dimensions with calibrating means, developing an index could be established to measure the state of development of corporations. It is, also, possible to develop models for the reference of corporations to develop their own philanthropic strategies.

Here we'd say a few words about the development of a social impact measurement tool suitable to raise the budget planning capability of social enterprises and align it to philanthropists' requirements. One of the purposes of this paper is to provide a basis for applied research about New Philanthropy's role in the development of social entrepreneurship in China. Departing from the traditional theories of philanthropy, we have acknowledged the emergence of participative forms of philanthropic behavior, among which are impact investments. These are mirrored by the needs of the nascent sector of social entrepreneurship within the Chinese context. However, poor transparency and lack of trust prevent the establishment of effective channels of communication and resource transfers between the two parties.

Therefore, we propose development of a social impact measurement tool suitable to raise the budget planning capability of social enterprises and align it to philanthropists' requirements. We suggest a stakeholder [30] approach in order to enhance the participatory nature of SIA.

The relevance of such an endeavor stems both from its originality and from its practical utility. Indeed, it will go beyond merely describing a state of facts. Rather, it will provide social entrepreneurs with a tool they can use to assess whether or not they are satisfying the expectations of their stakeholders, and with a set of best practices and problem-solvers. Besides, SIA proves a powerful way to plan future action, which would substantially increase transparency and facilitate access to funding and grants.

We value the possibility of developing the research in an on-going activity of SIA modeling to be carried out at partner institutions. The network of selected players will both benefit from the benchmarking and collection of best practices, and from the development of the model in a standard version useful to impact investors in developing countries.

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Notes

[1] According to the Public Welfare Donation Law (Article 3), "public welfare undertakings" refer to following non-profit activities: (1) Activities carried out by social bodies and individuals to provide disaster relief, aid the poor, and give support and assistance to the physically disabled; (2) Educational, scientific, cultural, public health, and sports undertakings; (3) Construction of environmental protection facilities and public utilities in society; (4) Other public and welfare undertakings in society that aim to promote social development and progress.

[2] The symposium was co-organized by the government, state and private corporations and the media, and was
reported by the official magazine Trends in Philosophy (哲学动态), Vol. 12, 1993.

[3] The symposium was co-organized by the government, state and private corporations and the media, and was
reported by the official magazine Trends in Philosophy (哲学动态), Vol. 12, 1993.

[4] I.e. Qiye Suodeshui Zanxing Tiaoli (企业所得税暂行条例), State Council 1994. It was revised and turned into
the Enterprise Income Tax Lax, i.e. Qiye Suodeshui Fa (企业所得税法) in 2008.

[5] The flood caused direct loss of 300 billion in US dollars, more than three thousand casualties, and 2.23 billion of the I.e. Zhonghua Renmin Gongheguo Gongyi Shiye Juanzeng Fa (中华人民共和国公益事业捐赠法), adopted by the 10th Session of the Standing Committee of the Ninth National People's Congress on 28 June 1999.

[6] According to the Development Index of Civil Economy and Society of the Ninth Five-Year Plan ("九五"时期国民经济与社会主要发展指标)of the Bureau of Statistics of China (国家统计局), government's fiscal revenue was 1/10, 1/11, 1/12, and 1/13 of the GDP from year 1996 to 1999. See: http://www.stats.gov.cn/tjsj/qtsj/95/95.htm#top

[7] According to All-China Federation of Industry and Commerce (中华全国工商联合会), "Non-public economy" (非公有制经济) refers to those out of the state-owned or state-held joint and collective economic bodies, including domestic private economy and foreign (including Hong Kong, Macao, and Taiwan) invested corporations. See:
http://www.acfic.org.cn/publicfiles/business/htmlfiles/qggsl/yjs_mjsj/200910/15283.html

[8] According to the data from the above resource, 42.8% was from domestic private economy, 12.6% from foreign and Hong Kong, Taiwan invested corporations.

[9] I.e. Resolution Concerning the Guiding Principles of the Socialist Spiritual Civilization Construction.

[10] Xie Bangyu (ed.) 1988: Gongmin shouce (Handbook for Citizens), Beijing: Huayi Press, 560 pgs.

[11] Wakeman and Duara presented their standpoints on the Sino-US symposium on contemporary history of China, Fudan University (Shanghai), May 1992. Their points were summarized by Wang Licheng (1992) in "Probing contemporary China's modernization process," Fudan Journal (Social Science Edition), No. 4, pp. 85-89.

[12] It's also notable that compared to corporate donations, individual donations have been a very small portion of the charitable giving in China. The only exception was the donation for the Sichuan earthquake in 2008. See Lu, 2002 and Ge, 2007.

[13] According to Lu(2002), private corporations outplayed the state owned or state joint stock corporations due to better fiscal performance, better management, and better understanding of corporate social responsibility (CSR).

[14] In the 1990s, there had developed eight types of corporations according to the constitutions of capital assets and their status in the economy, which were usually classified into public and non-public economies, or the state-owned/state-holding, inner-capital (i.e. Neizi minying qiye) and foreign-capital (i.e. Waizi qiye) corporations. See the Bureau of Statistics of China: http://www.stats.gov.cn/tjsj/qtsj/95/95.htm#top, or All-China Federation of Industry and Commerce:

http://www.acfic.org.cn/publicfiles/business/htmlfiles/qggsl/yjs_mjsj/200910/15283.html.

[15] Lu (2002) only offered the following chart, which indicated ways of donation among the corporations in his study. Types of corporation were not indicated:

Ways of donation	Donated before 1999	Donated in 1999
Total corporations: 503	465	335
Cash	90.5%	86.9%
Own products	30.8%	19.1%
Products of other companies	43.9%	22.4%
Charitable service	13.1%	11.9%
Charitable facilities	9%	6.3%
Others	2.6%	3.9%

[16] According to Wang & Yin (2001), there were over one hundred and sixty eight thousand laid-off individuals from the state-owned corporations from 1996 to 1997.

[17] For example, there had been experienced a great drop of its share of fiscal revenue from one-third of the national income in 1978 to about one-tenth in the late 1990s; this share returned to between 20-30% in the 2000s. See The Bureau of Statistics of China (国家统计局), http://www.stats.gov.cn/tjsj/qtsj.

[18] For instance, there had been no new foundation registered from 1998 to 2004 due to the government's straightening. Since 2000, the government has more consciously highlighted its roles in public welfare and charitable enterprises. This includes consecutive declarations in the government reports and the five-year plans for the development of national economy and society, producing governmental compendiums of guidance as well as promoting comprehensive legal system to regulate and standardize charitable enterprises.

[19] UBS-INSEAD. (2011). *Study on Family Philanthropy in Asia*. Retrieved on October 21, 2012 from http://www.insead.edu/facultyresearch/centres/social_entrepreneurship/documents/insead_study_family_philantropy_asia.pdf

[20] Wang, M. (2009, May). *Reports on the Civil Society Action in the Wenchuan Earthquake: China NGOs in Emergency Rescue*. Social Sciences Academy Press, p.1.

[21] http://www.hurun.net/usen/NewsShow.aspx?nid=215

[22] The Beijing Normal University's report gathered the data from China Foundation Center, an NGO active in mapping foundations all over Mainland China among the other services. More on the findings of the report, which was presented in occasion of the Third China Private Foundation Forum, can be found at http://www.chinadaily.com.cn/china/2011-11/25/content_14158536.htm

[23] The Chinese Government is currently revising the Charity Law of 2004, with an updated version expected as of December 2012. Discussion about the topic and monitoring of the evolution can be followed on the website of The International Center for Not-For-Profit Law at http://www.icnl.org/research/monitor/china.html

[24] Although many examples could be made of successful social business incubators and promoters, the Skoll and Schwab Foundation for Social Entrepreneurship peak as main drivers and global

influencer.

[25] Hua Yifu 1990: A reflection at the first anniversary of the June Fourth Incident from the perspective of political culture, The Nineties, June 1990, pp. 54-55.

[26] Wacker, G. (2012, October 5). Chinese civil society in a time of leadership change. *EU Institute for Security Studies*. Retrieved on October 21, 2012 from http://www.iss.europa.eu/publications/detail/article/chinese-civil-society-at-a-time-of-leadership-change/

[27] Wacker characterizes traditional Western NGOs as non-profit, private, voluntary, and self-governing

[28] UBS APAC philanthropy investment team leader D. Hayward-Evans imputes improper organizational practices and governance mechanisms were at the root of those scandals, rather than the individual culpability of donors. Eventually, this did not constitute an extenuating circumstance. http://www.philanthropy-management.com/news/Administration/Legislative_focus_on_philanthropy_in_China_set_to_accelerate.aspx

[29] Wacker, G. (2012, October 5). Chinese civil society in a time of leadership change. *EU Institute for Security Studies*. Retrieved on October 21, 2012 from http://www.iss.europa.eu/publications/detail/article/chinese-civil-society-at-a-time-of-leadership-change/

[30] The UN Global Compact Human Rights Working Group has further endorsed a Good Practice Note about stakeholder dialogue as a way for companies to align their business with the ten principles of the Global Compact Board of the Group available at http://www.unglobalcompact.org/docs/issues_doc/human rights/Resources/Stakeholder_Panels_Good_Practice_Note.pdf

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STAKEHOLDER PERSPECTIVES ON CORPORATE SOCIAL RESPONSIBILITY (CSR) OF MULTINATIONAL COMPANIES IN CHINA

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Abstract: With the advent of globalization, the track record of multinational companies (MNCs) has been vague in relation to their corporate social responsibility (CSR) in developing countries. What is even lacking is a better understanding of what exactly is required of today's MNCs to simultaneously generate profits for shareholders and satisfy the legitimate demands from the multiple stakeholders in the countries where they operate. Adopting the stakeholder theory framework and using a two-stage interview method, this study explores the CSR understanding and practices of MNCs considered as active in CSR. The findings reveal some interesting CSR practices by 11 MNCs in China. We discuss implications of the stakeholder approaches to CSR of MNCs generally and peculiarities in developing countries more specifically.

Keywords: corporate social responsibility, stakeholder theory, multinational companies, China

Introduction

Research on corporate social responsibility (CSR) has focused on the social responsiveness and social performance of companies in the developed economies (Margolis & Walsh, 2003; Orlitzky, Schmidt & Rynes, 2003). With the growing presence of multinational companies (MNCs) in the emerging countries, it is likely that MNC subsidiaries from developed country contexts, such as the United States or Europe, will find themselves embedded in a situation in which CSR conception and practices are different than what are prevailing in their home markets. It presents both a theoretical and practical question regarding how MNC subsidiaries approach CSR in emerging markets and whether or not they face particular challenges in aligning their CSR with local practices or expectations (Hou, Fu & Li, 2010). Yet, there is limited literature on multinational companies and their corporate social responsibility in emerging economies.

Our study is to gain a preliminary understanding of this issue and is structured around the stakeholder theory (Freeman, 1984), which views a business as a set of interwoven relationships among groups that either affect or are affected by the activities of that business. From the perspective of stakeholder theory, a business is considered successful only insofar as it can effectively balance and generate value for its stakeholders, especially stakeholders beyond the shareholders.

Our study aims to explore the following questions: 1) How do MNCs define CSR in China? 2) What are the key stakeholders for MNCs in China, and how do MNCs attribute importance to each stakeholder? 3) What are the most common CSR practices towards each stakeholder group? To address these questions, we first review the literature on CSR and stakeholder theory, followed by the presentation of our research study, including data collection and analysis. Then we present our findings based on interviews with top leaders or CSR managers from 11 multinational companies considered active in CSR activities. We conclude by discussing the implications of our preliminary study to both theory and practice.

Study Background

Over the past decades, corporate social responsibility has acquired a new resonance in the global economy. While the conceptualizations and practices of CSR have been typically developed in the context of nation-states, the process of globalization is bringing a "paradigm shift" as local, national, regional, multinational, and global corporations are subject to a new economic, political and social framework that is both global and fragmented (Scherer & Palazzo, 2008). With the accelerated global expansion of multinationals, as well as their rising economic and political power, more attention has been paid to the CSR issues of multinationals in the emerging economies characterized by unclear property rights, ineffective legal framework, and lax monitoring force (Tan, 2009). Moreover, the expanding reach of media coupled with advances in information technology, such as the Internet, has allowed immediate and widespread exposure of corporate activities in even the most remote corners of the world.

Multinationals are, therefore, under greater scrutiny and subject to more attention than ever before, especially when operating in the developing world where institutional and market environments are markedly different than those in their home countries. While there is abundant evidence of greater awareness and engagement with CSR among multinationals, there is mixed characterization of their involvements. For example, Jamali, Zanhour, and Keshishian (2009) found a lack of systematic, focused, and institutionalized approach to CSR of MNC subsidiaries in the Lebanese context. Tan's 2009 study in the Chinese context also highlighted the discrepancies of host and home country institutional environment to influence MNCs' social decision-making. Based on these empirical findings, they argued that the understanding and practice of CSR are likely to be molded by specific national and institutional realities. These realities reflect the status quo within developing economies and emerging markets. The level of institutional and societal development of the host country are likely to influence the prominence and sophistication of the CSR discourse and practices within a particular society (Campbell, 2007; Yin & Zhang, 2012).

CSR and Stakeholder Theory

One of the compelling arguments for why firms are motivated to invest in CSR programs comes from the domain of stakeholder theory (Argandona, 1998; Harvey & Schaefer, 2001; Post, 2003). Stakeholders refer to any group or individual who can affect or are affected by the achievement of the firm's objectives (Freeman, 1984). The stakeholder approach to CSR popularized by Freeman (1984) and Donaldson & Preston (1995) provides a useful theoretical lens to shed light on the peculiarities of CSR approaches (see Figure 1). Reconceptualizing the nature of the firm, the stakeholder theory suggests that only by meeting the needs of the company's various stakeholders can the organization survive and succeed (Freeman, 1984). Among the whole set of stakeholders, the primary groups of shareholders, employees, consumers, and government usually have been shown to exert pressure on business organizations to adapt their strategies (Freeman et al, 2004). However, secondary stakeholders, such as community, general publics, and NGOs, have been traditionally paid less attention to (Bondy, Matten & Moon, 2008) and have especially low status in the developing country contexts (Tan, 2009). It is unknown how multinational enterprises prioritize and balance the interests of different stakeholder groups.

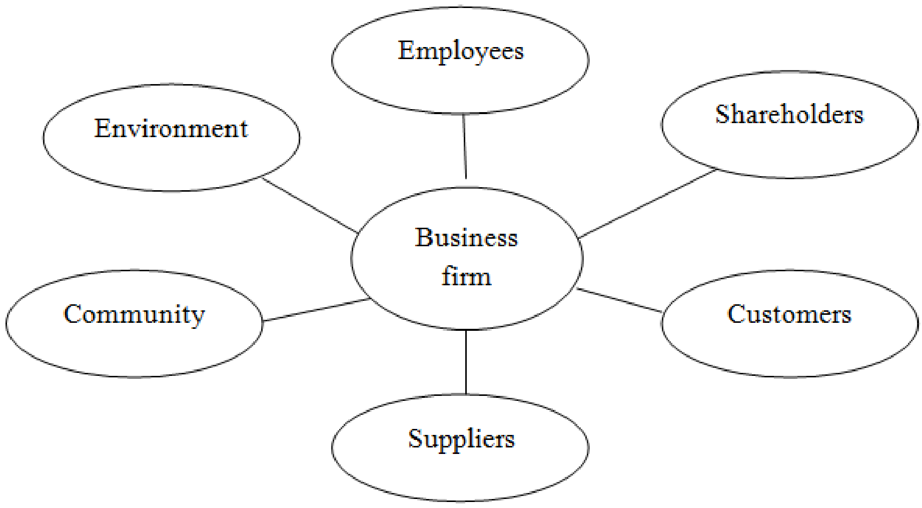

Figure 1. Stakeholder Approach to Corporate Social Responsibility
(adapted from Freeman, 1984)

Two Interview Studies

Using the stakeholder theory, the current research designed two studies to understand how MNCs operating in China view CSR within the Chinese context. We aimed to understand their articulation of their responsibility toward each stakeholder and what best practices they employed to fulfill their responsibility. In Study 1, we interviewed a sample of MNCs and a sample of Chinese companies. The purpose was to identify any obvious differences or unnoticed similarities regarding CSR philosophy and policies, as well as the major stakeholders of a company in the Chinese context. In Study 2, we focused on multinational corporations with a strong reputation for their strong CSR orientation. We aimed to identify their conception of CSR responsibilities and best practices related to each stakeholder.

Study 1: Exploring the Meaning of CSR and Identification of Major Stakeholders

Data Collection and Sample

Study 1 includes telephone and face-to-face interviews in July and August 2011. Altogether, 47 interviewees were reached through social networks, such as CSR sustainability- related web forums. Roughly half of them (25) come from professionals working in MNCs, 12 respondents from consultancies and public relations companies, and 10 respondents from Chinese companies, social enterprises, and other institutions. Our exploratory questions focus on CSR definition, stakeholder identification, CSR policies and departments, and obstacles to CSR. The interviews were conducted online, by telephone, or in person at the interviewee's office. We took notes during the interviews. The content from all three methods were analyzed to find the major themes. The results were reviewed and discussed among the research team members until agreement was reached regarding the major findings.

Study 1 Findings

The findings from this study can be summarized as follows: 1) Definition. CSR has been mostly defined as pervasive to company operations instead of a set of unrelated policies in the company. The internal dimensions of CSR received substantially more emphasis compared to the external ones. In other words, the interviewees expressed more attention on benefits to employees than benefits to community in their CSR involvements. 2) Stakeholders. The interviewees perceived that their employers put the most value on owners/shareholders and customers; specifically, smaller businesses tend to attach primary importance to the owners, and service businesses believe customers to be their most important stakeholders. Employees usually were considered second (after owners) or third (after owners and customers). A very small number of the interviewees also mentioned government and suppliers. 3) CSR policies and departments. Opinions are quite divided between those who deemed it important to set up a dedicated functional department for CSR in the organization that plan, guide and monitor social performance, and those who feel it an additional cost that would divert corporate resources. Moreover, many interviewees mentioned that compliance has been a problem with CSR policy implementation. In other words, operating units or subsidiaries in China do not always follow the CSR guidelines or policies established by the headquarters of the multinational corporation. 4) Obstacles to CSR. A lack of CSR awareness impedes the widespread adoption of best CSR practices in other units or other companies. Cultural differences, such as short-sightedness, overemphasis on profit objective and reluctance to change, also were identified to be obstacles to CSR development in China.

Study 2: Identifying Stakeholder-oriented CSR Responsibilities and Best Practices

Based on the learning from Study 1, we designed an interview study to explore further how MNCs approach CSR in China. We chose a sample of MNCs with the reputation of being progressive on their CSR. We interviewed the managers responsible for CSR to learn about their CSR policies and practices in relation to each of the major stakeholders.

Data Collection and Sample

Before the interviews, we read all publically available documents related to the companies' CSR activities for information about how each company presented itself with regard to its CSR engagements. These were used to prepare the interviews and to triangulate interview data. To capture the experiences and interpretations of relevant actors, a semi-structured interview method was used. All together, 13 interviews were conducted with key informants from 11 MNCs from June to December 2012.

We first identified a list of MNCs which are known for active CSR involvement in China, selected either by nomination of CSR research organizations or through previous CSR prize-awarding lists. All of the companies in our sample are leading Fortune 500 companies in respective industries with headquarters in the United States and Europe. The sample description is provided in Table 1.

Table 1. Case Sample

Company Code	Business Details	Position of Manager Interviewed	Years of Operation in China	Size of Subsidiary
MNC1	An American multinational retail corporation that runs chains of large discount department stores and warehouse stores	Senior Public Relations Manager	Since 1996	Over 100,000
MNC2	An American multinational corporation that offers data storage, information security, virtualization, and cloud computing products and services which enable businesses to store, manage, protect, and analyze massive volumes of data	Manager, Dept. of Corporate Citizenship & Government Affairs	Since 1996	Not available
MNC3	The second world largest professional services network in the world by revenue providing audit, tax, consulting, enterprise risk and financial advisory services	Director, Brand & Communication	Since 1917	Over 13,500
MNC4	A Fortune 500 corporation that designs, manufactures, distributes and services engines and related technologies, including fuel systems, controls, air handling, filtration, emission control and electrical power generation systems	Manager, Corporate Social Responsibility	Since 1979	Over 8,000
MNC5	An upscale mid-priced brand of hotels, as well as one of the world's largest hotel chains	Area GM (Beijing)	Since 1984	1051
MNC6	A chain of full service, upscale hotels catering to business travelers and to the meetings and conventions market	General Manager	Since 1984	1051
MNC7	The largest chemical company in the world and headquartered in Germany	Chief Representative	Since 1982	Over 6,000
MNC8	A pharmaceutical company headquartered in Belgium with the aim of conducting	Deputy General Manager	Since 1985	Over 3,000

	pharmacological research			
MNC9	The second-largest chemical manufacturer in the world by revenue manufacturing plastics, chemicals, and agricultural products with a presence in about 160 countries	China Sustainability Leader	Since 1979	Over 3,500
MNC10	The biggest German automaker and the second biggest automaker in the world	Executive VP, Finance; Executive VP, Corporate Affairs & JV Relations	Since 1984	Over 20,000
MNC11	A carbonated soft drink sold in stores, restaurants, and vending machines in almost every country, voted as the world's most valuable brand	Community Affairs Manager	Since 1979	Over 48,000

To ensure the anonymity of the company we promised the interviewees at the beginning of the interview, we used MNC1, MNC2, instead of real company names. The purposive sample (Baker, 2002) consisted of top or middle managers responsible for the development and implementation of CSR strategy within their organizations. The interviews lasted from 40 minutes to 90 minutes and were conducted in English. Interviewees were asked to discuss their understanding of CSR in general, the company's key responsibility towards different stakeholder groups, and specific CSR implementation processes and lessons learned during implementation. The interview guide is listed in the Appendix.

Data Coding and Analysis

All the interviews were transcribed and the content double-checked by the researchers. The constant comparative method was used to analyze the data (Langley, 1999; Miles & Huberman, 1998). The analysis focused on detecting commonalities or patterns of agreement in the statements. The first round of coding involved open coding, that is, categorizing the data into thematically relevant categories (Strauss & Corbin, 1998). Each interview was coded based on the themes identified within. All the themes and related explanations and examples were recorded in an Excel spreadsheet. The second round of coding involved further abstraction and dimensionalization, that is, grouping themes by similarity of ideas and allowing movement from concrete to more general and theoretically meaningful themes (Strauss & Corbin, 1998). The second-round coding resulted in fewer higher-order categories and relevant sub-categories. These categories were further checked with existing literature to ensure the themes were mutually exclusive and, also, collectively inclusive of all the data.

Study 2 Findings

We start with the CSR managers' views on the definition of CSR, then move to identification of the key stakeholder responsibilities for MNCs operating in China, and last, MNCs' best CSR practices in relation to each primary stakeholder.

Definition of Corporate Social Responsibility

Table 2 summarizes the interviewees' definitions of CSR. About half of the companies in the sample identified with a stakeholder view of CSR, equating CSR with stakeholder management. The companies adopting the stakeholder CSR viewed themselves as embedded in a network of stakeholder relationships and emphasized the importance of dealing with these relationships for corporate strategy implementation. As characterized by the MNC1 manager, "We define CSR as what we must do, so as to build up relationships with our stakeholders." The manager from MNC5 even equated CSR to being responsible to stakeholders, "CSR simply means being responsible for the environment, our owner, shareholder, and our employees. Actually CSR means we want to bring the benefits to those people."

Table 2. **MNEs Definition of CSR**

CSR Understanding	**MNC**
1. Stakeholder responsibility	1,5,6,10, 11
2. Not charity, not donation	3,4,7,8
3. Give back to community	2,3, 4,6
4. Integrated with business operations and development	1, 9,11
5. Corporate citizenship	2,7,11
6. Achieve sustainability	3, 9,11
7. CSR as an end, not PR	2,3,7

A lot of companies have shown a clear strategic CSR orientation and reached a consensus that CSR should go beyond charity or donation and be aligned with business operations and development. According to the manager from MNC 11, "CSR is more related to the comprehensive aspect of how the company operates. It not only covers the charity and philanthropy, as the old understanding shows." Correspondingly, these companies generally believe in the compatibility of CSR with business operations and performance. For example, the manager from MNC3 recognizes CSR as a precondition for business survival, "If you don't give back, your business is not going to be sustainable at all. So it's eventually down to the earth, mutually beneficial. So it is not some kind of charity or sacrifice. It is actually precondition for your survival."

However, four companies adhered to a traditional philanthropic view of CSR, which argued that CSR primarily means giving back to society. Three companies equated CSR with corporate citizenship, arguing that this view captured the embeddedness of corporations within the broader society. Three companies adopted a public responsibility view of CSR, considering CSR as an end itself instead of a means towards public relations or marketing goals. The manager from MNC7 illustrated this by expressing that, “It should not be a PR exercise, it should not be a toy of the CEO to look good…CSR is somewhere between marketing and legal requirement, reaching out to the community, communicating with public stakeholders about what the company does and just trying to be corporate citizens.”

Stakeholder Responsibilities and Best CSR Practices of MNCs in China

Although not every company equated the concept of CSR with stakeholder management, all the interviewed managers emphasized the importance of stakeholder management in their CSR practices. Seven stakeholder groups were identified by all of the companies as their primary responsibilities. They are employees, customers, shareholders, suppliers, environment, government, and community. How these MNCs define primary responsibility towards these stakeholders is summarized in Table 3. The best practices identified by these MNCs under each stakeholder-oriented responsibility are summarized in Table 4. Below, we discuss the key responsibilities that the sample of companies defines for each stakeholder along with the best CSR practices in relation to each stakeholder.

Table 3. MNCs’ Definition of Primary Stakeholder Responsibilities

Stakeholder	Key Responsibilities	N of firms (% of total)
Shareholders	Financial returns	10 (91%)
	Information disclosure and transparency	7 (64%)
	Sustainable growth	4 (36%)
	Legal compliance	2 (18%)
Employees	Competitive wage and welfare	9 (82%)
	Employee engagement in CSR programs	9 (82%)
	Training and career development	8 (73%)
Government	Public-private partnership/collaboration	7 (64%)
	Government capacity building	5 (45%)
	Alignment with government initiatives and concerns	5 (45%)
	Legal compliance	4 (36%)
	Tax payment	2 (18%)
Community	Investment in community education	10 (91%)
	Cross-sector collaboration	7 (64%)
	Community engagement and dialogue	5 (45%)
Customers	Product quality and service excellence	8 (73%)
	Customer engagement in CSR programs and CSR education	8 (73%)
	Meeting customer expectations	2 (18%)
Suppliers	Win-win partnership	7 (64%)
	Inclusion of social and environmental criteria in supplier selection	6 (55%)
Environment	Green workplace/factory	9 (82%)
	Environmental policies and management	5 (45%)

	Environmental education	4 (36%)

Table 4. MNCs' Best CSR Practices for each Primary Stakeholder

Stakeholder	**Best practices**	**N of firms (% of total)**
Shareholders	Ensure high profits/return on investment	10 (91%)
	CSR/Sustainability Report	3 (27%)
Employees	Family day (recreation, outing, dinner, etc.)	5(45%)
	Employee care program	5 (45%)
	Positive labor relationship	5 (45%)
	Healthy and safe work environment	3 (27%)
	Internal communication	3 (27%)
	Encourage employees into volunteering, donation	4 (36%)
	Build an ethical workplace	2 (18%)
	Ensure work-life balance	2 (18%)
Government	Comply with government regulations	4 (36%)
	Lead the government in industry standard-making	3 (27%)
	Involve government in CSR program design and issue identification	3 (27%)
	Help government improve service and capability	3 (27%)
Community	Donation to Project Hope, vocational schools for the children of migrant workers, and other educational initiatives	8 (73%)
	Engage employees in community volunteering	3 (27%)
	Sponsorship of cultural and sports activities	2 (18%)
	NGO training and capacity building	2 (18%)
Customers	Provide sustainable products and technology	6 (55%)
	Customer communication and CSR communication	5 (45%)
	Customers engagement	4 (36%)
	Timely customer feedback and tracking	3 (27%)
	Achieve high customer satisfaction rate	2 (18%)
Suppliers	Supplier education and capacity building	7 (64%)
	Certification and qualification	5(45%)
	Social and environmental auditing	3 (27%)
	Supplier code of conduct and ethical compliance (no gift-giving, no bribery)	3 (27%)
Environment	Energy saving and waste recycling	10 (91%)
	Educate the suppliers, customers, employees, publics on green practices	5(45%)
	Carbon emission control and offset	3 (27%)

1. Shareholder stakeholder responsibility and best practices. Ensuring satisfactory financial returns was the greatest responsibility towards shareholders mentioned by 91% (ten companies) of the sample. Specifically, these MNCs emphasized high profits or return on investment as their understanding of satisfactory financial returns. As expressed by the manager from MNC10, “They (shareholders) require satisfying profit. Green initiatives are recognized but are not a primary concern of this group. The majority of shareholders is concerned with distribution of profits and making sure the business operation is not at risk. So it is important we pay them good profit.” Beyond that, seven companies (64% of sample) believed that information disclosure and transparency was essential responsibility towards shareholders. For example, some companies issued CSR or Sustainability reports regularly independent of annual reports as means of information disclosure. Furthermore, four companies (36%) regarded maintaining a balance between short-term and long-term benefits as a key responsibility. Last, two companies (18%) mentioned legal compliance as important to ensuring shareholder interests.

2. Employee stakeholder responsibility and best practices. The vast majority (82% or nine MNCs) of the companies believed that providing competitive wages and welfare was the paramount employer responsibility. Commonly reported best practices include establishing social welfare fund and providing additional welfare package for employees with emergent needs. An equal number of companies (82% or nine companies) emphasized engaging employees in various CSR programs as a key element in their employee stakeholder responsibility. Common CSR engagements of employees include organizing employee volunteering in partnered NGOs, encouraging employees to donate to charity, and having CSR Days within the company. In addition to financial reward (pay, bonus and benefits), eight companies (73%) mentioned training and career development as a key responsibility. As expressed by the manager from MNC3, “First of all, financials. You have to make sure that they have their job. I think that is the ultimate responsibility an employer has for its employees. In addition, you have to make sure of their well-being when they work for you…But I will say, competitiveness always comes in the total package. You can’t just look at the numbers. The key attraction is beyond the numbers. It is the culture, and the room for development.” Some other practices associated with social responsibility toward employees include establishing employee care programs (such as family day, recreation room), building positive labor relationship, creating a healthy and safe work environment (such as emphasizing work-life balance), and ensuring timely communication with employees (such as installing internal hotline).

3. Government stakeholder responsibility and best practices. Public-private partnership was the priority choice reported by seven companies (64%) to engage with government on CSR projects. Some examples of public-private partnership include leading the government in industry standard-setting or involving government in CSR program design and implementation. Interestingly, almost half of the companies (45% or five MNCs) recognized capacity building and education as their responsibility towards government. The manager from MNC9 explained that, “We do not want to take advantage of cooperation or collaboration with government. Actually, in many cases we are helping the government to improve their capacity. For example, we work with the Ministry of Environmental Protection, the National Development and Reform Commission, also the State Administration of Work Safety. We are an expert in safety, so we help them a lot, we deliver training, we bring our best practices to them, so that is what we do (on government responsibility).”

Five companies emphasized that aligning with government initiatives and concerns was very important for the success of their companies’ CSR programs. The manager from MNC2 emphasized the importance of having a sense of belongingness for multinational companies in the host country of China, "We are not only the multinational company in China, but we also want to participate in China's direction. That's one message we want to deliver. Because in China, if you get the 12th five-year-plan, the third sector development, it is a very hard area but also tough area for Chinese government as well. What we did is that we want to actually engage in the social innovation part." Four companies mentioned legal compliance as representation of their responsibility towards government. Last, two companies thought tax payment was a form of government responsibility.

4. Community stakeholder responsibility and best practices. Almost all of the companies (91% or ten MNCs) emphasized their investment in community education as a key responsibility. From our interviews, it is evident that education has been a major focus for MNCs' community involvements in China. Our interviewees shared their experience of education investment in Project Hope and vocational schools for the children of migrant workers among other educational initiatives. It is interesting that seven of the companies (64%) consider cross-sector collaboration (with NGOs) as a key social responsibility toward the community (Table 3). Their collaboration with NGOs includes different forms, such as donation, employee volunteering, capacity building and training (Table 4).

Clearly, a trend among these MNCs is that instead of pure donation in cash or in kind, the majority of them prefer more integrative collaboration with the NGOs. Although government-organized NGOs (GONGOs) may still be the main partners for MNCs, grassroots NGOs are attracting more attention. The manager from MNC9 introduced that, "*Some others may want to work with the GONGO, the government-affiliated, because they want the brand name…But for our company, it is about integrity, it is about how we see this partner, whether we could really trust that based on what they do, what they have done in the past. For the NGO, the criterion for collaboration is based on their capacity, based on trust*." Moreover, a lot of the companies realized the importance of building an ecosystem that provides a flat platform for both GONGOs and grassroots NGOs. A common best practice is delivering NGO training for NGO capacity building. As expressed by the manager from MNC2, "We focus on the platform, that is, the ecosystem. For example, we do not approach NGOs one by one, but we work with foundations, and have the NGO leader education workshop. So you see how we choose our strategic partner, right now mostly in the social innovation part. In short, our workshop is more focusing on how to become an expert in helping people."

Five companies went a step further in defining proactive community engagement and dialogue as a responsibility, through establishing community panel, community involvement team, etc. The experience shared by the manager from MNC4 was that, "We have a very special organization called CIT (Community Involvement Team). For each CIT we have CIT members and at least one CIT leader. They are responsible for developing and maintaining the relationship with NGOs and responsible for designing, leading and inventing the CR initiatives in their entities."

5. Customer stakeholder responsibility and best practices. Ensuring product quality and service excellence had received greatest attention among eight companies (73% of sample). These MNCs define product quality and service excellence as sustainable product and technology, timely customer feedback and tracking, and a high customer satisfaction rate. A typical quote comes from the manager from MNC8 which is a pharmaceutical company, "Our first responsibility should be responsible for patients. We deal with high quality products. We set the world pharmaceutical standard, against which all the standards in

China benchmark." Equally important was engaging customers in CSR programs, as reported by 8 companies (73%, Table 3). Practices to implement customer-oriented CSR include communications with customers about product and service quality and CSR issues as essential to developing positive relationships with customers (reported by 5 companies). These MNCs conducted regular customer training on CSR topics, including sustainability, safety driving, and energy efficiency.

6. Supplier stakeholder responsibility and best practices. Building a win-win partnership with suppliers was the most essential supplier responsibility for seven MNCs (64%, Table 3). Specifically, these multinational companies spent time and money on supplier education, capacity building, and knowledge sharing (seven companies or 64%, Table 4). As explained by the manager from MNC3, "One key responsibility for large company like us is how you can grow your suppliers. So whether you can develop a long-term relationship with your supplier, treat them more like a partner, rather than supplier. You can't just grow yourself, but you grow with those who work with you together."

What is more, six MNCs (55%) expressed that using high social and environmental criteria in supplier selection is a key social responsibility pertaining suppliers (Table 3). Quality and environmental certification and qualifications were demanded in their supplier selection (five companies or 45%, Table 4). An ethical code of conduct was another way for continuous supplier monitoring. As the manager from MNC7 said, "We have internal audits in order to see that they don't employ child labor, and there is a clear set of rules on environmental treatment and human rights. We have to do this in a sensible manner with our suppliers and definitely this is not easy to do. For example, we have to make sure our chemistry is used for commercial and rightful purposes…We have to get rid of agents. It is better to not sell to distributors."

7. Environmental stakeholder responsibility and best practices. Ensuring a green workplace or factory was emphasized most by nine MNCs (82%) in defining environmental responsibility (Table 3). The companies (91%) have regular energy-saving and waste- recycling approaches (Table 4). Some have also started with carbon emission control and carbon footprint tracking. Five companies had even formulated detailed environmental policies and management system to facilitate their environmental management (Table 3). The experience shared by the manager from MNC5 was that, "We installed this Green Engage 2.0 system. We have a checklist, and have achieved the 40 points for level one, so the 40 points cover all the areas not only for all the energy departments and facilities, but also the laundry department, and the kitchen part. We assign responsibilities to each department, and have a green team in order within the hotel; every department has the person to be green champion, so they are doing monthly patrol of the hotel to check which area we can save energy." It is interesting to note that four MNCs engaged in environmental education with their customers, partners, and employees regarding proactive environmental education as part of their environmental strategy (Table 4).

Discussion

An investigation into the stakeholder approach of MNCs in the Chinese context suggests a number of interesting findings. This section will discuss the main findings observed in greater details in relation to the prior literature. Our study, in general, suggests the prevalence of a stakeholder approach to CSR, where MNCs recognize the importance of stakeholder management to CSR involvements. Moreover, the findings generally reflect a strategic conception of CSR among the MNCs in the sample, together with a public responsibility view. These MNCs do not see CSR as pure public relations building or marketing exercise; instead, they tend to believe in the compatibility of CSR with corporate business strategy, good reputation, and employee morale enhancement, and they further try to integrate this belief into their stakeholder management practices. In terms of how MNCs deal with specific stakeholder groups, our findings reveal some similarities and differences compared to existing studies. Most of the MNCs interviewed accord primary importance to shareholders, employees, the government, and the community, followed by suppliers, customers, and environment.

Three general patterns can be observed from our interviews. First of all, stakeholder prioritizing may be different for these MNCs operating in China. With respect to Freeman's 1984 stakeholder model in Figure 1, we noted that government was considered as a primary stakeholder in our cases, instead of as a secondary stakeholder as noted by most previous studies. Although prior literature in the emerging markets has already identified the government as playing a key role in the emerging economies, little research has explored how it might influence firms' dealing with social issues. On the one hand, the Chinese government has recently promoted several CSR-conducive policies, which act as legitimacy signals not only to domestic businesses but also to MNCs operating in China. On the other hand, these MNCs may take advantage of social issue participation to build up relationships with government to overcome the liability of foreignness (Zaheer, 1995).

Second, there is a salient instrumental stakeholder orientation observed. When stakeholders presented economic and rational motives for the MNCs, they were likely to receive due attention from MNCs. Take a community stakeholder for instance: although the community is usually considered as a less-important stakeholder for businesses, it might transition into a primary stakeholder when community initiatives are aligned with corporate legitimacy concerns and, sometimes, government initiatives, at least in the context of China, as our case evidence shows.

Third, a growing number of multinational companies have exhibited a more proactive CSR strategy with an aim to enact upon the external environment and to influence the key stakeholders with their expertise, experience, and knowledge. From the best practices of stakeholder engagement by these MNCs, we are able to see that many MNCs are not just complying with stakeholder expectations but are exerting more proactive influences on the key constituents. For example, these MNCs actively engaged customers, suppliers, and NGOs into CSR program design, implementation, and evaluation. Also, they almost universally emphasized education and learning in their different types of stakeholder responsibility with an aim to improve the ecosystem for the sustainable growth of businesses in China.

Implications for Theory and Practice

The stakeholder theory is grounded in a central belief that firm-stakeholder relationships are critical assets for the corporations' success in a multiple-stakeholder environment. While a large body of CSR research focuses on defining what responsibilities businesses ought to undertake, especially in relation to the natural environment, the multiple stakeholder approach provides a practical alternative to assess the social performance of multinational companies as regards key stakeholder groups (Turker, 2009).

Based on the eleven MNCs with a relatively strong reputation for their positive CSR orientation, we identified how they see corporate responsibility relative to each stakeholder and some of their CSR practices. We may consider these as "best practices" that could be learned and adopted by other MNCs or

Chinese companies if they desire to improve their CSR performance.

CSR research to date has focused primarily on the companies in mature economies, such as North America and Europe. The meta-analysis by Orlitzky, Schmidt, and Rynes (2003) provided robust evidence that CSR performance has a positive relationship to the company's financial performance. While it is possible that financially successful companies can afford to engage in more CSR activities, it is equally true, based on research evidence, that CSR activities will contribute to positive financial performance of the company. In other words, investment in CSR pays off for the company in terms of increased employee productivity, commitment, customer loyalty, and strong reputation in the local and broader community. All of these positive effects will help the company be more competitive in the product/service and labor markets.

Attention to environmental sustainability contributes to not only short-term positive reactions from the community, but long-term sustainability of the world community. According to the book *Natural Capitalism* (Hawkin, Lovin & Lovin, 1999), industries enjoy the use of natural resources at low cost or free. The services provided to industries by natural resources were estimated in the trillions of dollars. Future research on CSR should consider the natural resources used and destroyed as part of the cost of business in evaluating the net contribution to society in place of net present value to shareholders (Tsui, 2013). Cost to consumers in terms of faulty or harmful products also should be factored into the cost of production to hold firms socially responsibility for damages to consumers. Currently, the society through government pays the cost of irresponsible product design or manufacturing. Many companies, like those in our study, have accepted such social responsibility as part of the company strategic mission. Much research is needed to compare firms with proactive CSR and firms with reactive CSR in terms of their financial and social performance.

An additional practical implication of the research is to provide Chinese stakeholders, for example the government and NGOs, a clearer awareness and basis on which they themselves can judge the social decision-making and performance of multinational companies in China. This would help in setting the agenda for policy making with regards to international business.

Conclusion

Our study emphasizes the need to integrate stakeholder theory into CSR studies in examining the social performance of multinational companies. Stakeholder identification and prioritization might vary by the national contexts, and the configuration of stakeholder-business relationships may be different than those in their home markets (e.g. Jamali, 2008; Turker, 2009). For multinational companies operating in the emerging countries, when they are designing their CSR initiatives and programs, it is essential to adjust their focus according to different stakeholder-business relationships. We hope our modest study has provided some insight about CSR philosophy and practices by a few leading MNCs in China and that such insight will be useful to guide future research and current practices.

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Discussion Forum

Accountability and Transparency in the Financial Services Sector: Advancing Sustainable Finance

Thomas A. Myers

The Prevailing Framework for Reporting Guidelines Is Not Relevant to Significant Aspects of the Financial Services Sector

While the prevailing framework for accountability and disclosure of corporate environmental and social performance has accomplished substantial heavy lifting with respect to defining and adopting global corporate social responsibility ("CSR") core and performance indicators, boundaries, and reporting initiatives[1], such framework has been only moderately successful in addressing the sustainability reporting guidelines and parameters for the financial services sector. This is true, notwithstanding that the critical global financial services segment substantially influences both directly and indirectly the flow of capital to green [2] and other decisively important financial markets. Heretofore, it appears that the sustainability community has failed to appropriately reflect an important aspect of how the global financial system interacts: i.e. the extent to which rogue opportunism by major capital markets players can undermine a sustainable financial system and the concomitant imperative for long-term economic, social, and environmental value.

Existing CSR reporting and disclosure guidelines ignore the fact that a major subdivision of the financial services sector, the global commercial and investment banks ("big banks"), have had a disproportionately negative influence on nearly all of the financial crises experienced during the past 15 years. Many would argue that it was misbehavior on the part of the big banks that caused these crises -- crises that have bled the world markets to the tune of many billions, if not trillions, in capital that could, otherwise, have been deployed far more constructively for the benefit of global society. This includes a significant portion that could have been allocated for sustainable financial products. In particular, ill-contrived, structured finance schemes engineered by a number of global banks have been intrinsic to major financial fiascoes, wealth asymmetries and financial dysfunctions that have pervaded the global economy. Examples of cataclysmic market disruptions, where the big banks played seminal roles, include, among others, the Enron debacle, the subprime financial crisis, and the European debt disaster. [3] Clearly, certain members of the global banking community have been recalcitrant bad actors and, as widely reported, have lined the pockets of their excessively paid and short-term incented top management while taking actions that have been starkly inimical to the interests of the world economic community at large.

Among other things, the largest global banks have been and continue to be deeply into derivatives and other complex financial instruments that often derive their value from obscure, enigmatic structured finance assets that are extremely difficult to value. In the recent past, many of these financial institutions have made (and continue to make) outsized bets on whether or not particular financial instruments or entities (which are often poorly defined and difficult to value) would default during specified time periods.[4] Similar bets have been made regarding derivative instruments based on pure speculation rather than legitimate business hedging strategies. Big banks, with access to insider information and by virtue of the enormous resources they control, can manipulate market and information asymmetries to their unique benefit. Such zero-sum "gaming of the system" means that arm's-length investors -- including pension funds and institutional investors -- are often materially shortchanged. Notwithstanding the enormous systemic risks that such well-documented, high-stakes, financial gambling engenders, the existing CSR framework, including the Global Reporting Initiatives' Sustainability Reporting Guidelines for the Financial Services Sector ("Financial Services Sector Guidelines," or "Guidelines")[5] does nothing to address the inherent corporate irresponsibility that such activities may reflect.

Any methodology that purports to evaluate the corporate social responsibility of the financial sector must take into consideration the damaging practices that large commercial banks, directly or indirectly, can inflict on the world financial order. No less than environmental pollution, the exploitation of labor, or other social irresponsibility, aggressive, self-serving financial initiatives of big banks have inflicted and can continue to inflict serious systemic damage while operating to thwart and undermine sustainability objectives.

The existing GRI Sustainability Reporting Guidelines for the financial services sector focus on specific environmental and social components that recognize and give credit for financial products designed to deliver particular social or environmental benefits without addressing the potential for negative behaviors so destructive that they have demonstrated the ability to bring the world economy close to financial meltdown. It is certainly clear that commercial banks can and should encourage the use of green financial products (see below). However, to be useful, CSR ratings and/or reporting guidelines for large banks must not only contemplate and acknowledge behaviors that encourage and are conducive to green financial products; they should also identify and attribute negative consequences to those behaviors that have deleterious economic implications for the global financial and economic system as a whole.

“Green” Financial Products

There have been a flood of so-called "green" financial products that have been introduced by various financial sectors, including retail and investment banking, as well as by marketers of insurance products, among others. A key benchmark for these innovative offerings is that they are designed to enhance sustainable growth through the integration and promotion of environmentally friendly services and practices. A common theme of green financial products offered by the retail banking sector is to reward the consumer with lower interest rates or other financial incentives when undertaking to finance a conventional product that has been enhanced through the adoption of environmentally friendly technology or practices. Such green financial products might include, for example, green mortgages that sport lower interest rates on energy-efficient homes; green commercial building loans that reflect lower interest rates and financing costs on projects that are characterized by lower energy consumption, reduced waste and/or less pollution than traditional buildings; green car loans that charge less interest for cars that demonstrate high fuel efficiency; and even green credit cards that offer to make eco-friendly NGO contributions as a percentage of each purchase.

The investment banking sector has promoted green financial products through, for example, the securitization of green mortgage-backed securities and/or offering structured finance products secured by collateral drawn from related green financial products. Investment bankers have also encouraged "green indices," where, for example, investors can support sustainability by purchasing interests in an equity index consisting of firms that have been objectively selected for their commitment to some aspect of environmental sustainability. As well, investment bankers have supported socially responsible and environmentally friendly causes by underwriting initial public offerings of acknowledged entities with demonstrable sustainability credentials. For a more complete discussion of green financial products and services, see the United Nations Environment

Program Finance Initiative on the subject at https://www.globalreporting.org/resourcelibrary/GRIG4-Part1-Reporting-Principles-and-Standard-Disclosures.pdf .
Although no universal criteria exist for measuring and/or rating objectively individual financial institution environmental and/or green finance compliance, as noted above, thoughtful and substantive steps have been created to establish such guidelines.

The Financial Stability Board ("FSB") was established by the leaders of the G20 countries to coordinate at the international level the work of national financial authorities and international standard-setting bodies and to develop and promote the implementation of effective regulatory, supervisory, and other financial sector policies. The FSB is comprised of senior representatives of central banks, regulatory and supervisory authorities and ministries of finance, standard-setting bodies, and international financial institutions, among others. According to the Financial Stability Board, "systemically important financial institutions" ("SIFIs") are

> …institutions whose distress or disorderly failure, because of their size, complexity and systemic interconnectedness, would cause significant disruption to the wider financial system and economic activity. To avoid this outcome, authorities have, all too frequently, had no choice but to forestall the failure of such institutions through public solvency support. As underscored by this crisis, this has deleterious consequences for private incentives and for public finances.

It should be painfully obvious that a systemically important financial institution that fails because of risk-taking and speculation regarding its own portfolio -- a phenomenon frequently encountered in the recent subprime financial crisis -- can cause significant disruption to the world financial system at large. In so doing, such big banks can materially curtail the availability of funding for green financial products and/or other financially sustainable alternatives. Yet, the current sustainability guidelines do not screen for the self-interested risk-taking and speculation of large financial institutions, which are capable of undermining the world financial order. As such, the existing guidelines are shortsighted. The development of more sophisticated sustainability guidelines for the financial services sector that address such anomalous and potentially catastrophic behavior is an imperative.

The Financial Stability Board has identified some 29 institutions as SIFIs[6]. Many of these institutions, which because of their size, complexity, and systemic interconnectedness, could cause significant disruption in the global financial system, are frequent abusers of the securities fraud statutes. Under U.S. law, this means that the bank has made intentional material misstatements in its public disclosures and/or that it has omitted to make disclosures regarding its financial condition and circumstances that would otherwise be necessary for a reasonable investor to evaluate bank financial wherewithal. Among the SIFIs, such chronic bad actors, who collectively have paid many billions of dollars to settle securities fraud claims include Bank of America, Barclays, Credit Suisse, Citigroup, Deutsche Bank, Goldman Sachs, J.P. Morgan Chase, Morgan Stanley, UBS and Royal Bank of Scotland, among others.

Because the existing sustainability reporting guidelines reward the finance sector for good behavior, generally described as facilitating the development of green financial products, but fail to punish socially irresponsible behavior (e.g., massive securities fraud), certain systemic bad actors can obtain a CSR "clean bill of health" when, in fact, they are consistent financial system pariahs.[7] This is analogous to, for example, considering notorious American prohibition gangster, Al Capone, a good citizen because he contributed to numerous Chicago charities during his murderous reign in the late 1920s. Similarly, we see institutions like the contemporary J.P. Morgan Chase, which has played a major role in facilitating each of the systemic financial crises of the recent past, including Enron, the subprime debacle, and the European debt crisis, passing itself off as a good CSR citizen because it is the sponsor of green mortgage bonds. However, J.P. Morgan Chase has been fined $135 million USD by the U.S. Securities and Exchange Commission ("SEC") for its intrinsic role in the original Enron fraud [8]. In a bit of irony, more than ten years later, J.P. Morgan Chase will pay even more, $410 million USD, pursuant to its recent agreement to settle its Enron-style manipulation of California electricity prices. Meanwhile, U.S. authorities are currently demanding more than $6 billion USD from J.P. Morgan Chase to settle allegations of securities fraud regarding its highly criticized conduct in facilitating the subprime financial crisis. [9, 10] Similarly, Goldman Sachs recently received the largest fine in the history of the SEC for misleading investors in its role as the sponsor of the infamous Abacus subprime synthetic collateralized debt obligation scam.

Reporting Standards Sensitive to Bank Financial Misbehavior

Clearly, a robust, sustainable, and green economy cannot proliferate when the failure of big banks, regardless of the cause, otherwise stresses the capital markets and shuts down capital available for sustainable initiatives. In the wake of the financial crisis, there have been many proposed global banking regulatory reform measures which have been proffered in Europe, the United States, and other jurisdictions. Even though Chinese banks, to their credit, did not play a role in the opportunistic, subprime structured finance collapse that characterized the 2008 financial and economic crisis, China's economy is, nonetheless, affected. It is, indeed, the systemic implications of big bank misconduct that create an "800 pound gorilla" that is capable of casting a long shadow over a desired globally sustainable financial system. Yet, the GRI Sustainability Reporting Guidelines for the financial services sector do not address, much less incorporate, the global regulatory reform proposals designed to curb excessive behavior and to mitigate exposure to otherwise deleterious self-serving actions taken by certain large, global banking consortiums. Just as major polluters, environmental degraders and exploiters of labor should be held accountable to applicable CSR standards, so, too, should the big banks be held responsible where, out of their own reckless self-interest, they inflict systemic damage to the world economy.

In hindsight, it is apparent that the financial and economic crisis, from which many would say the world is still suffering, resulted from, among other things, a failure of systemic governance, including political, policy, supervisory, and institutional failures. Critics have asserted that instead of "regulating" the big banks, the Federal Reserve and other primary banking regulatory agencies have "represented" the big banks. With the advent of "too big to fail," and its corollary, the "too big to jail,"[11] big bank regulatory conundrums, sustainable finance architects must create measures that recognize and serve to eliminate the ultimate short termism and misaligned incentives which characterize certain aspects of financial sector behavior. They must, in turn, engineer performance indicators that identify and address the fundamental conflicts and potential for reckless, self-serving, behavior that has, in the past, created financial upheaval in the capital markets.

Where can sustainability advocates look for insight into appropriate reporting standards that are sensitive to big bank misbehavior? Reform measures designed to rein in big bank past excesses are a representative starting point. We shall briefly examine some of the more salient banking reform proposal themes out of an unprecedented number of regulatory and legislative reform initiatives that have been proffered by regulators and lawmakers from the United States, Europe, and various global groups.[12] In this context, we must paint with a broad brush: it is beyond the scope of this discussion to critique the pros and cons of these legislative and regulatory proposals that continue to emerge. Rather, the following discussion should serve as a cursory overview of the major banking issues to be considered for insight into potential reporting guidelines. Such issues include: "Too big to fail" institutions' crisis management and recovery; credit rating agencies; accounting standards; capital requirements; OTC derivatives; control of systemic risk; commodities; short sales; hedge funds; structured finance and securitization; and liquidity issues and accounting standards, among others.

It should be noted that most of the related policy and regulatory initiatives are aimed solely at the creation of a more tenable global economic system and are primarily characterized by measures to restrict big bank speculation, including through the manipulation of derivatives and other structured finance products for their own account, collusion with ratings agencies, manipulation of prime rates, and other opaque, self-serving, often off-balance sheet operations. The sustainability community must examine relevant banking reform initiatives and strive to incorporate the essence of these proposed measures -- and the behaviors such measures are designed to eradicate -- into the existing reporting guidelines for the financial services sector.

Overview of Global Bank Regulatory Reform Proposals

The 2008 financial and economic crisis engendered a plethora of global regulatory reform proposals aimed at preventing another world financial crisis. Lawmakers and regulators from the United States, the European Union, the UK, and other global groups have produced thousands of pages of reform proposals. It is beyond the scope of this paper to discuss these regulatory initiatives in anything more than a brief passing. Rather, the suggestion is made that sustainability architects reflect the legislative and regulatory intent of these measures in preparing and augmenting financial service sector guidelines, performance indicators and reporting initiatives that capture the overall spirit and intent of these proposed regulations.

In the broadest sense, the numerous regulatory initiatives have covered the major areas and nooks and crannies of bank abuse identified in the financial and economic crisis of 2008. Such abuses include bank self-dealing in volatile and enigmatically structured finance products and the related massive losses that were experienced by the systemically important financial institutions. In particular, proposals have been aimed at crisis management and recovery relating to the failure of systemically important banks; regulation of over-the-counter derivatives designed to provide greater transparency and less volatility in the markets; capital requirements and liquidity criteria to buttress banks against inordinate losses; accounting standards that capture the risks, both contingent and real, to banks from both on and off balance sheet exposures; curbs on exorbitant executive compensation; ratings agency collusion with banks that sponsor securitization and other structured finance products; greater transparency with respect to hedge funds; and other measures aimed at curbing speculation, and volatility, including with respect to short sales and commodities, among others.

Other Measures…

Certainly, mainstream bank policymakers could do considerably more by requiring that additional sustainability provisions regarding the environment and social responsibility be prominently featured in their proposed, post-financial crisis reform regimen. Such measures could include, for example, provisions to require ratings agencies to integrate environmental and social responsibility parameters into the ratings mix; that sustainable investments be allowed to count against the Basil III Capital Holding requirements; and that policymakers build long-term environmental considerations into the legal and statutory fiduciary framework. Such fiduciary measures could be designed to encourage and ensure that long-term environmental and socially beneficial measures be taken into consideration by pension funds, sovereign wealth funds, policy directed banks, and others who act, in a position of trust, on behalf of beneficiaries who stand to benefit the most from long-term environmental and social initiatives. The creation of a global coalition of institutional investors that, collectively, through the use of financial and reputational leverage, would espouse sustainable financial products on a worldwide basis, is a starting point.

The Institutional Investors' Bill of Rights

Collectively, pension plans, endowment funds, and institutional investors all over the world represent trillions of dollars of capital that Wall Street covets. Pension plans, in particular, have a fiduciary obligation to protect the rights of their beneficiaries, and pension plan funding depends on the labor of its beneficiaries. If all pension plans, endowment funds and other institutional investors were to band together and assert a revolutionary "Investor's Bill of Rights," they would be in a position to dictate more appropriate behavior from the financial markets controlled by Wall Street. Like a union for labor, institutional investors should join together to collectively demand socially responsible investment products which must be sold by transparent entities that demonstrate the kind of integrity consistent with a high level of corporate governance and commitment to environmental, socially responsible, investment objectives.

Such institutional investors could collectively reflect the view that, as fiduciaries, environmental, social, and corporate governance issues have a great impact on the ultimate performance of investment portfolios. Accordingly, such institutional investors could agree to incorporate such issues into their portfolio strategies so that the objectives of their beneficiaries and society at large can better be served. Indeed, such a coalition has been formed by the United Nations. Called the PRI (for "principles of responsible investment"), this coalition represents an initiative with a set of aspirations and voluntary guidelines for investment entities wishing to address environmental, social, and corporate governance issues. Much work needs to be done, but it is a brave start. Collectively, an organization of pension funds and institutional investors could demand proactive and enlightened ESG measures.

Much Ado about Nothing?

Three years after president, Barack Obama's signing of the ambitious, Dodd - Frank regulatory reform initiative in the United States, which represented a sweeping overhaul of lending and high finance rules, the implementation of many of its key provisions is well behind schedule. While Dodd - Frank mandated key steps to ameliorate systemic exposure to self-interested and financially dysfunctional behavior by the "too big to fail" global bank actors, many of its proposed regulations have yet to be written, let alone enforced. The law, which was considered to be a "robust" response to the numerous financial system admonitions that spewed from painful examination of the 2008 financial and economic crisis etiology has, to date, been largely ineffective at reining in the behavior of the big bank cartel.[12] At the present time, the consensus among thoughtful observers is that the big banks still pose potentially catastrophic risks to the world economy.[13] Efforts to learn from the painful lessons of the financial crisis and to implement measures to prevent a recurrence have been consistently thwarted by partisans and big bank lobbyists in the U.S. who attempt to marginalize Dodd - Frank by characterizing it "as an incomprehensibly complex piece of legislation that is harmful to the floundering economy and in dire need of repeal."[14] Five years after Lehman Brothers filed for bankruptcy, ushering in the worst financial crisis in 80 years, the Wall Street banks are larger than ever. Rules that were designed to stop them from making speculative bets with the insured deposits of customers have yet to be implemented -- courtesy of the banks' lobbying prowess.[15]

Certainly, the prevailing framework for ESG16 accountability and transparency recognizes and reflects the financial system imperative to deliver low carbon, resource efficient, and socially responsible markets and economies; however, at the same time, too little has been done to screen for, much less prevent, the potential for rampant opportunism, which still casts an irresistible lure for big banks and other financial players who may wish to pursue their own selfish, inimical financial interests, often for the exclusive benefit of top management (or other wealthy elite) to the detriment of a sustainable economic, social, and environmentally responsible global economic system. Indeed, it would appear that too little has changed in the regulatory and policy-making environment where current sentiment tends towards "business as usual" prerogatives, while the public, media and capital markets' amnesia operates to diffuse and ultimately to obfuscate the important lessons of the recent past.

Advocates for greater ESG accountability and transparency must have the essential awareness and concomitant fortitude to acknowledge and adopt performance indicators that give negative ratings weight to the systemically counterproductive and self-serving practices that major capital markets players may adopt. Failure to do so may thwart otherwise well-articulated objectives which are designed to encourage positive governmental, environmental and social responsibility behaviors. Submissive regulators, conflicted ratings agencies, and opaque markets must all be recognized for the threat they pose to an environmental and social responsibility renaissance. The pathway to an effective sustainability implementation initiative lies in the willingness of sustainability thinkers to confront that which has been so dreadfully obvious in the recent past: that is, so-called "too big to fail" financial bad actors have received and continue to be given the license to subvert global economic concerns for their own self-interests. Such perverse incentive exists, even to this day. Regulatory initiatives, such as Dodd - Frank, need to be implemented, enforced, and ultimately enhanced -- not watered down by politicians bowing to the lure of the lobby dollar offered by powerful and entrenched interests.

China Implications

By objectively and consistently identifying the perverse potential that has existed and still exists for financial sector systemic institutional self-interest and market manipulation, the Peoples Republic can build towards a model of sustainable capitalism that exemplifies superior long-term value creation over short-term profit maximization. Accountability and transparency guidelines must be built into the existing financial services sector reporting guidelines in order to facilitate and complement China's commitment to a socially responsible and sustainable world financial order. Decisive action on China's part will ameliorate the potential for future global financial crises that could undermine sustainability initiatives and exacerbate the growing trend towards the inequality of global income and wealth.

Chinese policymakers would do well to insist on appropriate corporate and environmental behavior, even while recognizing the pervasive and inexorable reach, influence and self-interest potential inherent to the existing global investment bank sector. Existing CSR core financial services sector performance indicators, boundaries, and reporting initiatives are inadequate to prevent systemic market manipulation by institutions that are "too big to fail" under existing global regulatory and legal regimens. Notwithstanding that substantive banking regulatory and legal reform measures have been introduced, there is no assurance that such proposed measures will not be emasculated or otherwise rendered ineffective. Consequently, sustainability advocates should develop and implement appropriate reporting guidelines that independently measure the potential for big bank misconduct. The copious global bank reform proposals and the deleterious, systemic behaviors such proposals are intended to address provide an appropriate framework for designing responsive ESG reporting initiatives. China could readily develop such independent ESG reporting initiatives and plan for their judicious implementation.

Certainly, the China Banking Regulatory Commission ("CBRC"), through its innovative "Green Credit Guidelines," has pioneered a major regulatory resource to engineer environmental and socially responsible business behavior. Such regulation, which applies to all commercial banks, rural cooperative banks, and all Credit Unions established within the People's Republic of China, are broad in scope and sweeping in their requirements for China's banks and their borrowers to develop and improve systems and procedures that demonstrate environmental and social sensitivity. The promulgation of such regulations should be encouraged, not only in China, but also as a template for enlightened socially responsible and environmentally sensitive banking worldwide. The green credit guidelines, which stipulate that bank "credits may not be granted to clients whose environmental and social performance fails to meet compliance requirements," place China at the very forefront of innovative and enlightened global regulatory initiatives.

The Financial Standard Board has designated less than 30 global banking institutions as SIFIs. However, the Green Credit Guidelines require that financial institutions of any size should be measured through the lens of social responsibility and sustainable financial conduct. China would be well served to consider appropriate behavior prerequisites for global banks with the potential for systemic disruption before permitting such big banks substantial entrance into the sustainable Chinese markets. The conceptual basis for identifying China as an influential nexus to foster a more sustainable global economy is derived, in substantive part, from China's status as an enormously influential global financial presence and, concomitantly, based on its standing as the largest global creditor nation in the world. Conceptually, as lender to the world, China should be in a position to exert significant influence on ethical standards in the global capital markets.

In reforming its financial system, China would do well to apply the lessons of the recent global financial crisis and to scrutinize those potentially vulnerable and analogous aspects of its own financial system that may weaken and/or ultimately corrupt otherwise sound policy objectives emphasizing environmental and social responsibility. In particular, the proliferation of unregulated shadow banking and wealth management products must be controlled and managed to facilitate sustainable initiatives and, conversely, to ameliorate any potential adverse effects on China's financial system reform.

Notes

[1] See, eg., the widely acknowledged Global Reporting Initiative, Sustainability Reporting Guidelines, Reporting Principles and Standards Disclosures at https://www.globalreporting.org/resourcelibrary/GRIG4-Part1-Reporting-Principles-and-Standard-Disclosures.pdf .

[2] The "green" financial market refers generically to those financial products in the market that result in improved human well-being and social equity, while at the same time they reduce environmental risk and enhance sustainable development. The term "sustainability," as it is applied in this discussion, refers to the potential for long-term maintenance of well being, and encompasses ecological, economic, governmental, and social dimensions.

[3] See appendix for discussion of big banks' role in Enron, subprime, and European debt crises.

[4] Even after the trauma of the recent subprime financial crisis, large, "too big to fail" global banks continue to make huge bets in the speculative derivatives market, notwithstanding the demonstrable systemic implications. Consider, for example, the recent example of J.P. Morgan Chase's "London Whale" derivatives trades which the U.S. Senate Permanent Subcommittee on Investigations, on March 15, 2013, characterized as "a case history of derivatives risks and abuses."

[5] https://www.globalreporting.org/resourcelibrary/FSSS-Complete.pdf

[6] Such systemically important financial institutions include Bank of America, Bank of China, Bank of New York Mellon, Banque Populaire CdE, Barclays, BNP Paribas, Citigroup, Commerzbank, Credit Suisse, Deutsche Bank, Dexia, Goldman Sachs, Group Crédit Agricole, HSBC, ING Bank, JP Morgan Chase, Lloyds Banking Group, Mitsubishi, UFJ FG, Mizuho FG, Morgan Stanley, Nordea, Royal Bank of Scotland, Santander, Société Générale, State Street, Sumitomo Mitsui FG, UBS, Unicredit Group, and Wells Fargo.

[7]For example, the United Nations Environment Program Finance Initiative gives credit for "carbon market" promotion to Goldman Sachs, Merrill Lynch, J.P. Morgan chase, Morgan Stanley, Citigroup, and Bank of America, all which have been widely castigated, and deservedly so, for their role in the financial crisis.

[8] See appendix.

[9] Kara Scannell and Tom Braithwaite, "J.P. Morgan Woes Deepen As US Demands $6 Million Penalty," Financial Times, August 27, 2013

[10] J.P. Morgan Chase has recently committed to donate an undisclosed amount to China's Tsinghua University to create a scholarship for American students. The People’s Republic must be able to recognize a wolf in sheep's clothing. China should be able to identify systemic CSR bad actors and consider the manner and extent to which its proposed, enlightened and reformed, financial system will wish to interact with chronically irresponsible systemic institutions.

[11] See comments of U.S. Atty. Gen., Eric Holder regarding the Justice Department's failure to pursue large bank criminal conduct: http://www.huffingtonpost.com/tag/eric-holder-too-big-to-jail

[12] It is beyond the scope of this paper to capture all of the various regulators, legislators, and others involved in promulgating global reform legislative and regulatory initiatives. However, briefly, global primary actors include the G-20, International Organization of Securities Commissions ("IOSCO"), the Basel Committee on Banking Supervision, the International Monetary Fund and the Financial Stability

Board. In the UK, the Bank of England and HM Treasury are prominent, while in the United States, the U.S. congressional committees, Federal Reserve, OCC, Securities and Exchange Commission and the Department of Treasury, played major roles. In the EU, the European Commission, the European Systemic Risk Board, European Banking Authority and the European Parliament have played prominent roles, among others.

[13] See, e.g., Ted Kaufman, "Three Years Later, Dodd-Frank Is a Failure," USA Today, July 22, 2013

[14] See, e.g., the statement of Sen. Carl Levin at the J.P. Morgan London Whale Inquiry by the Senate Permanent Subcommittee on Investigations: http://www.levin.senate.gov/newsroom/press/release/levin-statement-on-settlement-and-penalties-in-jpmorgan-london-whale-trades

[15] Quote from Republican House Financial Services Committee Chairman Jeb Hensarling, an early opponent of Dodd – Frank.

[16] The so-called "Volker rule," designed to prohibit financial institutions from speculating for their own account with the deposits of their customers, although mandated by Dodd-Frank, has yet to see the light of day.

[17] “ESG” is an acronym for environmental, social, and governance values.

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Partner Organizations:

Founded in 1986, the Caux Round Table advocates comprehensive global ethical principles for businesses, governments, non-profits and those who own wealth. CRT management approaches bring ethics and social responsibility into focus as praxis and not just moral theory.

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The China Credit Research Center was founded in October 2002 to assess public policy towards credit markets in China and provide independent support for policymakers in the development of a China's credit system.

Globethics.net is a global network of persons and institutions interested in various fields of applied ethics. It offers access to a large number of resources on ethics, especially through its leading global digital ethics library. In addition, it facilitates collaborative web-based research, conferences, online publishing and active sharing of information. Globethics.net aims especially at increasing access to ethics perspectives from Africa, Latin America and Asia. It strengthens global common values and respect of ethical contextual diversity.

The W. Paul Stillman School of Business at Seton Hall University provides professional education geared toward the complex, practical needs of business leaders. The mission of the School is to enrich the life of each student through a nationally recognized educational experience that is inspired by innovative teaching, supported by applied research, and guided by a values-centric curriculum. The Stillman School collaborates with the Center for International Business Ethics to produce JIBE, together forming JIBE's joint editorial board, and awards scholarship to the winners of the annual CSR Essay Competition hosted by the Center for International Business Ethics.

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