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## **Does it Really Take the State?**

### Limited Statehood, Multinational Corporations, and Corporate Responsibility in South Africa

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#### **Abstract**

This paper explores the role of the state for an effective engagement of multinational corporations (MNCs) in corporate social responsibility (CSR). In the OECD context, the 'shadow of hierarchy' cast by the state is considered an important incentive for MNCs to engage in CSR activities that contribute to governance. However, in areas of limited statehood, where state actors are too weak to effectively set and enforce collectively binding rules, profit-driven MNCs confront various dilemmas with respect to costly CSR standards. The lack of a credible regulatory threat by state agencies is therefore often associated with the exploitation of resources and people by MNCs, rather than with business' social conduct. However, in this paper we argue that there are alternatives to the 'shadow of hierarchy' that induce MNCs to adopt and implement CSR policies that contribute to governance in areas of limited statehood. We then discuss that in certain areas such functional equivalents still depend on some state intervention to be effective, in particular when firms are immune to reputational concerns and in complex-task areas that require the involvement of several actors in the provision of collective goods. Finally, we discuss the 'dark side' of the state and show that the state can also have negative effects on the CSR engagement of MNCs. We illustrate the different ways in which statehood and the absence thereof affect CSR activities of MNCs in South Africa and conclude with some considerations on the conditions under which statehood exerts these effects.

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<sup>1</sup> The paper draws on findings of a four-year collaborative research project "Business and Governance in South Africa", conducted in the Collaborative Research Center (SFB 700) "Governance in Areas of Limited Statehood" (cf. <http://www.sfb-governance.de/en/index.html>).

## Introduction

In an increasingly globalized economy, multinational companies (MNCs) are assumed to escape strict national regulation by relocating their production sites to areas of limited statehood where regulation is low and enforcement is weak. This behavior drives states into a ‘race to the bottom’, leading to the degradation of natural resources and the compromising of social standards for the sake of economic growth or short-term foreign investment (Chan and Ross 2003, Kaufmann and Segura-Ubiergo 2001, Lofdahl 2002, Rudra 2002). At the same time, however, companies have been “drawn into playing public roles to compensate for governance gaps and governance failures at global and national levels” (Ruggie 2004: 13; cf. Cutler et al. 1999; Hall and Bierstecker 2002; Flohr et al. 2010, Haufler 2001; Pattberg 2006). Empirical evidence abounds on companies which voluntarily commit themselves to social and environmental standards and adopt private self-regulatory regimes – even in the absence of a regulatory threat by the state (Vogel and Kagan 2004; Mol 2001, Flanagan 2006; Risse 2011). Studies show, e.g., that foreign direct investments originating from a country with high levels of self-regulation unleash norm-diffusion dynamics among competitor firms that in turn lead to higher levels of business self-regulation in the weakly regulating host country, i.e. where the investments are made (Prakash and Potoski 2007; Greenhill et al. 2009). Also, exporting to a highly regulating country creates a surge for higher standards in low-regulating countries (Greenhill, et al. 2009).

These studies leave no doubt that companies can contribute to the provision of common goods and services, which we term ‘governance’. What remains open and will be explored in this article are the conditions under which companies are in fact willing to provide such governance contributions, channelled through their corporate social responsibility (CSR) activities in areas of limited statehood. How does statehood and the absence thereof affect whether companies effectively contribute to collective goods provision? We define governance as the crafting and implementation of collectively binding norms and rules for the provision of common goods or the provision of common goods itself (Risse 2011; Börzel and Risse 2010).

This article suggests, firstly, that it does not always take the threat of state regulation, elsewhere depicted as the ‘shadow of hierarchy’ (Scharpf 1997; Héritier and Lehmkuhl 2008), to make MNCs engage in CSR that contributes to governance. Rather, we identify alternatives or ‘functional equivalents’ (Draude 2007; Börzel and Risse 2010) to the ‘shadow of hierarchy’. By functional equivalents this article understands factors other than the threat of state regulation that generate incentives, positive and negative, for MNCs to engage in forms of CSR that contribute to governance. We consider in particular the following factors: market incentives,

reputational concerns and public pressure, the ‘shadow of anarchy’ (see Scharpf and Mayntz 1995), defined by the absence of any state involvement in the provision of common goods, and an external ‘shadow of hierarchy’ cast by home states of MNCs and by international organisations.

Secondly, we discuss which CSR activities may still require the involvement of the state and, thus, a certain amount of state capacity to set and enforce regulations and to provide basic infrastructures in order to effectively contribute to governance. To what extent do functional equivalents to the ‘shadow of hierarchy’ still depend on a minimum of statehood to make MNCs engage in CSR that effectively contributes to governance? Do different degrees of statehood give rise to different forms of CSR governance contributions? We argue that there are two conditions under which statehood is still relevant: First, a degree of state capacity is necessary to make companies, that are immune to reputational concerns, contribute to CSR. Second, complex-task CSR activities require the co-production of governance with the state.

Having dealt with statehood as positively related to business’ CSR engagement that contributes to governance, we turn the perspective and discuss, thirdly, potential ‘dark sides’ of the state. Despite limited capacities, states can discourage or undermine the provision of common goods by MNCs in areas of limited statehood: state actors can engage firms in exclusive governance arrangements that result in club goods benefitting only privileged individuals or groups closely related to the state. Such ‘patrimonial collusion’ (Handley 2008; Hönke forthcoming-b) is the opposite of inclusive governance arrangements. Inclusive governance is concerned with the reduction of negative externalities and the contribution to the provision of open-access goods. Our third argument thus emphasises that although state capacities are necessary to make companies engage in CSR in some areas, state capacities – limited as they may be – can also negatively affect firms’ attempts to contribute to governance.

The article starts with a definition of key concepts. We then outline how functional equivalents to the ‘shadow of hierarchy’ induce CSR activities of MNCs that contribute to governance in areas of limited statehood. The subsequent sections discuss the ambivalent role of the state, limited as its capacities might be, as both a facilitator and inhibitor of CSR governance contributions. Finally, we present empirical case studies which illuminate the different ways in which statehood and the absence thereof affect CSR activities of MNCs in areas of limited statehood. Empirically, we draw on extensive research on corporate engagement in governance in South Africa. Areas of limited statehood are widespread in South Africa and the capacity of the South African state to set and, particularly, to enforce binding regulation is weak, especially at the local level. South Africa thus provides a

context to explore what difference limited statehood makes to the CSR engagement of MNCs that contribute to governance. The article concludes with a short summary of our main arguments and some considerations of potential scope conditions for the causal relevance of statehood.

### **The CSR engagement of MNCs and governance in areas of limited statehood**

While the engagement of MNCs in CSR is well understood, research on their governance contributions in so called ‘areas of limited statehood’ is still emerging. We define areas of limited statehood as areas in which government lacks the capacity to set and implement collectively binding rules and to provide collective goods (Risse 2011; Börzel and Risse 2010). This lack reduces the ability of government to cast a credible ‘shadow of hierarchy’, by which we understand the threat of government to enforce regulation in an issue area or industry (Scharpf 1997, Héritier and Lehmkuhl 2008). A prerequisite for an effective ‘shadow of hierarchy’ is the capacity of the state to hierarchically impose collectively binding rules, for which sufficient financial and material resources, personnel, and expertise are essential. Many governments are not capable to either set or enforce legislation at the domestic level. Notorious examples of areas of limited statehood are the *favelas* in Latin America, the townships of Africa, the ‘special economic zones’ in Asia, or secessionist regions in the Western Balkans, the Southern Caucasus and China. It is important to note that we find different areas of limited statehood *within* states, such as in South Africa; states’ capacity to set and enforce collectively binding rules and provide common goods can be limited in specific issue areas, such as environment, health, or security, and in geographical sub-regions (cf. Risse 2011). The concept of areas of limited statehood applied in this article avoids the methodological nationalism inherent in concepts of failing/failed states; it focuses on state capacities (*statehood*) rather than state territory, and identifies limitations in the specific functional and geographical *areas* in which MNCs operate.

By governance contributions we refer to those CSR activities by business that help to set and implement collectively binding rules for the provision of common goods or the provision of common goods itself. This entails the reduction of negative externalities, such as environmental pollution, as well as direct governance contributions, e.g. the development and implementation of HIV/AIDS programs. While companies do not have to perform these latter governance functions in cooperation with state agents, the impact of their CSR (voluntary, self-regulatory) activities should reach beyond the purview of the companies to qualify as more than a private good. Moreover, we do not consider commitment to CSR initiatives alone but focus

on MNC engagement that translates into policies, institutions and resources dedicated to put a commitment to CSR into practice.

Why should MNCs engage in types of CSR which contribute to governance in areas of limited statehood? Firms are not committed to the common good. They pursue private interests. The business of business is to maximize private profits, not social welfare.<sup>2</sup> Empirically, however, we find that under certain conditions firms engage in CSR activities which contribute to governance. The literature on governance in areas of consolidated statehood shows that the ‘shadow of hierarchy’ cast by the state is a key incentive in this respect. In order to avoid state regulation, firms choose voluntarily to commit themselves to reaching a regulatory outcome closer to their preferences. Moreover, the possibility of state regulation reduces the incentive to renege on a voluntary commitment.

In those parts of the world, however, where the state’s capacities to regulate business behavior are weak and a ‘shadow of hierarchy’ is therefore absent, it is far less clear what could be the motivation of firms to contribute to governance. Nonetheless, we do find MNCs engaging in CSR in these areas of limited statehood. They do not only adopt global standards to govern their worldwide business activities (Epstein and Roy 2007; Prakash and Potoski 2006, 2007) but voluntarily implement environmental protection standards, provide HIV/AIDS-related services, or agree to use sustainable energy (Flohr, et al. 2010; Börzel and Thauer forthcoming). In some instances, they even regulate their supply chains, and seek to foster state regulation by pressuring for stricter legislation and helping to strengthen the enforcement capacity of state actors (Börzel and Thauer forthcoming, Vogel and Kagan 2004). How can we explain these findings?

#### *Functional equivalents to the ‘shadow of hierarchy’*

We start from the assumption that (the threat of) state regulation – that is, a credible ‘shadow of hierarchy’ – is not necessarily a precondition for companies to participate in the provision of common goods. More precisely, we argue that functional equivalents to the ‘shadow of hierarchy’ can make MNCs engage in CSR that contributes to governance in areas of limited statehood. The threat of state regulation is not the only way to generate incentives for firms to engage in the provision of common goods (cf. Börzel and Risse 2010). Functional equivalents can ensure that firms agree to engage in CSR (commitment) and do not renege on their commitment (compliance). Four such functional equivalents stand out. First, CSR can be a successful market strategy. Standards can yield economic gains by enhancing the

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<sup>2</sup> Milton Friedman, “The Social Responsibility of Business is to Increase its Profits” in: *The New York Times Magazine*, 13 September 1970.

product quality and, as a consequence, the prospect of a more successful marketing of the product (Ammenberg and Hjelm 2003; Anton et al. 2004; Parker 2002). By incorporating environmental and social standards into their management systems, for instance, MNCs have been able to secure and expand their market shares and reduce production costs (Porter and Kramer 2002; Porter and van der Linde 1995; Barney 1997). Competitors may follow suit for fear of losing market shares or because they seek to emulate their successful peers (Bansal 2005; Potoski and Prakash 2005; Prakash and Potoski 2006). We suggest that such a ‘race to the top’ (Vogel and Kagan 2004) – a competitive dynamic leading to the adoption and spread of higher standards among firms – is also at work in areas of limited statehood.

Second, the reputation of a company and the loyalty of its clients constitute a key corporate asset (Spar and LaMure 2003). This is especially true if companies sell to the ‘LOHA’ segment (Lifestyles of Health and Sustainability), i.e. to consumers that value and demand sustainable products and the respect of social and environmental standards and are willing to pay a premium for this. Such brands will gain a competitive advantage vis-à-vis competitors if they take the lead position in their industry with respect to strict self-regulatory standards (Smith 2008; Auld et al. 2008; Epstein 2008). Conversely, a competitor in that segment which is found to blatantly neglect its corporate social responsibilities will lose customer loyalty and its reputation and, consequently, market shares (Haufler 2001; Mol 2001: 97-100; Blanton and Blanton 2007). Moreover, obvious violations of social or environmental standards may provoke campaigns by transnational NGOs (Baron 2003; Flohr, et al. 2010; Newell 2001) and local community-based organizations (Eweje 2005; Lund-Thomson 2005; Bowen et al. 2008). Such public shaming can result in consumer boycotts, loss of reputation and market shares, falling stock market prices and criticism by shareholders (Wheeler 2001; Hendry 2006; Waygood 2006). We therefore argue that companies under attack will seek to pacify the critics through the adoption of high self-regulatory standards and an ostensive commitment to social responsibilities (Schepers 2006; Trullen and Stevenson 2006; Hoffmann 2001; Halftack 2008). Pressure to engage in CSR, finally, can also emanate from peers who are concerned that ‘one rotten egg spoils the entire cake’, i.e. the reputation of an industry sector (Hönke and Kranz forthcoming, Hönke forthcoming-b, Prakash 2005). Business associations and informal networks often act as transmitters of peer pressure (Kollman and Prakash 2001). The vulnerability of companies to these various kinds of pressures is stronger if a company has intra-firm investments in technology and human capital formation (Thauer 2010, 2012) or a brand name to protect, targets a high-end market (Haufler 2001; Mol 2001: 97-100; Blanton and Blanton 2007), has an international (export) orientation (Bansal and Roth 2000) or if its product is highly visible to end-consumers (Deitelhoff and Wolf 2010). Highly visible multinational companies operating in areas of limited statehood, such as from extractive

industries for instance, are not only confronted with an alert public but also with a general suspicion to do bad in these areas. Engaging in CSR, even without having been targeted by a specific shaming campaign, is a way to signal good behavior to shareholders and the public (Hönke and Kranz forthcoming).

Third, while companies operating in areas of limited statehood hardly face a credible ‘shadow of hierarchy’ cast by the host state, it may be precisely the absence of the threat of strict(er) regulation that creates an incentive for companies to engage in CSR. If the state is not capable of setting and enforcing collectively binding decisions, companies are not confronted with a situation in which they have to weigh the costs of cooperation and voluntary commitment against the possibility of a suboptimal hierarchically imposed policy by the state. Rather, they face the danger of not having a common good at all. If the pursuit of their individual profit depends on the provision of certain common goods and collectively binding rules to produce them, respectively, and the state is not capable or unwilling to provide them, the ‘shadow of anarchy’ (Mayntz and Scharpf 1995) provides companies with a major incentive to step in and fill the governance gap. Yet, they still confront free rider problems. Hence, instead of voluntary self-regulation, we expect in such situations collective CSR activities in the context of business associations, which can mitigate the free rider problem through strict rules, information provision and the imposition of costs for non-compliance (Ronit and Schneider 2000).

Finally, while the ‘shadow of anarchy’ substitutes for the ‘shadow of hierarchy’, the latter can also be generated externally. International organizations and foreign governments can commit companies to the common good. On the one hand, under international law, MNCs can be obliged to comply with standards of good governance in areas of limited statehood (Ladwig and Rudolf 2011). On the other hand, national governments of (consolidated and democratic) states, where MNCs have their headquarters, may also force them to contribute to governance in areas of limited statehood. In this particular case, home country laws are in place and enforceable which require non-state actors such as companies to comply with standards of good governance or other regulations (e.g. environmental laws) irrespective of where they invest or act.

In sum, we argue that firms may engage in CSR activities that contribute to governance in areas of limited statehood despite weak capacities of the state to set and enforce collectively binding norms and rules. The ‘shadow of anarchy’, an external ‘shadow of hierarchy’, competitive and reputational costs or benefits provide incentives that are functionally equivalent to the ‘shadow of hierarchy’ cast by the state to make MNCs adopt and implement CSR policies.



*Is the state still necessary? Areas where limited statehood and governance collide*

While functional equivalents can make MNCs engage in CSR activities, it may still require a minimum of statehood to ensure that these activities really contribute to governance, particularly when it comes to putting voluntary commitment into practice. We submit two arguments in this respect. First, when firms are not much concerned about their reputation, pressure from consumers, peers, shareholders, or NGOs may yield hardly any effects on the CSR activities of MNCs. Under such circumstances, the state may become the addressee of advocacy networks and consumer campaigns in order to make it put pressure on firms to commit to CSR. We call this mechanism ‘invoking state authority’. Local activist groups exert pressure on the state to put pressure on individual companies. This may seem to contradict the notion of areas of limited statehood, where the state by definition is too weak to threaten companies with the implementation of strict regulation. However, while limited capacities of the state refer to the overall lack of ability to regulate companies systematically, state actors and resources do exist nonetheless. The question is on which tasks they are spent. If state agencies are pressured to concentrate their activities and resources on one or a few particular companies, these companies will have to react and give in to the pressure that is exerted upon them in turn. Ultimately, such a concentration of state activities threatens the ‘license to operate’ of the targeted company. Such mechanisms of ‘invoked state authority’ are also relevant for the external ‘shadow of hierarchy’ cast by consolidated states hosting the head quarters of MNCs – or by international organizations whose capacity to enforce international standards depends on the cooperation of consolidated states.

Second, MNCs willing to abide with CSR norms and to contribute to governance may still be inhibited from doing so by limited statehood. The ‘shadow of hierarchy’ cast by the state can be substituted by economic incentives. However, there is more to statehood than generating incentives. CSR activities often need to be institutionally embedded in order to contribute to the provision of a common good. In other words, their effective implementation might depend on a functioning state structure. This is particularly likely in the case of complex task areas of CSR activity. Such tasks are interactive and tightly coupled with a number of actors and functional fields (Perrow 1972). Combatting HIV/AIDS is such a complex, context-specific issue that characterizes the non-market operational environment of MNCs in many Sub-Saharan countries. Workplace and community programs that combat the epidemic can be understood as a cross-functional CSR engagement in the areas of human resources, health and development. For example, automotive firms in South Africa that invest

substantially in specific skills of their employees often feel inclined to safeguard this investment by setting up HIV/AIDS workplace programs (Thauer 2010, 2012). Large mining firms in South Africa dispose of a largely low-skill workforce, yet still engage in HIV/AIDS workplace and community programs. With these activities firms respond to public pressure and reputational concerns as well as to the costs HIV/AIDS imposes on firms in contexts with strong labor regulation, such as South Africa (Hönke forthcoming-a). Combatting HIV/AIDS effectively requires a comprehensive health care system that reaches out to entire families and communities in order to prevent infection and provide care for infected people. It is also related to broader social, economic and cultural factors that need to be addressed. Similarly, environmental standards must be set locally to be at all applicable for firms. If local state agencies do not issue any such regulation, MNCs face difficulties in asking their suppliers to adhere to the standards to which they have committed under their CSR engagement. Governance without government can be, and sometimes needs to be, strengthened by governance by government in the same area in order to be comprehensive and effective. See also Amengual 2010. Turning the CSR activities of MNCs into governance contributions often requires a basic institutional infrastructure. This is particularly the case where the provision of a common good is a complex, ‘coupled task’ (Schäferhoff forthcoming) that relies on the cooperation with – or fulfillment of functions by – other actors than the MNCs. With respect to CSR activities that reach beyond the corporate purview it is often the state that is looked upon to provide the infrastructure to put in place such cross-functional governance and to provide basic security or legal certainty as a precondition for contributions by firms in complex-task areas of CSR. By contrast, if the task is ‘decoupled’ (Schäferhoff forthcoming), MNCs do not require any additional state capacities to provide common goods. We therefore expect that the more CSR activities of MNCs concern a coupled task, the more it takes the state to turn them into governance contributions, *ceteris paribus*.

#### *The role of the state reconsidered – the ‘dark side’ of statehood*

While statehood may often be needed for turning CSR activities of MNCs into governance contributions, its presence can also have the reverse effect. This is, however, not so much related to statehood casting a credible ‘shadow of hierarchy’, as to the lack of willingness on the part of state actors to encourage governance contributions by companies in the first place. On the one hand, governments in areas of limited statehood tend to lack autonomy from business. On the other hand, they may (ab)use their legal authority to impose some of their political and personal economic interests on firms. MNCs rely on informal political networks to receive state contracts and licenses in many areas of limited statehood. Companies then owe members of these networks personal favors (Reno 2001; Handley 2008). State actors may

also prevent companies from providing a particular common good and obstruct their CSR activities if these activities address issue areas in a way not supported by government or opposition groups. In the sensitive area of security, for instance, government authorities seek to demonstrate and reinforce their claim to sovereignty which is inherently linked to controlling the use of force, by preventing companies from providing human rights training to the police (Hönke forthcoming-b). In South Africa, the government has long opposed conventional theories about HIV/AIDS and therefore obstructed business engagement in combating the pandemic. Another way of the state acting against governance contributions by firms is to use the law as a weapon against MNCs that pursue a politically sensitive agenda, as recently experienced by Google in China. Hence, governments in areas of limited states may be too weak to cast a 'shadow of hierarchy' over MNCs to make them engage in CSR that contributes to governance. But they can still undermine the provision of common goods by CSR activities of MNCs casting a 'reversed' 'shadow of hierarchy' by 'throwing the book of law' on firms if they undermine their political power or act against their economic interests. Finally, state actors may refuse to provide MNCs with the necessary support for contributing to governance fearing 'agency loss' or 'agency capture' because of the inferiority of their financial resources, personnel and expertise (Stigler 1971; Hellmann et al. 2002; Börzel 2009). Collective goods provision by companies may in fact be perceived as negatively affecting the authority of the state in a particular functional field or region (Tsai 2011).

The dark sides of statehood may be reinforced by companies that actively seek to use political networks to gain access to markets or favorable contract conditions. Such 'neopatrimonial collusion' (Handley 2008; Hönke forthcoming-b) of business and state increases the likelihood that CSR activities of MNCs take on the form of club goods limited to a political network. In this case, the good provided is not accessible for the general public or group of designated beneficiaries, but benefits those that are privileged already. MNCs may find such 'neopatrimonial collusion' acceptable or even economically beneficial (Hönke 2012; Reno 2001). Yet, if companies are reputation-driven, it constitutes a serious economic risk. NGOs or the media may pick up on such practices, with potentially severe consequences for the brand image of the firm.

To conclude, while a certain degree of statehood may be still necessary to make CSR activities that contribute to governance work, statehood can also discourage or undermine MNC efforts. This raises the question of scope conditions. Our findings indicate that the dark side of statehood is less likely to emerge if it is kept in check by institutional restraints (Börzel 2009; Börzel 2012). At the national level, such restraints can consist in an effective rule of law and institutional checks and balances on

government, such as democratic elections. At the local level, social cohesion can hold local politicians accountable and make them strive for inclusive governance outcomes (Tsai 2007). Local leaders are thus more likely to engage in exclusive governance arrangements where low social cohesion combines with weak accountability mechanisms.

### **CSR and MNCs in South Africa**

To illustrate the different ways in which statehood and the absence thereof affects the ways in which the CSR engagement of MNCs contribute to governance in areas of limited statehood, we draw on the findings of a four-year research project on corporate engagement in CSR in South Africa (cf. Börzel and Thauer forthcoming). South Africa is a newly industrializing country whose legal standards are fairly well developed in most policy areas, while the state's capacity for implementing regulations and securing compliance is rather weak. The capacity of the state to cast a credible 'shadow of hierarchy' is weak in various geographical areas and policy fields. For instance, since the mid-1990s, the South African government has developed ambitious and far-reaching environmental legislation in the fields of water, biodiversity and recently also air. While legal requirements are comprehensive and demanding, details pertaining to the specific behavior of firms are often not spelled out in detail. Moreover, overlapping responsibilities of several government departments lead to regulatory confusion, contradicting requirements and implementation gaps. Most importantly, the implementation of regulations is in many cases deficient since local state agencies lack the capacity to effectively monitor and sanction corporate malpractice. However, the capacity of local state authorities varies such that implementation and enforcement are for example much better in the Western Cape than in Limpopo province. Finally, compliance with environmental standards tends to entail significant costs, which firms are reluctant to bear.

The situation is very different with regard to the fight against HIV/AIDS. South Africa belongs to the countries with the highest HIV/AIDS rates in the world. This makes the pandemic a highly relevant, context specific issue of CSR for companies operating in South Africa. With widespread prevalence of HIV/AIDS, firms experience an increase in employee turnover. Employees remain absent from work because they fall ill or because infected family members need to be looked after. The South African state has lacked both the capacity and the political will to comprehensively fight the disease. In the absence of public health care provision in this area, in particular those firms that have invested in skills of employees have a basic interest in contributing to overcoming this problem. But also firms with low-skilled labor respond to reputational challenges and

costs imposed by the specific South African environment with the establishment of extensive HIV/AIDS workplace and community programs.

To inquire the role of the state and its capacity to set and enforce collectively binding rules for governance contributions of MNCs empirically, we will analyze the CSR behavior of several companies in the automotive and mining sectors. The automotive sector is dominated by seven international brands that operate production sites in South Africa: BMW, Ford, General Motors, Nissan-Renault, Mercedes Benz, Toyota and VW. Generally speaking, two to three out of these seven brands – BMW, Mercedes Benz and Toyota – target a premium segment of the automotive market. Ford, General Motors, Nissan-Renault, VW and Toyota produce cars for a middle class mass segment. Toyota is in many ways an exception, as its strategy is the most comprehensive of all automotive producers. The company strives for market dominance in all market segments (recent problems with production notwithstanding) and is thus a mass as well as premium segment producer.

The South African mining sector is dominated by some of the largest multinational companies worldwide, including Anglo American, BHP Billiton and De Beers. These are followed by important large and medium-sized companies such as AngloGold Ashanti, Goldfields, Impala Platinum and others. In contrast to the automotive sector, most of these companies are originally from South Africa. Anglo American and BHP have shifted their headquarters to the UK and Australia, respectively, after the end of apartheid. Both of them, as all large and medium-sized companies considered in this article, are listed on international stock exchanges in London, New York and/or Toronto.

The two sectors comprise a significant number of foreign as well as local companies with or without brand names, catering to different market segments within South Africa. The firms we analyze also differ in size and are exposed to varying pressure from NGOs and foreign competition. Comparing their CSR engagement and contribution to environmental protection and the fight against HIV/AIDS in different localities allows us to explore the impact of functional equivalents to a ‘shadow of hierarchy’ cast by the South African state.

#### *Functional equivalents to the ‘shadow of hierarchy’*

The cases of multinational automotive and mining companies in South Africa clearly show that there are functional equivalents to the ‘shadow of hierarchy’. Reputational costs and benefits linked to the protection of a brand name and yielded by the higher market value of products, respectively, as well as pressures by NGOs, foreign competitors and their country of origin induce MNCs to engage in CSR activities that contribute to environmental

protection and the fight against HIV/AIDS. We also find support for the 'shadow of anarchy'.

To illustrate the effects of reputational concerns, we analyze two automotive firms that target a premium segment of the consumer market and one firm that focuses on the mass market (Thauer 2010).<sup>3</sup> The difference in the target market is reflected in the fact that the firms aiming at the premium market sell their products at higher average prices than the one firm targeting a mass market. Managers of the two high-end market firms stated in addition that they rely less on economies of scale than other automotive firms targeting low-end markets, and are able to add mark-ups to end-prices.<sup>4</sup> The difference in the target market is further reflected in the importance of consumer expectations. Especially as regards quality, the two high-end market firms are faced with much higher consumer expectations<sup>5</sup> than the mass-market firm.<sup>6</sup> Hence, they are more vulnerable in this respect. Moreover, the high-end market producers stated that they do not perceive themselves as competitors of the low-end market firm. That is, they do not operate in the same consumer markets. Hence, our analysis features two firms that are particularly affected by reputational losses as well as reputational gains, and one firm less driven by reputational concerns.

How do these differences impact upon the CSR related governance contributions of the three firms? We find a variation in the extent of self-regulation of the three automotive producers.<sup>7</sup> The differences, however, occur at a relatively high level of regulation: All three automotive manufacturers apply high levels of self-regulation as regards strictness of rules and the resources allocated to implement these rules. All three firms

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<sup>3</sup> We chose the three cases as they are highly similar in all important aspects except for the factor 'brand name / target market'. Thus, this case selection allows us to evaluate the isolated effects of different intensities of reputational concerns on CSR policies of MNC.

<sup>4</sup> Interviews with the corporate affairs manager and the public communications manager/high-end market firm 1 (anonymized), Munich, 02 August 2007; telephone interview with the director of public affairs and policy/high-end market firm 2 (anonymized), 06 August 2007.

<sup>5</sup> Ibid.

<sup>6</sup> Interviews with the corporate social responsibility manager, the corporate affairs manager and the environmental manager/low-end market firm (anonymized), Rosslyn, 14 February 2007.

<sup>7</sup> The following draws on information from the interviews with the environmental manager and the corporate planning manager/high-end market firm 1 (anonymized), Rosslyn, 20 February 2007; the interviews with the corporate affairs manager and the public communications manager/high-end market firm 1 (anonymized), Munich, 02 August 2007; the interview with the occupational health and corporate social responsibility manager/high-end market firm 2 (anonymized), East London, 26 February 2007; the telephone interview with the director of public affairs and policy/high-end market firm 2 (anonymized), 06 August 2007; the interviews with the corporate social responsibility manager, the corporate affairs manager and the environmental manager/low-end market firm (anonymized), Rosslyn, 14 February 2007.

operate ISO 14001 and ISO 9001 certified management systems. These systems come to bear within a firm *and* within the supply chain (Héritier et al. 2009). All three producers request both kinds of management systems from their first tier suppliers: ISO 14001 is an environmental management system; ISO 9001 is a quality management system with environmental components. These two certification schemes demand a high level of standards, independent legal compliance audits and certificates. Since South African environmental legislation is quite demanding as regards formal provisions (even though implementation is not satisfactory) this means that the environmental policies of the three manufacturers are quite strict. Moreover, the implementation of self-regulation is subject to an auditing process and systematic control. Non-compliance is sanctioned by non-certification. In other words, the certification schemes not only provide for monitoring, but also for enforcement.

Beyond these similarities in the application of ISO certified management systems, there are also some differences in the self-regulation of the three firms. The high-end market producers operate, in addition to the ISO management systems, particularly strict and demanding in-house environmental and quality management systems. These systems are company-specific and prescribed by their global headquarters. As regards the degree to which rules are demanding, their scope and strictness, they go beyond both the standards of the ISO management systems and of South African legislation. In fact, these specific in-house systems require full compliance with all relevant European environmental process and product regulations and even go beyond European legislation. The mass producer, on the other hand, in addition to the ISO certified systems, also provides its own in-house policies. These policies are, however, less strict when compared to the premium producers. Moreover, the mass producer's practice focuses almost exclusively on quality standards, rather than requiring more stringent environmental self-regulation.

In sum, the self-regulatory standards of the mass producer are less demanding than those of the premium producers. This difference, however, only exists with respect to in-house self-regulation. Self-regulation with respect to the supply chain is very similar in all three firms: all automotive manufacturers only require ISO certified management systems from their first tier suppliers.

One possible explanation for this finding is that a similar and standardized approach in the supply chain guarantees 'vertical compatibility' (Farrell 2007: 378). It decreases the degree to which large automotive buyer firms are dependent on specific suppliers, thereby reducing the risk of becoming victims of 'hold ups' and excessive rent seeking behavior in their relationship with suppliers (Héritier, et al. 2009; Farrell 2007). Next to the

effects of reputational concerns on companies, this finding also illustrates our argument that ‘race to the top’ dynamics (Vogel and Kagan 2004) with respect to voluntary standards can take place in areas of limited statehood, if the adoption of standards yields economic gains.

While such ‘race to the top’ dynamics (Vogel and Kagan 2004) certainly contribute to environmental governance in South Africa, they may have adverse effects on the governance of other issue areas, such as competition and social policy. Raising the level of standards in an industry sector always means that competitors that do not meet these standards are kept out of the market (Greenstein and Stango 2007). A striking example in this respect is the South African association of automobile manufacturers (NAAMSA), which successfully lobbied the South African government to issue stricter environmental regulation to keep low-regulating competitors from China, India and South America and their cheaper cars out of the South African market (Thauer 2010). More precisely, the association – driven by European, Japanese, and German originating mass market producers – feared an entrance of cheap Chinese and Indian cars on the South African car market and therefore pressed the government to issue stricter regulations with respect to emissions of new vehicles.<sup>8</sup> In response to this lobbying attempt, the South African government raised the level of emission regulations as requested by NAAMSA, so that the cheap car competitors could not sell cars legally on the South Africa market.<sup>9</sup> Mobility is a prime social issue in South Africa, and the lack thereof a main barrier to employment for people who live in remote townships far away from the industrial centres. Keeping cheap cars out of the market may thus be regarded not only as an obstacle to free trade, but also as hampering enhanced mobility and an inclusive labor market. Hence, this example demonstrates that raising standards may involve trade-offs – in this case between, on the one hand, an enhanced environmental protection and, on the other hand, enhanced mobility and free markets.

Unlike in the automotive sector, end-consumer markets do not play a role in the case of most mining companies as most industrial and precious metals are traded at the London Metals Exchange or are sold on the basis of

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<sup>8</sup> Cf. Cokayne, Roy 2008: “McCarthy Adds Cheap Chery Range”, in: *Business Report*, 12 May 2008: [www.busrep.co.za/index.php?fSectionId=563&fArticleId=4397598](http://www.busrep.co.za/index.php?fSectionId=563&fArticleId=4397598) (last accessed 11 June 2011); interview with the chairperson of the fuel and emissions committee of NAAMSA who also serves as the environmental and industrial planning manager of a low-end market firm/NAAMSA and low-end market firm 1 (anonymized), Rosslyn, 20 February 2007; interview with the occupational health and corporate social responsibility manager/high-end market firm 2 (anonymized), East London, 26 February 2007.

<sup>9</sup> Consumers would have to buy these cheaper cars illegally – which would have severe negative consequences in case of liabilities and their warranties. Hence, in the case of emissions standards regulations are self-enforcing (and thus do not require effective state enforcement in order to be effective).



bulk contracts to governments and large companies. Yet, end-consumers do play an important role in one special case, namely in the diamond mining industry. We have argued that the reputation of a company and the loyalty of its clients constitute a key corporate asset and can earn a premium for ‘socially responsible’ products. Such companies are, at the same time, particularly vulnerable to campaigns that undermine their reputation. Clearly a luxury good for the upper-end consumer market, people attach emotional values to the stones taking them as a symbol for purity. That image was successfully put at risk by the campaign against blood diamonds that accused large companies such as De Beers and other traders of precious stones to buy and sell stones from conflict regions. De Beers is engaged in the production, trading and selling of diamonds and this campaign threatened the company’s brand as well as the image of the product itself. In reaction, De Beers joined a certification system for diamonds, the Kimberley Certification System set up in 2003.<sup>10</sup>

De Beers’ engagement in governance in this case cannot only be traced to social mobilization and concerns over reputational costs. By the time of the blood diamond campaign, the company was losing market shares to smaller traders. De Beers saw the certification scheme not only as a tool for regaining consumer confidence, but also as a way of keeping new traders out of the market and regaining its earlier dominant market position (Paes 2005, Kantz 2006). This case supports our argument that brands gain a competitive advantage vis-à-vis competitors if they engage in strict collective regulation.<sup>11</sup>

The De Beers case stands out from other mining companies concerning the role of consumer confidence. However, the mining industry in general provides clear evidence for our argument that campaigns by transnational NGOs and local community-based organizations against violations of CSR norms can impose reputational costs on companies. These do not need to work through consumers’ shopping decisions. The public shaming of companies may as well result in falling stock market prices and shareholder criticism. Mining companies under attack have sought to pacify critics through the adoption of high self-regulatory standards and an ostensive commitment to CSR (Hönke and Kranz forthcoming). Among the companies operating in South Africa, large global companies such as BHP Billiton and Anglo American, and companies that were targeted by a human rights campaign, such as Anglogold Ashanti (AGA), take the lead in the Social

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<sup>10</sup> See [www.kimberleyprocess.com/](http://www.kimberleyprocess.com/) [last accessed 25 June 2011]; cf. Kantz 2006; Paes 2005.

<sup>11</sup> The Kimberley scheme involves states so that some may argue that it should not be seen as a functional equivalent to the state. That would be a misunderstanding of our argument. We hold that social mobilization and market incentives served as functional equivalents to the state’s ‘shadow of hierarchy’ in making De Beers engage in governance with regards to its operations in areas of limited statehood.

Responsibility Index of the Johannesburg Stock Exchange.<sup>12</sup> While the medium size company AngloGold Ashanti comes second in the 2010 ranking, other small and medium-sized companies score less well.

Many of the smaller companies operating in South Africa, however, are ‘followers’ at best, or do not participate in the discourse at all. An increasing number of medium and small mining enterprises have emerged in the course of the industry’s restructuring process. They are mostly subcontracting firms supplying technical assistance and machinery or exploratory services to larger companies. They do not have the historical legacy of apartheid complicity and are much less visible and thus are not likely to be targeted by transnational campaigns. They populate the more risk-friendly business segment of the mining industry (Szablowski 2007, Malherbe 2000).<sup>13</sup> AngloGold Ashanti is an exception in this regard. The medium-sized gold mining company has become a leader in engaging in human rights and security-related CSR.<sup>14</sup> This can be traced back to a major campaign against the firm’s operations in Eastern Congo. AGA was accused of complicity with the rebel group FNI<sup>15</sup> who used to control the region in which it holds its concession. The case became central to international NGO campaigns urging regulation against companies fuelling conflict.<sup>16</sup> Other medium-sized companies, such as Goldfields or FQML, do not engage in governance as much. They have not been targeted by shaming campaigns.<sup>17</sup>

We also find ostensive sector-wide governance activities by mining companies. This is in line with our argument that pressure to engage in CSR can also emanate from peers who are concerned that ‘one rotten egg spoils the

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<sup>12</sup> See [www.jse.co.za/Products/SRI.aspx](http://www.jse.co.za/Products/SRI.aspx) and the 2010 ranking: [www.jse.co.za/About-Us/SRI/Results/2010Results.aspx](http://www.jse.co.za/About-Us/SRI/Results/2010Results.aspx) (last accessed 12 June 2011).

<sup>13</sup> Interview with the deputy directors environment/DME, Pretoria, 27 March 2007; interview with a consultant and lecturer/School of Mining Engineering at the University of the Witwatersrand, Johannesburg, 20 March 2007; interview with the environmental manager/BHP Billiton, Witbank, 26 November 2007.

<sup>14</sup> AGA ranks second on the high-impact industries best-performers list of the Sustainable Investment Index 2010 of the Johannesburg Stock Exchange, [www.jse.co.za/About-Us/SRI/Results/2010Results.aspx](http://www.jse.co.za/About-Us/SRI/Results/2010Results.aspx) (last accessed 20 June 2011). The company has become a member of the VPs in 2007. See AGA’s global security strategy and the reporting on the VPs: [www.anglogold.co.za/Sustainability/Other+public+reports/](http://www.anglogold.co.za/Sustainability/Other+public+reports/) (last accessed 28 June 2011). Interviews with the manager community relations and social development/AngloGold Ashanti Ltd., Johannesburg, 3 October 2007.

<sup>15</sup> Nationalist and Integrationist Front (FNI).

<sup>16</sup> HRW 2005.

<sup>17</sup> Both are not members of the Voluntary Principles of Security and Human Rights. Internal policies on security and human rights are weak and/or little implemented in practice (see [www.goldfields.co.za/sus\\_reports.php](http://www.goldfields.co.za/sus_reports.php) and <http://www.first-quantum.com/s/Social.asp?ReportID=134525> (last accessed 25 June 2011)); interview with a manager/Gold Fields Protection Services, Johannesburg, 29 November 2007; interview with the regional security manager/FQML, Ndola, 26 October 2007. See also Hönke forthcoming-b.

entire cake', i.e. the reputation of an industry sector. Why should companies go beyond implementing individual standards to restore their reputation in response to a campaign? Reputation in the mining industry – and the level of threat of regulation – is often not company-specific but a collective issue (Hönke forthcoming-b, Szablowski 2007, Hönke and Kranz forthcoming; Prakash 2005). This points to our argument that the threat of external regulation (external 'shadow of hierarchy') is another functional equivalent to the state's 'shadow of hierarchy'. The mining industry has faced extensive criticism for its negative impact on the environment, especially in developing countries. Extractive industries are high-impact industries: they leave a large negative footprint on the local environment and often have detrimental effects on social relations and security (negative externalities). In addition, they extract non-renewable resources and are thus an extremely unsustainable industry. There is a particularly high number of transnational campaigns (e.g. PWYP, by GW, HRW, Friends of the Earth etc.) and regulatory attempts of the industry (see in particular the debate about the UN Norms until 2003, initiatives for home state regulation in the UK, Canada, the EU, the US).

While smaller companies can free-ride on the positive image produced by CSR-activities of major companies, the entire sector suffers reputational damage when any mining company in any country gets under fire. This damage in many instances materializes in a decline in credibility in the financial markets and in a looming threat of stricter regulation by states that have the necessary enforcement capacities. In order to counter increasing public pressure, the industry has come up with a number of initiatives, not only at the company level, but also in the form of collective business responses at the transnational level. There are a number of transnational, sector-specific CSR initiatives.<sup>18</sup> In 1999, for instance, nine of the largest mining companies closed ranks to form the Global Mining Initiative (GMI), presenting the industry as committed to environmental principles and standards. In preparation of the World Summit of Sustainable Development in Johannesburg 2002, a comprehensive consultation and research program was initiated; the Mining/ Metals and Sustainable Development process (MMSD). It resulted in the development of state of the art sustainability policies within the industry, amongst others in the Southern African region. The International Chamber of Mines and Metals (ICMM) was created to coordinate the approach of the industry's global players towards issues such as sustainability, human rights or social development. It developed a common global reporting standard for the industry, the Sustainable Development

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<sup>18</sup> Voluntary Principles on Security and Human Rights (2007), Kimberly Process Certification Scheme (KPCS 2007), Extractive Industries Transparency Initiative (EITI 2007), Initiative for Responsible Mining Assurance (IRMA 2007), International Council on Mining & Metals (ICMM 2007).

Framework (SDF).<sup>19</sup> Membership in the ICMM obliges companies to report according to the SDF framework. These developments build evidence for our argument that shaming campaigns do in fact prompt companies to engage in CSR. In addition, they can unleash market pressure and increase the threat of state regulation for an entire industry, inducing mining companies to engage in sector-wide governance initiatives.

We also find support for the ‘shadow of anarchy’, the third functional equivalent to the ‘shadow of hierarchy’. The South African automotive industry strongly relies on skilled labor and heavily invests in the training of employees. These investments, however, are threatened as a consequence of the HIV/AIDS pandemic in South Africa. Estimations are that between 15-20 per cent of the population in the sexually active age group has contracted the virus.<sup>20</sup> Sick leaves, lower productivity, and social conflict associated with the disease can undermine the profitability of the investment in skills. Empirical studies have shown that this risk is a sufficient incentive for firms that invest substantial resources into the training of employees to engage in HIV/AIDS workplace programs and comprehensive health care provision (Thauer 2010, 2012).

In addition to such in-house workplace programs, automotive firms also reach out to the industry as a whole and to state institutions to contribute to a generally healthier labor force in the country.<sup>21</sup> More specifically, Mercedes Benz in East London, VW and General Motors in Port Elizabeth and Uitenhaage, BMW on the outskirts of Pretoria as well as Toyota in Durban run projects with local as well as nation-wide business associations and local public health institutions (schools, clinics, hospitals) that are directed at raising awareness of the disease in the population, publicizing preventive measures such as condom use, and improving health care services for those who have contracted the virus (for example, through the training of nurses and doctors in local clinics on the specifics of HIV/AIDS treatment). Why do these firms engage in public health care provisions and programs that reach out far beyond their own workforce?

In line with our argument about the ‘shadow of anarchy’, the business model of these companies heavily features the provision of public health. As the state in South Africa proves neither willing nor capable of addressing the HIV/AIDS pandemic effectively, these companies decided to organize the

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<sup>19</sup> Following the MMSD process, the former transnational mining association ICME was transformed into the ICMM, charged with carrying forward the GMI agenda. See [www.icmm.com](http://www.icmm.com) (last accessed 5 January 2011) for further details.

<sup>20</sup> According to Unicef “estimated adult prevalence rate (aged 15-49) in 2007 is 18.1 per cent”. [www.unicef.org/infobycountry/southafrica\\_statistics.html](http://www.unicef.org/infobycountry/southafrica_statistics.html) (last accessed 5 January 2011).

<sup>21</sup> Ibid.

production of this common good by themselves, not only individually but also collectively. On the global level, many of these companies engage in the World Economic Forum Global Health Initiative (GHI) and the Global Business Coalition on HIV/AIDS and other communicable diseases.<sup>22</sup> Nationally, they work with the South African Business Coalition against HIV/AIDS (SABCOHA), Business Unity South Africa (BUSA) and NAACAM, the National Association of Automotive Component Manufacturers, which organizes the suppliers of these big MNCs. On the local level, where their main focus of activities lies, companies initiate many projects with local chambers of commerce. All of the major South African car companies are actively involved in association work on the issue of HIV/AIDS. Associations help them push workplace programs onto their supply chains, which they usually share. Hence, the reason for coordination in associations is efficiency gains rather than mitigating free-rider problems.

The case of mining is similar in the sense that De Beers, Anglo American and others have been pioneers in fighting HIV/AIDS beyond the workplace. Yet, the reasons for this engagement are different from those of the automotive industry. Trade unions played a key role in pushing companies towards adopting a comprehensive and non-discriminatory HIV/AIDS policy in the South African mining industry (Hönke forthcoming-a). Having identified HIV/AIDS as an economic risk as early as the 1980s, the mining industry initially enacted a discriminatory policy and excluded infected employees. Opposed by the labor movement, which has been a close political ally of the ANC, the new ANC government interdicted such practices. Post-apartheid labor regulation in South Africa effectively changed the cost calculation of firms in the field of health: newly designed labor regulations now prohibit mandatory testing and automatic dismissal due to an HIV infection. Furthermore, companies are bound to guarantee the same pension and home-based care benefits to early retired HIV-positive workers and dependents of deceased workers as to everybody else (Mahajan et al. 2007). In 1991, companies signed an agreement with the National Union of Mineworkers; in 2003 another agreement between the Chamber of Mines and the trade union guaranteed health care arrangements for dependents. Overall, public pressure, normative change and reputational concerns were crucial incentives for mining firms to tackle the issue of HIV/AIDS. Reputational concerns in this regard are connected to the widespread negative perception of mining companies in South Africa, which is not only related to the companies' discriminatory behavior in the past. Rather, their migrant labor system is seen as a major cause for the HIV/AIDS pandemic in Southern

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<sup>22</sup> Interview with CEO/NAAMSA, Pretoria, on various occasions in 2007; interview with CEO/NAACAM, Johannesburg, September 2008; interviews with CEOs and production managers of various suppliers, Rosslyn, Brits and Bellville, March and September 2007; interview with automotive expert, Durban, October 2007. See also [www.naamsa.co.za](http://www.naamsa.co.za) (last accessed 5 January 2011) for reports.

Africa (Fourie 2006). Cross-functional engagement in development and health programs that address the pandemic is a response to these concerns.

Overall, the rationale of companies for taking collective action on the problem of HIV/AIDS is highly problem-oriented. Fighting HIV/AIDS and thus contributing to public health is a highly coupled task and cannot be fulfilled by companies alone. The employees of the companies we analyze live their private lives outside the factory gate. This private sphere, in which employees confront the greatest risk of contracting HIV/AIDS, lies beyond the control of any individual company. Workplace programs alone are thus not sufficient to address the problem of HIV/AIDS. It takes collective action within associations, but also with state agencies and NGOs. This finding partially disconfirms the causal logic of our ‘shadow of anarchy’ argument. However, it is, in line with the argument that the solution of complex tasks requires a minimum of statehood (see below).

#### *The collision of limited statehood and governance*

The case of the automotive industry demonstrates that while functional equivalents can make MNCs engage in CSR, it still requires the involvement of the state for CSR to contribute to governance. Where companies are not particularly concerned about reputational losses – for example, because they lack a brand name – the state becomes an addressee of the demands of transnational advocacy networks to put political pressure on companies to change their behavior. The case of a Cape Town-based large chemical fibre producer for the tyre industry is illustrative in this respect.<sup>23</sup> In the 1990s, the firm was heavily polluting the environment and surrounding neighborhoods suffered heavily from industrial fallout, effluents, uncontrolled hazardous waste disposition and emissions. Local neighborhood organizations stood up against this kind of unrestrained pollution, and teamed up with other NGOs and support groups (Héritier et al. 2009). The resulting public ‘shaming’ campaign alone, however, did not have much impact on the fibre company since it does not have any end-consumer business. Recognizing their failure, the NGOs changed their strategy and re-directed their pressure to local members of parliament and to the municipality, demanding state authorities to regulate the company more effectively. The company had existed in Cape Town already before most of the relevant environmental regulations were in place. Hence, changes could not simply be legally forced upon the company, but had to be negotiated. The state delegated negotiations back to the NGOs, but remained in the background, threatening the company with new (applicable) regulation or a generally unfriendly business environment, should it not engage constructively in the

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<sup>23</sup> Interviews with the managing director, a union representative, the environmental manager and various floor managers/chemical fiber producer (anonymized), Bellville, 30 March 2007; interview with a Manager/TEXFED., Johannesburg, 21 March 2007.

negotiations with the NGOs. This ‘shadow of hierarchy’ helped to bring about the Belleville Environmental Forum, which is considered to be a model of dealing with environmental conflicts in South Africa.<sup>24</sup>

The Belleville Environmental Forum resolved the conflict of the firm with the local NGOs. Through the negotiations, the firm gradually reduced its pollution level up to the point that it is now in the process of ISO 14001 certification. Moreover, interactions within the forum changed over time. While participants describe the atmosphere as overtly hostile in the beginning, the parties to the negotiation warmed up to each other over time and some unusual alliances were formed.<sup>25</sup> Having implemented many changes in its production processes, the firm started to actively sponsor the forum in order to make other firms – and especially competitors – engage in environmental pollution reduction, too. Once again, we find that race to the top dynamics can be triggered even under conditions of rather limited statehood.

The case of the automotive industry also demonstrates that a degree of statehood is necessary if the organization of governance is a highly coupled task. As shown above, automotive firms have a genuine interest in contributing to the fight against HIV/AIDS given their high investments in skills development and training. In light of the high interdependence of various actors in their attempt to find a solution to the problem of HIV/AIDS, these companies decided to reach out to the industry as a whole via associations and state agencies by means of public-private partnerships to contribute to a generally healthier labor force in the country. Mercedes Benz in East London, VW and General Motors in Port Elizabeth and Uitenhaage, BMW on the outskirts of Pretoria as well as Toyota in Durban run projects with local as well as nation-wide business associations and local public health institutions (schools, clinics, hospitals) that are directed at raising awareness of the disease in the population, publicizing preventive measures such as condom use and improving health care services for those who have contracted the virus (for example, through the training of nurses and doctors in local clinics on the specifics of HIV/AIDS treatment).<sup>26</sup>

Two main motivations drive firms in their attempts to strengthen statehood through such public-private partnerships. Firstly, they understand

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<sup>24</sup> Ibid..

<sup>25</sup> Interviews with the managing director, a union representative, the environmental manager and various floor managers/chemical fiber producer (anonymized), Bellville, 30 March 2007

<sup>26</sup> Interview with the CEO/NAAMSA, Pretoria, February 2007; interview with the CEO/NAACAM, Johannesburg, September 2008; interviews with the health- and corporate affairs managers of various automotive producers, Rosslyn, East London and Port Elizabeth, February and September 2007; interview with an automotive expert, Durban, October 2007.

that HIV/AIDS is as much a societal problem as a disease and can therefore only be tackled effectively through collective action of all relevant actors. Secondly, in the field of HIV/AIDS abatement, weak statehood is a significant obstacle to private initiatives to fight the disease. HIV/AIDS workplace programs are highly problematic if the state cannot guarantee that patients will be taken care of by public health institutions in case a firm decides to let staff go or if it moves away.<sup>27</sup> More precisely, extending these programs to full antiretroviral medication provision is problematic if there is no medical scheme for employees who lose their job. This bears the danger that persons who contracted AIDS develop resistances towards anti-retroviral medication.

The field of the environment provides further examples of the necessity of statehood for CSR activities that contribute to governance when dealing with coupled tasks. The big MNCs in the automotive industry are generally all ISO 14001 certified. Hence, they operate on relatively high environmental standards. However, ISO 14001 is in essence a management system which prescribes procedural rules. The level of substantive – that is, pollution limiting – standards in which this management system is embedded can vary. At a minimum, ISO 14001 requires that a company implements the legal prescriptions prevailing in the country where its operations take place to be certified. In many areas, environmental regulation is a highly complex and coupled task to fulfill:<sup>28</sup> National guidelines may exist, but they have to be applied at the local level, and for that it takes an active state which is capable of setting these standards. Often, however, we find that the state is not able to fulfill this basic function – as, for example, in East London, where a big German automotive MNC was confronted with the situation that it had to undergo ISO 14001 certification without knowing its effluent, emission and waste deposition limits. As a result, certification almost failed, and the company found it impossible to formulate an appropriate CSR policy.<sup>29</sup>

Difficulties in implementing the elaborated South African Water Act provide an example for how weak statehood can hinder compliance of mining companies with CSR. The act requires companies to reapply for new water licenses, which requires them to go through a complex procedure involving a comprehensive Environmental Impact Assessment. The department's own capacities have proven to be weak in dealing with the large number of applications combined with the ambitious requirement of the act itself. Due to

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<sup>27</sup> Ibid.. See in addition the interview with the health expert/Border Kai Chamber of Commerce/Daimler Trust, East London, September 2007.

<sup>28</sup> Certification officer/SABS (South African Bureau of Standards), 12 September 2007, Pretoria.

<sup>29</sup> Interviews with the environmental-, the occupational health and corporate social responsibility managers/high-end market firm 2 (anonymized), East London, 26 February 2007.



the slow bureaucratic procedures and the lack of monitoring and enforcement capacities of the government, mines used to operate without having a water license. Even though the claim of the Chamber of Mines that large companies were in danger of disqualification from ISO 14001 seems to be exaggerated,<sup>30</sup> the issue of legal compliance is a recurrent issue of debate during ISO audits.<sup>31</sup>

Besides the need for a minimum of statehood in the host state in order to successfully implement and sustain CSR that contributes to governance, the state also plays an important role in a number of transnational multi-stakeholder initiatives set up to address governance problems. The Voluntary Principles of Security and Human Rights (VPs) were initiated by the US and UK governments together with US and UK companies.<sup>32</sup> As for the Kimberley process, NGOs and external state actors are instrumental in setting up such regulatory initiatives. Involving host states is crucial though. Successful implementation of the VPs requires the support of host governments that cooperate controlling police and military and improving their compliance with human rights standards (Börzel and Hönke 2011). The Kimberley process depends even more on a minimum of willingness and capacity of diamond-exporting states to implement the certification scheme. Participant countries are required to put in place national legislation and institutions to monitor the scheme.<sup>33</sup>

Summing up, we find functional equivalents to the ‘shadow of hierarchy’ that make companies engage in CSR that contributes to governance in areas of limited statehood. Whereas statehood can be substituted by other mechanisms that incite CSR activities, a limited degree of statehood is still required to turn these CSR activities into effective governance contributions. Statehood is particularly necessary when MNCs are immune to reputational concerns, governance tasks are coupled, and the ‘shadow of hierarchy’ is to be cast externally.

#### *The ‘dark side’ of statehood*

While statehood is often needed for CSR contributions to governance, its presence can also have the reverse effect. This is in particular the case in complex-task areas in which effective governance would require the co-

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<sup>30</sup> Interview with the environmental adviser/Chamber of Mines, Johannesburg, South Africa, 16 March 2007.

<sup>31</sup> Interview with the manager sustainable development/AngloPlatinum, Johannesburg, 20 November 2007.

<sup>32</sup> See [www.voluntaryprinciples.org](http://www.voluntaryprinciples.org) (last accessed 25 June 2011).

<sup>33</sup> See the requirements in sections II, V a and VI 8, 9 of the Kimberley Process Certification Scheme (KPCS), [www.kimberleyprocess.com/documents/basic\\_core\\_documents\\_en.html](http://www.kimberleyprocess.com/documents/basic_core_documents_en.html) (last accessed 25 June 2011).

production of collective goods by business' CSR engagement and state provision of services and basic infrastructure. Yet, in the complex-task area of HIV/AIDS the state has used its limited capacities to prevent companies from combatting the pandemic in South Africa . In their fight against the HIV/AIDS pandemic in the area of Durban in the 1990s and early 2000s, MNCs, together with the Global Fund, the local municipality and the local chamber of commerce, initiated a public-private partnership for HIV/AIDS prevention and comprehensive treatment. It was to be rolled out throughout the local business world and from there on to society.<sup>34</sup> However, the central government, fearing agency loss and threat to its sovereignty, insisted to take full control over the budget and content of the project right before it started. In light of the erratic stance of the then national government towards the pandemic and its obvious failure to respond to it effectively, its insistence on controlling the partnership de facto meant its ending, as it forced the partners of this project to withdraw. This case illustrates that in emerging markets, the state may be weak, unwilling or incompetent in some specific issue areas, but it is often still strong enough to break up governance structures on the local level and maintain control and authority over local governments and private actors. Even where statehood is more limited, such as the Democratic Republic of Congo, the state does prevent companies from CSR contributions in salient issue areas in particular when these are considered to threaten state sovereignty. When Freeport MacMoRan and Anvil Mining wanted to conduct human rights training for the state police forces the firms worked with, a requirement of the Voluntary Principles of Security and Human Rights, they were refused to do so. Such training was perceived by state authorities as undermining their authority and state sovereignty (Börzel and Hönke, 2011). In politically salient and contested issue areas, local private and public-private governance initiatives may thus be threatened by statehood. Overall, if the goals of CSR contributions are not in line with government position, states will rather obstruct than support them.

Apart from an overtly destructive role of statehood in the governance of contested issue areas, we also find examples of 'neopatrimonial collusion' that affect the quality of governance contributions by CSR (Hönke, forthcoming-b; Hönke, with Thomas 2012). Fighting HIV/AIDS, MNCs in South Africa try to reach out to local governments. As mentioned above, medical treatment programs for employees presuppose an agreement with the local public health care institutions to take care of employees who are let go by the company.<sup>35</sup> In exchange for this guarantee, MNCs usually offer to

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<sup>34</sup> Interviews with CEO/Durban Chamber of Commerce and Industry and Durban Chamber Foundation; interviews with various health managers of automotive firms in Durban 2007 and 2008.

<sup>35</sup> Interview with the CEO/NAAMSA, Pretoria, February 2007; interview with the CEO/NAACAM, Johannesburg, September 2008; interviews with the health- and corporate affairs managers of various OEMs, Rosslyn, East London and Port Elizabeth,

extend their HIV/AIDS workplace program to parts of the local community. In East London, the government insisted on a highly exclusive deal: In exchange for the guarantee to take care of former employees of an MNC, the health department demanded to have its *own* employees enrolled in the company's workplace program.<sup>36</sup> This is certainly a case where the attempt of a MNC to contribute to a common good was transformed by the government's neopatrimonial habits into an exclusive club good. The MNC offered to take relatively poor persons from the neighboring townships on board of its program, which would have made a contribution to an improved local public health situation. Instead of persons who otherwise have no access to health care, now government officials who are relatively well off and could afford private insurance benefit from the program of the MNC.

Even though 'neopatrimonial collusion' might be less a problem in South Africa than in other countries, evidence from the mining sector in the field of security supports the argument that at the local level of implementation such collusion between local administration and companies may lead to exclusive governance contributions. However, this process is not only driven by state actors (Hönke forthcoming-b). Mining companies concentrate state and non-state security capacities in the areas in which their operations are located; their in-house security services cooperate with private security companies and the South African police. The outcome of these security arrangements is, however, exclusive. Security is provided as a club good with negative effects on poor neighboring communities. While bound to common good provision, the police are drawn into such arrangements and concentrate their activities on lucrative cooperation with the companies. Companies cannot police on their own, as much as some of them would like to; a mine security agent explains that "[Y]ou know we were policemen and we knew we could do it"<sup>37</sup>, but companies are legally obliged to rely on the police for a number of activities, such as making arrests, taking fingerprints, preparing a docket and opening a case in court. Therefore there is engagement with the police: "You support them because you have to rely on them".<sup>38</sup> As part of their cross-functional CSR engagement in local communities, the mining companies engage in building the capacities of some local police stations to enable them to govern security in the mining area. However, they restrict this support to priority areas, with "those [police stations] which have the most direct impact on you", and with regard to those functions "which you can't do and for which you are relying on the police".<sup>39</sup> Mining

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February and September 2007; interview with an automotive expert, Durban, October 2007.

<sup>36</sup> Interview with the occupational health and corporate social responsibility manager/high-end market firm 2 (anonymized), East London, 26 February 2007.

<sup>37</sup> Interview with company security manager/platinum mining company (anonymized), Johannesburg, 14 December 2007.

<sup>38</sup> Ibid..

<sup>39</sup> Ibid.

companies provide material resources to these selected stations, such as vehicles or satellite police stations, or let them use their vehicles.<sup>40</sup> Such CSR engagement is selective in its geographical, social and functional scope. Selectively building state capacities thus translates into nodes of security governance that provide security as a narrow club good.

The consensual collusion of MNC branches with host political authorities also takes place with non-state actors at the subnational level and undermines CSR that contributes to inclusive collective goods provision in similar ways.<sup>41</sup> We found evidence in the platinum mining area that is partly under the jurisdiction of the traditional authority of the Royal Bafokeng in South Africa's North-Western Province. Impala Mining operates in this area in a joint venture with the Bafokeng traditional authority. Impala's operation was opposed by the small community of Luka when it wanted to open a new shaft in the community's neighborhood in 2003. Luka residents complained that they would not benefit from the mining project. Teaming up with the conservative leadership of the Royal Bafokeng, Impala was able to bypass and ignore criticism of its negative environmental impact upon the Luka community, which is within the Bafokeng area, just next to the mine. The Luka Environmental Forum that organized the protest is composed of young, critical, mostly non-Bafokeng members. They have been silenced and sidelined in the political process by Bafokeng authorities and Impala.<sup>42</sup> This case illustrates that 'neopatrimonial collusion' can render community pressure ineffective and result in exclusive governance. It also shows that collusion took place because the protesting community was marginalized in the area and had no means to hold the Bafokeng authority accountable and responsive to its needs.

## Conclusion

This article has shown that MNCs engage in CSR activities that contribute to governance even in areas where the state is too weak and often also unwilling to provide common goods. In light of the commonly held expectation that firms relocate production to such areas of limited statehood precisely because regulation is low and enforcement is ineffective this poses an important puzzle: Why would firms that are committed to CSR invest in areas of limited statehood in the first place?

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<sup>40</sup> Interviews with researcher/Business Against Crime, national office, Johannesburg, 23 March 2007 & July 2007; interview with a local manager/auditing firm managing social investment projects of a mining company (anonymized), Rustenburg, 3 December 2008.

<sup>41</sup> For more on subnational collusion see Hönke forthcoming-b.

<sup>42</sup> Interview with Luka Environmental Committee, Rustenburg, 8 October 2008; interview with Rustenburg Environmental Coalition (RECO) and ex-Bafokeng-Councilor, Rustenburg, 9 October 2008.

We argue that investment decisions follow similar rationales as the engagement in CSR and governance in areas of limited statehood. Firms seek to make profit. Areas of limited statehood provide business opportunities, particularly if they host emerging economies with strong growth rates and a great market potential (such as the BRIC states). Having a production site in a country gives firms access to markets that are often protected by trade restrictions and also yields reputational gains with potential local costumers. Moreover, many MNCs had already invested in areas of limited statehood before they subscribed to CSR; in these and other cases operating in an area of limited statehood provides an important incentive to engage in CSR to avoid being accused of engaging in a ‘race to the bottom’. Such reputational concerns are crucial for making MNCs engage in CSR activities that contribute to governance in the normative environment of the post-cold war era, which has confronted especially highly visible multinational companies with much public attention and pressure. Extending CSR activities beyond the corporate purview contributing to governance in areas of limited statehood is subject to the same cost-benefit-calculations. Beside reputational concerns and competitive advantages, the absence of any state provision of governance and an external ‘shadow of hierarchy’ cast by home-country states or international organizations can substitute for the incentives generated by the threat of state intervention that is often not credible in areas of limited statehood.

Yet, these functional equivalents to the ‘shadow of hierarchy’ still require the involvement of the state to make MNCs contribute to the broader common good in many areas if CSR activities are to reach beyond the purview of MNCs. This is particularly the case where MNCs are immune to reputational concerns – the threat of state regulation is necessary to make companies engage in CSR providing governance. Statehood is also required where governance tasks are complex and coupled.

At the same time, statehood may also be an obstacle rather than a facilitator for CSR governance contributions. While being too weak to set and enforce collectively binding rules for the provision of common goods and to provide these goods, respectively, state actors can invoke their legal authority to prevent MNCs from contributing to governance in contested issue areas or make CSR activities serve their own political and economic interests rather than the public good. Especially firms little concerned with reputation or public pressure may benefit from and encourage such behavior. These dark sides of statehood should caution against any conclusions that the state – if the capacities are given – will always make MNCs contribute to governance. This would reify the statist bias in parts of the governance literature that sees the state as the superior provider of governance (Rotberg 2003; Leibfried and Zürn 2005; for a critique see Brozus 2011). Unlike companies, the business of

the state is to produce common goods. Yet, like companies, state actors need to be restrained and committed to the public interest by institutions and held publicly accountable to comply. These institutional mechanisms are often as weak as the capacity of the state to provide common goods and set and enforce collectively binding rules in the first place. Governance requires both responsible states and responsible companies. For areas of limited statehood, the institutions to hold governments and companies responsible are increasingly located at the international and transnational level, where the states are only one group of actors, albeit an important one.

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