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THE USE OF CORPORATE SOCIAL RESPONSIBILITY TO MITIGATE POLITICAL RISKS IN DEVELOPING COUNTRIES

MS. VIOLETA IFTINCHI[1] AND DR. GHEORGHE HURDUZEU

ABSTRACT

Forced to enter new markets, which are most of the time riskier than those of their home countries, multinational corporations have to face the associated risks of investing in developing countries. One of them is political risk. Corporations can suffer significant damage or the loss of their entire investments following various adverse actions by political stakeholders. Corporate social responsibility (CSR) policies can help mitigate part of the political risks that affect corporations in developing countries by building relationships with the host communities, thus making CSR part of the risk management strategy. The aim of this paper is to see how CSR as a political risk management strategy is reflected in the literature, to highlight its benefits and to examine ways for an effective and successful implementation of CSR policies, taking into account its limitations. It also introduces in the literature two categories of political risk that CSR policies target: intrinsic and extrinsic political risks.

Key words: political risk, corporate social responsibility, risk management

INTRODUCTION

According to a report of the Multilateral Investment Guarantee Agency (MIGA) on world investments and political risk, developing countries attracted in 2013 around 41% of global foreign direct investment, the highest level since 2000 (MIGA, 2013). In contrast to the stagnant markets of developed economies, corporations find significant opportunities for doing business in emerging markets. Although developing countries have also been suffering from the global financial crisis, their growth rates still exceed those of advanced economies. However, moving into rapid-growth markets comes with additional risks.

One of them is political risk, which Molano (2008, p. 18) defines as "the broad spectrum of actions in the political and social environment which can influence a transnational actor's property rights, income or market". Local, regional and national governments, non-governmental organisations (NGOs) or non-organised activists, rebel/terrorist groups or organisations, the home government or other foreign states or multinational organisations and any other individual involved in political action can create political risk (Bremmer and Keat, 2009; Jakobsen, 2012). Corporations can suffer significant damage or loss of their entire investments following expropriation or nationalisation, transfer and convertibility restrictions, breach of contracts, acts of terrorism, domestic political violence (e.g. the hostile actions of national forces, revolutions, civil war, and insurrection) or other adverse regulatory changes and/or negative government action.

Political risk is more relevant to the companies operating in emerging markets (Bremmer and Keat, 2009; McKellar, 2010). In MIGA's 2013 report, multinational corporations operating in developing countries ranked political risk as their second highest concern over the following three years, immediately after macroeconomic instability (MIGA, 2013). Under great pressure to gain revenues and new markets, corporations see risk avoidance only as an extreme method to manage political risk. Consequently, they have been forced to find the most suitable risk management strategy specific to the particular political risks that each of them is facing, for each country or government where they operate under a given period

[1] Ms. Violeta Iftinchi, PhD Student, Bucharest University of Economic Studies.

of time (García-Canal and Guillén, 2008). This political risk management strategy should fit with their international growth strategy and desired corporate identity.

Within developing countries, multinational corporations are a strong force for economic integration, income generation and employment opportunities for the local population (Tully, 2012). Although the role of corporate social responsibility (CSR) in risk management and, furthermore, in political risk management is difficult to quantify, experts and scholars acknowledge that the measures undertaken by corporations to integrate social, environmental and commercial concerns in their operations and stakeholder interactions can help mitigate adverse political risks.

CSR AND POLITICAL RISK MANAGEMENT

The concept of CSR

Tully (2012, p. 20) defines CSR as "the conditions under which society grants corporations the right to pursue profit maximisation. It typically refers to a range of voluntary measures undertaken by corporations to integrate social, environmental and commercial concerns in their operations and stakeholder interactions." Bremmer and Keat (2009, p.102) use "social accommodation" to refer to a process of acting as a good neighbour who responds to the needs of the local community. CSR activities include building infrastructure, schools and hospitals, or any other activity that improves the local economies and raises the living standard of the population.

The CSR concept has many facets and has been forced to evolve. Terms like "responsible business", "corporate sustainability" and "corporate citizenship" are all used by companies and experts. More recently, Porter and Kramer (2011) introduced the concept of "shared value", which should replace CSR programmes. According to the principle of shared value, companies can ensure their own self-interest while, in addition, creating "value for society by addressing its needs and challenges" (Porter and Kramer, 2011, p. 64). In this respect, CSR policies cannot be totally separated from the corporation's profit motivation as this would create agency conflicts if managers were to put forward such initiatives. Thus, they have to be shaped to align with the business interests of the corporations' shareholders (Pesmatzoglou et al., 2014).

CSR and political risk

This paper introduces two categories of political risks in the literature that CSR policies target: intrinsic and extrinsic political risks.

The first category – *intrinsic risks* – refers to the types of political risks that corporations themselves are creating or increasing as a result of the nature of their activities. Corporations may impact significantly the social, environmental and cultural environment of host communities. Their investments may require the relocation of entire communities and changes in the natural environment, like the deviation of water sources. Contamination of natural sites and, more dangerously, of water sources may cause health problems. Protests caused by dramatic environmental and social problems, or water impacts and risks associated can create conflicts. Extractive corporations, construction projects or water-intensive industries are dealing the most with this kind of "project-specific grievance" (Jakobsen, 2012, p. 90).

The second category – *extrinsic risks* – comes from the difficulties in establishing and sustaining a good relationship with the host community. One of the most challenging forms of political risk is the lack or the loss of a "social license to operate" (Farrell, Hamann and Mackres, 2012). Richert, Rogers and Burton (2015, p. 121) define the social license to operate as "an implicit contract between parties which reduces the risk of socio-political challenges to the actions of the company". The social license to operate goes beyond the legal licenses that a corporation needs to operate (Wiig and Kolstad, 2010) and has become more important than the legal "compulsory" authorisations (Idemudia, 2009). Parsons, Lacey and Moffat (2014) call it a "community licence". Any project that does not enjoy the approval of the local community, its acceptance and trust will not be sustainable (Slack, 2012; McDonald and Young, 2012). Community opposition can trigger extensive delays in the development of projects, resulting in increased costs and political turmoil, which can turn a safe project into a risky and unfeasible one, possibly leading to suspension or ultimately project abandonment (Slack, 2012; Warnaars, 2012). This has made corporations aware of the importance of earning and maintaining their social license to operate (Ackah-Baidoo, 2012; Suescun Pozas, Lindsay and du Monceau, 2015).

CSR – a tool for political risk management

According to MIGA's 2013 report, almost 40% of multinational enterprises are using engagement with local communities as a tool to mitigate political risk in developing countries(MIGA, 2013). Social measures have become a condition to access political risk insurance from private underwriters (e.g. Lloyds) or international organisations like MIGA (Rosenau et al., 2009), thus recognising the role of CSR in a political risk management strategy.

McKellar (2010) argues that sound global corporate citizenship, that is, the contribution of a firm to the societies in which it operates and the alignment with its social values, is fundamental to political risk mitigation, and therefore, to international business performance. CSR can offer "the possibility to minimise the risk of conflict and to assist with restoring and gaining confidence and support from a wide audience, as well as creating a favourable public opinion of a company's operations" (Warnaars, 2012, p. 231).

A distinction between the contributions of the CSR policies to manage either intrinsic or extrinsic risks is difficult to make. As regards intrinsic risks, CSR tackles risks from the damage caused by companies, giving rise, for example, to environmental protests (Wiig and Kolstad, 2010). Meanwhile, corporations have had to shift their "do no harm policy" to a direct engagement in social development projects, especially for host communities negatively affected by their operations (Warhurst, 2001; Del Bosco and Misani, 2011). As regards extrinsic risks, by effectively engaging with local communities, corporations ensure and maintain tacit permission to continue operations. CSR contributes to obtaining the social license to operate (Idemudia, 2009), thus becoming a tool for risk management. The World Bank (2006) includes managing risks to earn/maintain a license to operate as one of the top drivers of CSR.

Overall, using CSR may not be as efficient when corporations are confronted with the risk of expropriation, transfer and convertibility restrictions, or widespread political risks like national revolution or civil war, but it can be very helpful in case of local violence or the potential aversion of the local community to foreign companies. Del Bosco and Misani (2011) have demonstrated the benefits of the CSR in reducing conflict and violence, thus contributing to the security of a firm (e.g. preventing attacks on the company's physical assets and employees). Community engagement has also helped to reduce the highly visible security presence employed to protect the company's operation sites (Rosenau et al., 2009). In addition, CSR may improve the ability of the corporations to get contracts, concessions and licenses (Wiig and Kolstad, 2010; Virah-Sawmy, 2015). It may also be useful in dealing with legal and regulatory controls (Sprinkle and Maines, 2010) and improve government relations (Yin and Jamali, 2016).

IMPLEMENTING CSR POLICIES TO MITIGATE POLITICAL RISKS

Extractive corporations – front-runners in CSR policies

Compared with other economic sectors, extractive corporations' activities face a higher risk of environmental damage and social disturbance (Slack, 2012; Pesmatzoglou et al., 2014). They usually entail environmental externalities most affecting the poor and vulnerable population. The potential for the rejection of their activities is higher, for extractive industries are capital intensive and create few local jobs. Therefore, extractive corporations' operations have caused significant political turbulence in many countries, resulting in mass protests and ultimately the end of commercial activities (Gardner et al., 2012). Among the extractive industries, the mining sector is recognised as producing the most substantial and sometimes irreversible effects on the natural environment and population, such as accidents, environmental degradation, health threats and violations of human rights (Mutti et al., 2012). Intrinsic risks are thus the major target of the CSR policies of mining companies.

Corporations in the mining sector have been under extreme pressure to act against the damage they cause the local environment and communities during the exploitation of projects and after the mining resources are exhausted. A more recent approach is to implement CSR policies in the early stages of the exploration of a project (Suescun Pozas, Lindsay and du Monceau, 2015), thus minimising the risks of future conflicts. Developing CSR responses post-conflict may increase the costs and efforts of obtaining acceptance of the community (Warnaars, 2012). This proactive approach is a major and positive shift from the usual reactive character of CSR policies (Mutti et al., 2012). In this case, corporations have to start booking the costs associated with the CSR policies before their projects are even generating revenues (Farrell, Hamann and Mackres, 2012), thus increasing the upfront costs of investment. One such example is Xstrata. The company received the right to explore the 'Las Bambas' project in Southern Peru in August 2004; however, it was only in March 2011 that the Ministry of Energy and Mines of Peru approved the company's environmental impact study. The company used this seven-year period to obtain, in addition to the legal authorisations, the support of the local community that must be relocated for their project (Murray, 2011). Xstrata began its campaign to secure the acceptance of the community before the exploratory drilling in 2004.

Although their offshore operations are located far away from the host country populations, oil and gas corporations are still subject to the scrutiny of communities or the criticism of NGOs. Their operations can generate significant unrest if the population does not benefit from the corporations' revenues. In this case, Ackah-Baidoo (2012) introduced the term "offshore CSR".

Extractive companies have gained extensive experience in the areas of environmental management and community relations, and have developed policies to address indigenous population, human rights protection and corporate governance (Warhurst, 2001). In 1980, more than 70% of the multinational corporations in this field reported the use of institutionalised assessment activities that involved explicit and systematic analysis of political risk (Lax, 1988). Their long-term involvement and experience made extractive corporations leaders in the CSR movement in developing countries (Farrell, Hamann and Mackres, 2012). Mining companies have established specific departments to deal with CSR issues (McDonald and Young, 2012). Despite all this, there is still criticism of mining companies for their unsatisfactory results regarding the social and economic development as well as their environmental impact, especially in developing countries (Slack, 2012; Pesmatzoglou et al., 2014).

Role of partnerships

The role of CSR partnerships in managing political risk has been widely recognised (Warhurst, 2001). They can take different forms, such as tri-sector partnerships (agreement between business, government and civil society), the growing trend of bi-sector partnerships (between the corporation and either civil society or government), or non-traditional stakeholders like local tribes (Pesmatzoglou et al., 2014). McDonald and Young, (2012) refer to cross-sector partnerships as a form of CSR activity.

The benefits coming from the implementation of CSR policies within partnerships are numerous (Rosenau et al., 2009). Partnerships can reduce costs for corporations (Idemudia, 2009). The home state may also support financially the CSR projects of its companies. In Cameroon, Rabobank (the Dutch lender), which has its origins in the agricultural industry, has helped establish co-operatives for small cocoa bean growers. The project is funded by the Dutch government's "cocoa buffer fund" and it is implemented by a consortium that includes cocoa bean processing companies, large corporate buyers, development organisations and research groups (Murray, 2011).

Local leaders may facilitate communication between corporations and communities (Gardner et al., 2012). They can bring their knowledge of the communities' problems and lead the corporations into the complex dynamics of the communities.

Partnerships are important to build credibility of and trust in CSR policies. As corporations are known for their profit maximisation objectives rather than for their social motivation, local communities may not be always convinced of the corporations' initiatives to promote social and environmental well-being (Idemudia, 2014). The collaboration with NGOs can remove these suspicions and reduce public hostility. NGOs' local expertise can prevent the emergence of new risks by helping corporations navigate through sensitive community matters, such as competition between various tribal and ethnic groups, and sacred religious and historical sites (Stephens, 2015). Therefore, the fact that 25% of multinational corporations are using engagement with NGOs as a tool to mitigate political risk in developing countries (MIGA, 2013) is not surprising. In locations with limited government capacity, partnerships with NGOs can facilitate the work of corporations and contribute to the success of CSR programmes (Farrell, Hamann and Mackres, 2012).

A couple of decades ago, NGOs and companies used to see each other as opponents, but recent years have seen a radical change. Some NGOs have had corporate partnerships for many years. The one between the US-based Environmental Defence Fund and McDonald's is one of the oldest, dating from the 1990s. Since then, others have followed. The World Wide Fund for Nature works with companies like Procter & Gamble, Marks and Spencer, HSBC and SABMiller. Oxfam has established partnerships with companies such as Aviva and Accenture. Unilever has been working with Greenpeace to incentivise companies to move to sustainable palm oil and end deforestation. It has also worked with NGOs in areas such as water hygiene, sanitation and basis nutrition. Meanwhile Nestlé is partnering with the Fair Labour Association, a non-profit organisation dedicated to eliminating sweatshop labour, in order to probe its supply chains in Ivory Coast. Nestlé has been the target of many protesters over the years, for example over the use of palm oil in its Kit Kats and sales of infant formula to mothers in Africa, who mixed the powder with unclean water (Lucas, 2012); thus its current NGO partnerships may also improve its reputation and social acceptance.

Partnerships with central and local governments can help to share the responsibility of the developments projects, thus diminishing the risks of transforming corporations into the only responsible entity for the failure of a social project (the case of CSR policies in Nigeria is one of the most quoted in the literature). Multinational corporations operating in China recognise the government as a powerful stakeholder (Tian and Slocum, 2016) and give priority to public–private partnerships to implement CSR projects (Yin and Jamali, 2016). If no formal partnership is agreed between the corporation and the government, corporations should at least ensure that their CSR policies are backed by the state authorities (Ackah-Baidoo, 2012) or aligned with government initiatives in order to guarantee the effectiveness and success of their CSR programmes (Suescun Pozas, Lindsay and du Monceau, 2015; Yin and Jamali, 2016).

Limitations of CSR in political risk management

There are many cases where CSR policies have ended by exacerbating conflict instead of improving stakeholders' relations and reducing risks (Warnaars, 2012; Idemudia, 2014). CSR can become itself a source of conflict or can expose the company to additional risks.

Firstly, risks may come from the way in which CSR policies are implemented. Partnerships involving government agencies that prove to be corrupt or in breach of human rights can weaken community trust and the credibility of the CSR policy (Warhurst, 2001).

Corporations may face conflicts with the host government when its CSR policies cross the boundaries of development responsibilities held by the state (Cash, 2012) or local authorities (Mutti et al., 2012). Local traditional leaders may not always advocate community benefits, but support personal interests primarily and undermine community development (Wilson, 2015).

Secondly, the problem of communities' expectations towards the role of corporations has been a source of conflict for a long time. The implementation of CSR policies in fragile states characterised by high instability, weak institutions and political capacity is even more difficult as corporations may be forced to take over some of the public responsibilities usually carried out by the state and engage in more CSR activities than intended, especially in resource-rich developing countries (Bremmer and Keat, 2009; Cash, 2012; Osemeke, Adegbite and Adegbite, 2016). In the absence of state involvement, communities may develop high expectations towards corporations. In some cases, corporations themselves can raise these hopes unfairly in order to gain public support in the initial stages of the investments (Mutti et al., 2012). When those expectations are not met, conflicts can occur between communities and corporations (Rosenau et al., 2009; Suescun Pozas, Lindsay and du Monceau, 2015). In these cases, corporations no longer represent partners for their communities, but are perceived as replacing the role of the state and as compensating for its failure (Warnaars, 2012). For these reasons, corporations have to ensure that stakeholders are aware of their role, i.e. "to contribute to and/or enhance existing socioeconomic development, not to replace government policy" (Cash, 2012, p. 144). Local communities have to acknowledge that their primary relationship is between them and the government, while corporations are only a means of boosting that connection (Cash, 2012). However, making communities set out more realistic expectations may prove problematic and risky for corporations (Slack, 2012).

Finally, corporations may be faced with the problem of the unequal distribution of the CSR benefits. Conflicts may arise when CSR policies target only specific communities, such as certain ethnic groups, social class or region (Rosenau et al., 2009; Kotilainen at al., 2015). If some groups benefit more than the others from the company's CSR programmes, corporations may see their initiatives rejected by the communities. Local rivalries can also be intensified and low-level conflict risks in the community may be amplified (McKellar, 2010).

SUMMARY AND CONCLUSIONS

The higher the return, the higher the risk. This may be the case for multinational corporations who operate in emerging markets or developing countries. Confronted with the slow-growth rates of their home countries, mainly developed ones, and the prospects of new resources (natural, human, etc.) in developing economies, corporations have to put into place risk management techniques to tackle additional threats, like political risk. Starting with the 1970s, scholars have underlined the necessity to manage political risk (Robock, 1971; Kobrin, 1979). This is even more the case when operating in developing countries, where this type of risk is more prevalent.

This paper contributes to the literature on political risk management by examining the possible ways in which CSR policies can become a strategy to mitigate political risks. By integrating social, environmental and commercial concerns in their operations, CSR policies can help mitigate political risks. It is obvious that not all categories of political risk can be managed using CSR programmes. This paper introduces from the literature two categories of political risk that CSR policies target: intrinsic and extrinsic. The first category relates to the risks that corporations themselves are creating or increasing as a result of the nature of their activities. Protests or confrontations with the local community are very likely to appear when the corporations' activities negatively impact the environment or the social and cultural development of the community. The second category is the result of difficulty in establishing and maintaining a good relationship with the host community. This is mostly referred to in the literature as the "social licence to operate". The leading companies in the implementation of CSR to manage their political risks, either intrinsic or extrinsic, are the extractive corporations, especially mining companies. Because of the long experience gained, their strategies are now particularly refined. Their proactive approach (like Xstrata) may be the solution to the many CSR failures and it should be used by all corporations. The paper also examines methods for the effective and successful implementation of CSR policies, building on the experience of extractive corporations, which are recognised as front-runners in CSR policies. It highlights the benefits of creating partnerships with civil society and/or government. Partnerships can reduce costs, facilitate the communication of corporations with the host community, and share the responsibility of CSR projects. They can also bring the acceptance of the local stakeholders and add credibility to the initiatives. Finally, practice has demonstrated that CSR policies can easily have the opposite effect, like exacerbating risks or bringing additional risks. For these reasons, this paper addresses three areas of "risk": host government relationship, communities' high expectations of corporations, and unequal distribution of CSR benefits. The way to tackle those limitations adds to the complexity of the process, but corporations have to be aware of them before designing their CSR policies.

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