

Managing CSR beyond the first tier of suppliers.

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Abstract: Multinational Companies (MNC) are expected by an expanding range of stakeholders to take responsibility for the environmental and social impact of their entire supply chain. Most MNCs use code of conduct to manage their suppliers. Agency theory seems to be an adequate framework to explain why and how MNCs use code of conducts. However, this approach is inadequate to secure an environmental and social responsible supply chain according to an analysis of first tier suppliers. They argue that their capabilities need to be developed in order for them to implement code of conducts and manage their own suppliers. Their point of view is best captured by resource-based theory. The implications for MNCs are discussed.

Intro

Today, CSR extends beyond organisational boundaries and increasingly companies are held responsible for their supply chain partners' social and environmental practices. Suppliers, over whom they have no ownership or direct control, are no exception (Neef, 2004; Roberts, 2003). This entails that companies have to go beyond the first tier and ensure good standards throughout the supply chain, as being associated with poor conditions in the supply chain can have severe consequences for reputation in form of negative publicity and boycotts (Millington, 2008; Pedersen & Andersen, 2006; Roberts, 2003). This is particular a problem for MNC because of their high brand value. Managing global supply chains has therefore become increasingly important for MNCs in order to mitigate reputational effects and act responsible. MNCs have consequently started to adopt and implement voluntary standards and Codes of Conduct (CoC) to manage their supply chains (Mamic, 2004; Millington, 2008; Neef, 2004; Pedersen & Andersen, 2006; Teuscher, Grüniger, & Ferdinand, 2006). However, research has indicated that many MNCs struggle with the issue of code implementation in their global supply chains, and the fact that there is still a lack of managerial tools to guide the process (Leigh & Waddock, 2006; Roberts, 2003).

Often CoC are implemented in a top-down fashion, where first tier suppliers¹ are given a set of codes and without further interaction or communication are expected to comply. Furthermore, first tier suppliers are often expected to manage their own suppliers (Jiang, 2009). This approach to supplier management and implementation of CoC are likely to result in passiveness, lack of commitment and therefore unsuccessful implementation and anchoring of CoC in the supply chain (Jiang, 2009; Neergaard & Rahbek Pedersen, 2005).

Most current research has focussed on implementation of CoC from the point of view of the buyer (Leigh & Waddock, 2006; Roberts, 2003) and little attention has been given to the point of view of the suppliers (Mamic, 2004). This paper will compare and contrast the views of buyers and suppliers concerning CoC implementation. It will be demonstrated that different theoretical frameworks are needed to understand challenges in code implementation for respectively buyers and suppliers.

Theoretical approaches

It has been discussed whether supply chain management (SCM) is a theory in itself or if it is better understood by using different theoretical approaches from other streams of research when studying the flow of material in the value chain (Halldorsson et al. 2007 p. 286). They argue that there is no such thing as a unified theory of SCM and suggest that one can choose one theory as the dominate, explanatory theory and then complement it with one or more alternative theoretical perspectives (Halldorsson, et. al 2007 p. 284). They propose that transaction cost analysis (TCL), principal-agency theory (PAT), resource based view (RBV) and network theory (NT) are the most useful theories to explain management issues in supply chains. In this paper, PAT and RBV will be used in the empirical part. These theories have been selected as they prescribe two very different approaches to managing supply chains.

PAT is based on the separation of ownership and control of economic activities between a principal - the MNC, and the agent – the supplier (Eisenhardt, 1989). The principal delegates work to the agent which often causes agency problems due to conflicting objectives, self centred behaviour, asymmetric information, outcome uncertainty and bounded rationality

¹ The first tier supplier can be a manufacturer, distributor or an agent etc.

(Halldorsson, 2008; Eisenhardt 1989). Contracts are used to govern the relationship and to mitigate potential agency problems. The contract relies on a mix of behavioural and outcome-based incentives to motivate the agent to act in the best interest of the principal. In the buyer-supplier context, CoC are often part of the contract and is used as the instrument to manage the relationship (Pedersen et. al. 2006). The contracts or codes of conduct imposed by MNC are costly and time consuming for the suppliers to implement, manage and document (Pedersen, 2006, Utting, 2000). This is particularly a problem when different MNCs formulate different codes for the same supplier (Mamic, 2005). In addition, the benefits of acting social responsible are mostly associated with a well-known brand name and therefore only benefitting the MNC. Furthermore, MNCs are often not willing to pay more for the product but continue to base sourcing decisions on traditional criteria such as price, quality and delivery (Neff, 2004). A CoC therefore causes conflict between the principal and the agent; subsequently the agent might act self-centred. The agency problem is further complicated by asymmetric information, which occurs because the principal do not have access to all relevant information available to the agent. This is a problem when formulating the contract as well as in monitoring if the conditions in the contract have been fulfilled. In the absence of efficient ways to monitor and mechanisms to align interest suppliers will lack incentive to act social responsible in accordance with the CoC mainly due to lack of resources and economic benefits. This in turn will to a large degree affect the suppliers' incentive to manage their own suppliers in a social responsible way.

RBV advocates a very different view of managing supply chains. The RBV offers a framework for how companies achieve and sustain competitive advantages due to the possession of heterogeneous resources and capabilities (Penrose, 1959; Halldorsson, 2007). According to RBV, resources must be: valuable, rare, difficult to imitate, and have limited transferability to constitute a source of sustainable competitive advantage (Eisenhardt et al. 2000, Skjøtt-Larsen, 2004). It is argued that competition today is not between different companies but between different supply chains (Skjøtt-Larsen, 2004). Therefore, the development of competencies for all parties in the supply chain is essential to stay competitive and subsequently, the focus in this context is on how to develop and renew capabilities of all partners in a supply chain. According to Andersen (2005) the RBV has developed into two different strings of research: the traditional static RBV and the dynamic capability approach. The traditional approach focuses on how competitive advantages are built through path-dependent development processes generating rent in stable environments (Ambrosini et al. 2009). The dynamic capability

approach focuses on the development of capabilities in rapid changing environment. For the purpose of this paper the traditional RBV shall be applied, as the empirical analysis will attempt to depict suppliers' capabilities at a given point of time. Capabilities can be described differently, but Leonard-Barton, 1992, p. 113 and Andersen, 2005 propose that capabilities consist of four dimensions: skills and knowledge, technical systems, managerial systems and values and norms. Skills and knowledge include techniques and scientific understanding specific to the firm and embodied in employees. This knowledge is in turn embedded in technical systems and encompasses tacit knowledge that has been accumulated, codified and structured over the years. The managerial system embodies ways in which a firm develops and controls knowledge including both formal and informal processes and procedures. Finally, values and norms are the integrative dimension of capabilities and conceptualize reality and beliefs consistent with these values (Van Marrewijk et al. 2003).

Methodology and case description

The research has been conducted in a large and well-known company – called company X. The company has been working with CSR issues since the early 90s. The company is a member of UN Global compact has issued its own global standards for sustainable sourcing covering compliance with laws and regulation, environment, health and safety, labour practice, ethics and sub-suppliers. In 2009 a pilot project was initiated in a sourcing unit covering indirect spend to test a new conceptual sustainable sourcing (SS) process. The pilot project is the subject of this analysis, but here focus is solely on the CSR issues in the pilot project. A sustainable sourcing scorecard was developed with the aim to obtain an indication of the social and environmental performance in the supply chain, and not only the first tier. This is because the first tier is often an agent within indirect spend categories, and company X wants to explore the possibility of enforcing CoC throughout the supply chain. However, the objective is that the first tier suppliers “*take responsibility for their own supply chain*” according to company X.

The SS scorecard consists of a self-evaluation where new suppliers shall grade themselves on a scale from 1-5 on a number of issues related to compliance, environment, labour practice etc. Each score from 1-5 describe the practice for the particular issues. The first tier suppliers fill in the scorecard on behalf of their supply chain and sign it. Based on the outcome of the scorecard suppliers are invited to participate in further negotiations, and if a contract is signed the supplier is required to comply with company X' CoC. It is intended that suppliers in the future will be audited to ensure compliance.

Data has been collected through meetings with employees in company X, and through semi-structured interviews with 8 first tier suppliers. The interviewees are all responsible for CSR issues in their particular company. Their position varies from Managing Director, Sales Manager, Director over to Quality Manager. All the first tier suppliers are located in the UK whereas their suppliers are all located in the Far East.

Analysing the suppliers

Managing suppliers, from the point of view of MNCs, is likely to depend very much on the awareness and commitment of the supplier toward CSR. Different models have been developed to illustrate maturity stage, behaviour and practice concerning sustainability (Zadek, 2004, Dunphy et.al. 2007). Dunphy et.al. suggest a sustainability model with six phases ranging from rejection of CSR to becoming a sustainable company. The phases and the popular interpretation of them are: 1. Rejection – *it is not our business*, 2. Non-responsive – *business as usual*, 3. Compliance – *We will do just as much as we have to*, 4. Efficiency – *it is just business*, 5. Strategic pro-active – *it gives us a competitive edge*, 6. The sustainable corporation – *we need to make sure that everybody does it*. Not all companies move from one phase to the next in a straight line because organizations develop and learn differently (Zadek, 2004). However, for the purpose of this article we use the model to provide a preliminary assessment of the development stage the suppliers subject to the analysis are residing in.

Eight first tier suppliers have been subject to analysis. Two of these are MNC, which have their own CSR policies and CoC in place and a dedicated department to manage their supply chain accordingly. They both use Life Cycle Analysis indicating that they manage the entire value chain. They can both be described as sustainable corporations according to Dunphy et. al. The remaining six suppliers all represent small companies based in the UK. The number of employees ranges from 10 to 36, and none of these have a department or person fully dedicated to work solely with CSR. Half of these suppliers argue along the line that "our responsibility is to meet standards and comply with regulations". They subsequently have a compliance approach to CSR according to Dunphy et al. The other half of the suppliers has a more efficiency-oriented approach. They acknowledge the importance of managing environmental and social issues when sourcing from developing countries and have either adopted external management systems or developed own CoC for their suppliers.

Managing suppliers from the perspective of the buyer - Company X.

According to written statements in company X one of the aims of their system to manage suppliers is to “*mitigate risks and protect the image*”. With regards to the pilot project it is further stated that the “*strategic approach will be that our suppliers take responsibility of their own supply chain*”. Furthermore, the suppliers in the pilot project do not receive any compensation in form of higher prices or rewards, and no communication, training, or tools are provided to guide the first tier. Moreover, there is no formal knowledge sharing or long-term contract in place to provide suppliers with incentives or guidance on how to manage their supply chain in order to ensure compliance. In this way, company X makes use of contracts, monitoring and audits to safeguard against non-compliance, which corresponds to a top-down approach to implementation of CoC. Therefore, agency theory seems to be a very suitable framework for understanding supply chain management from the point of view of the buyer, where contracts and monitoring behaviour is the only measures used to limit self-centred behaviour. Despite this contractual way to manage suppliers, company X acknowledges the need for more collaborative approaches in order to trickle CoC down through the supply chain.

The suppliers’ perspective

The aim of this section is to analyse the suppliers’ possible challenges in implementing company X’s CoC as well as to obtain their perspectives on this approach. The section is based on interviews conducted with the 8 first tiers suppliers. The analysis will not distinguish between the 6 small suppliers, which are at different development stages because their perspectives do not differ.

One challenge mentioned by all suppliers is the fact that price continue to be the major driver behind clients’ sourcing decisions, and subsequently prices rarely reflect or include the environmental and social requirements. This is perceived as a lack of commitment to CSR from the buyer as one supplier states: “*the most important thing is that the marketing and sourcing teams are trained in this [CoC/CSR], but ultimately they don’t want to hear about it*”. In addition, it was indicated that differences in perception between cultures makes it very hard to communicate the SS Scorecard and CoC to Far East manufacturers. Sending the SS scorecard to suppliers in the Far East was not considered to provide a truthful picture of the supply chain performance. One supplier stated: “*Let me be blunt, they [Far East manufacturers] don’t think they are telling lies, they are not lying because of the way the Chinese mind work, they don’t want to give an answer that would embarrass or upset anyone*”.

in a business relationship” In relation to this, several implied that a ‘top-down approach’ to implementing CoC with their manufacturers was not considered to be a useful approach, as one supplier stated: *“if we were to come down on them very hard, they were gonna run to the hills and we would never hear from them again, ‘you will do this’ would not be the appropriate way”*. Other challenges relate to large and constantly changing supply chains which makes it difficult to work with sub-suppliers in actually improving standards over time. One obvious reason for this challenge is a lack of resources, as stated: *“We simply do not have the resources available to do that [manage all suppliers] in such a small company”*. Furthermore, as cost continues to be a main driver, the first tier suppliers felt ‘forced’ to manage their own suppliers at arm’s length in order to shop around and achieve the best deals.

When asked what would enable the suppliers to implement company X’s CoC, the importance of commitment, loyalty, and long-term contracts and buying power were mentioned as important ways to incentivise and motivate both themselves, but maybe even more importantly their own suppliers. The reasoning behind this is simple: It takes time and resources to implement CoC and it cannot be done overnight. Compliance cannot be achieved by just handing over a new CoC to suppliers if there are no incentives in form of more business, large or reoccurring orders. The suppliers emphasised an increased need for long-term relationships and contracts, which allows for aspects such as training, communication, and commitment before standards can be truly improved in the supply chain. This is in stark contrast to the ‘top-down approach’ used by company X, which is associated with contracts, control, code compliance and audits in accordance with the agency theory (PAT). According to the suppliers collaboration would enable knowledge sharing and goal congruence through commitment. Moreover, trust will be build up over time in long-term relationships making monitoring less necessary. The above have illustrates that the resources based view (RBV) seems to capture the point of view voiced by the suppliers.

The MNC suppliers on the contrary have an incentive similar to company X’ to protect their image as they are both known brands. They have good control of their supply chain and have CoC initiatives in place to ensure compliance with their own CoC. Subsequently, as the MNCs have already implemented X’s requirements into their supply chain, they do not perceive this as a challenge. Consequently, the MNCs and X’s perspectives are aligned, as the MNCs perceive CoC to be a natural part of the contract.

From the above analysis it is illustrated that company X and the six small suppliers differ significantly in regards to preferences for the actual management of the supply chain in order to implement CoC. Table 1 provides an overview of the main differences.

Different perspective on management and implementation of CoC	
X's approach	Supplier perspective
<ul style="list-style-type: none"> ➤ Contract & CoC ➤ Scorecard & Monitoring ➤ Audits 	<ul style="list-style-type: none"> ➤ Collaboration & long-term relationships ➤ Knowledge sharing & training ➤ Trust & commitment

Table 1: Overview of the differences in perspective in X and it's suppliers

The present approach with a top-down implementation of a CoC supplemented with monitoring and audits does not seem to insure compliance with the code beyond the first tier. According to the six small first tier suppliers a RBV framework should be adapted to achieve the aim. The next section will be using Leonard-Barton's capability framework to analyse the capabilities of these six first tier suppliers and highlight how capabilities can be developed. The six small suppliers are divided into two groups according to the development stage: the compliance group called SME_C, and the efficiency oriented called SME_E. The capabilities of the two groups will be analysed separately.

The capabilities in the compliance group of suppliers

The interviews showed that values supporting sustainable sourcing (SS) in the SME_C lack consistency and dedication. First of all, no significant information about SS initiatives or company position on the issue are available on the SME_C website. Moreover, management only very rarely if ever visits suppliers in the Far East, hence SS values were not encouraged or explicit expressed through management behaviour and statements. In addition, there are no formal principles and guidelines to direct employees in their daily work with SS, and there are no formal training programs in place to guide internal employees or external supply partners on SS issues. This implies that SS is not implemented into the core management systems, as no policies and strategies for SS are outlined. It is also illustrated by the fact that the SME_C do not have their own formal COC that their suppliers have to adhere to. A general lack of understanding of the CoC is also illustrated in this citation" .. , *but you know, freedom to associate, and business integrity, and all that type of things, that are not the critical issues ... but more 'nice to have' features*". However, these issues are in fact often preconditions in

order to improve wages and child labour standards (ILO), which indicate low level of knowledge and skills concerning SS.

Overall, the SME_C had very few experiences to share about how they have previously approached SS and how they have worked with other clients, and there was a clear lack of technical systems to support work with SS. When asked what it would require, in form of e.g. resources, training or support, for them to implement X's requirements with their own suppliers, their answers reflected that they have very little idea about what they lack and how to approach this. It seemed it was difficult for them to visualise themselves in the mentoring role in relations to training and conveying CoC to their own suppliers. To sum up the capabilities in the SME_C seem at present insufficient to implement and convey company X' CoC to their own suppliers.

The capabilities in the efficiency group of suppliers

Management in the three SME_E shows support for SS in various ways. First of all, all three SME_E have made public statements on their webpage about SS. Furthermore, over the years focus on SS has become part of their business model, as it is perceived to provide a competitive edge for them. Management in all three SME_E is also actively engaged in screening and audits of new and current suppliers as indicated in the following: *“We have our directors out in the Far East at least twice a year”* All of this indicates management commitment as SS values are explicitly expressed through statements and behaviour. The values underpinning SS is supported by management systems which are in place to outline strategies and policies and direct employees in their daily work. Formulation of CoC and implementation of external management systems such as SA8000 and ISO14001 are examples hereof and suppliers' facilities are checked in accordance with these standards. Control mechanisms were moreover emphasised by all three SME_E as being important, as one stated: *“We have all seen how sourcing without proper control can go terribly wrong”*.

All the SME_E have acquired knowledge and skills about SS over the years. They are able to talk about their previous experiences, failures, and success with different approaches and have technical systems to support and document their work. However, they feel left behind having difficulties in developing sufficient capabilities as stated: *“what we don't understand all the time is what these companies (MNCs) are thinking in terms of CSR. And their thinking is always ahead of us. Their policies and their thoughts of the whole CSR issue are constantly*

developing and we are only ever behind that change and we can only ever find out about it when they decide to give it to us". Hence, the SME_E are very aware of their capabilities and limitations within this area, and how X can leverage their knowledge to them. The suppliers perceive an increased need for communication of goals and requirements and leveraging of knowledge from buyers such as company X. In accordance with the RBV, the argument is that certain capabilities are needed to implement a specific SS strategy.

Overview of capabilities

An overview of the findings from the analysis is provided in table 2. It presents the suppliers' awareness stage, perspectives and capabilities. The group of MNC supplier is also presented in the table, despite that the capability analysis of this group has not been accounted for.

Supplier factor	SME _C	SME _E	MNC
Sustainability phase	Compliance phase	Efficiency phase	Sustainable
SS Capabilities	+	++	++ ++ +
Ability to support/train own suppliers	-	++	++ ++
Incentives, motivations & Safeguards preferences	- Long-term contracts - Commitment & trust - Develop capabilities & and knowledge transfer from NN	- Long-term contracts - Commitment & trust, - Share knowledge & best practise. - Mutual development of capabilities.	Contracts
Resource requirements for X	++ ++ +	++ +	+
Risk for company X	++ ++ +	++ +	+
Attitude towards collaboration	Very interested and eager to learn, see it as a way to gain a competitive advantage	Interested, see it as a way to enhance their competitive advantage	Perceive themselves as super advance, and therefore no benefit from collaboration
Possibility of joint learning	+	++ +	+ (not interested)

Table 2: Overview of awareness, attitude and capabilities in relation to SS

The conclusion is that each group of suppliers have different levels of SS capabilities, which consequently shape their perspectives and preferences for how CoC should be implemented and the supply chain managed. As explained by the agency theory, suppliers who lack resources, capabilities, and economic incentives, are less motivated to implement and comply with a buyers' CoC. As stated by the SME_{C+E}, this implies that more collaborative and trust-based approaches are likely to be more successful in managing suppliers and implement CoC than the traditional top-down approach. This argument is supported by the RBV as capabilities typically are not easily acquired in that they are difficult and costly to replicate and therefore must be built (J. B. Barney, 1999). The suppliers are dependent on MNCs to support them in the process of building the required capabilities.

Implications for business

To sum up, MNCs are recommended to adapt their supply chain management approach to fit the level of capabilities inherent in the supply chain in order to best manage their suppliers. This might include the exclusion of reactive suppliers if they cannot with reasonable resources be transformed into proactive supplier. However, MNCs must also apply more collaborative approaches even to continue sourcing from proactive suppliers, as these will require more communication, collaboration, knowledge sharing and capabilities as well. Subsequently, a consolidation of the supplier base is needed to select a few preferred suppliers, with which a more long-term and trust-based relationship can be achieved. This can facilitate supply chain learning and safeguards in form of trust, which might also be more efficient in countries where contracts and CoC are difficult to enforce. Furthermore, in order to consolidate the supply base, systematic tools are required to efficiently map, evaluate and select suppliers. Finally, there are indication of that MNCs currently do not possess the capabilities required to actually engage in training and capacity building of suppliers. Hence, internal anchoring and development of capabilities can be considered to be a precondition for engaging in a more collaborative approach.

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