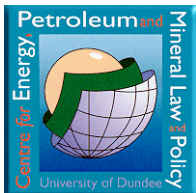


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Adding public value: the limits of corporate responsibility
The scope for corporate investments in public sector capabilities
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Summary

Corporate investments in public sector capabilities vary widely in nature ranging from the transfer of specific skills and knowledge to the promotion of ideas about 'good governance'. The incentives to invest in government capabilities in any particular case appear to be shaped by the company's perceived need to protect their reputation and/ or investment, and modified by the stance adopted by host governments, by institutional investors, by IFIs and international donors, and by NGO activists. The relative importance of each requires further investigation. A particularly important factor shaping corporate behaviour in this area seems to be leadership provided by individuals, especially senior management. Finally, there is some evidence that incentives for investment in public sector capabilities differ between private and state-owned companies.

The 'boundaries of corporate responsibility' are the outcome of complex negotiations between host governments and companies, influenced by other factors such as civil society and international organisations and the ideological and political ambience of the time.

However quite fundamental conceptual and analytical problems remain to be resolved. The normative (what companies should do) and the analytical (what they actually do) requires careful distinction.

Corporate investments in 'good government'

The effects of foreign direct investment in extractive industries has captured the attention of academics, NGO activists, International Financial Institutions, the press and, increasingly, multinational corporate managers largely because of the observation that the resulting income and tax windfalls have not always generated accelerated economic growth, a more diverse economy or improved public services. Instead, there is a suspicion that in some resource-rich countries, extractive industry revenues have contributed to macroeconomic distortions or fuelled the accumulation of economic rents by political elites. What, if any, responsibility does a foreign investor have to improve the chances that the exploitation of natural resource wealth will result in good outcomes and at what point does the exercise of that responsibility invade the domain of a sovereign host government?

The primary investment in natural resource extraction has the potential to generate employment (more so in mining than in oil and gas extraction) and to contribute directly to GDP and to government revenues. In addition, extractive industry corporations typically make a variety of secondary investments to ensure that their operations remain profitable over an extended period of time. These include investments in their workforce skills (more in the case of oil and gas extraction than mining), health and safety and in local utilities and physical infrastructure. Such investments contribute directly to the success of the operation but may also have 'spill-over' effects that benefit the local population.

Of central interest here is a specific kind of secondary investments. A few corporations have provided resources to the public sector capabilities in the expectation of improved capabilities to provide public services. Such investments include the provision of specific skills and knowledge required to improve macroeconomic, including fiscal, management, sector policy design and implementation, and funding for government staff training.¹ The significance of such investments is that, if they succeed, their 'spill-over' benefits for the

¹ Some corporations have invested in improved international market structure, as in the case of the Kimberley Diamond Initiative, or have endowed research. These investments have the potential to generate international externalities, including benefits to countries where natural resources are being extracted, but it is investments in national 'public goods' which is the prime focus here.

host country society may be particularly great. While such investments may seem desirable from this point of view, few companies have actually engaged in such activities. The main reason seems to be that, from the perspective of the individual company, the returns on this kind of investment are uncertain and open to free-riding. Additionally, companies may be reluctant to engage in such activities if they carry the potential of conflict with state authorities on the grounds that they interfere with national sovereignty.

Why then, have companies made such investments?

The incentives for companies to invest in public sector capabilities²

On the basis of case studies discussed in the course of the workshop series, there appear to be two main reasons for companies to undertake such investments:

- reputation protection: companies may choose to invest in public sector capabilities because they do not wish to be associated with failing states.
- investment protection: companies may choose to invest in public sector capabilities because this helps to maintain or develop current or planned investment.

However, it appears that non-corporate actors can play an important role in strengthening these incentives:

- NGOs
- International Financial Institutions and aid donors
- governments
- institutional investors

Finally, the case studies suggest three pathways by which corporate incentives to invest in public sector capabilities can be modified:

- by lowering the company's investment costs or raising the costs of not investing

The costs for an individual company to invest in public sector capabilities can be lowered through collaboration with other groups. For example, NGOs or aid donors can contribute expertise. On the other hand, NGOs and institutional investors can raise the costs for non-investing. NGOs can discredit a company, for instance by associating individual companies or industry sectors with certain kinds of governance failure such as corruption and human rights violations. Institutional investors could influence corporate strategies by placing greater emphasis on Extra Financial Factors in analyzing companies and incorporating them in the investment process. International aid organizations can lower the investment costs for individual companies by providing additional funds for public sector development.

They can also lower transactions costs for companies by providing a platform for co-ordination and negotiation with other stakeholders.

- by augmenting the legitimacy of such investments

There is evidence that companies have sought the collaboration of NGOs and IFIs before engaging with governance problems in order to reduce criticism of undue corporate influence on public policy. Thus, NGOs and international donor agencies may augment the legitimacy to such investments. However, this crucially depends on whether these groups are themselves considered legitimate by the host government and society.

- by providing leadership

Leadership is a key factor in any new endeavour and so it is in corporate investment in public sector capabilities where few structures and institutions exist to guide action. Leadership can be provided by both individuals and organizations. Individual leadership

² See Roemer-Mahler, Anne (2006) Drivers of corporate investment in public sector capabilities *Adding public value: the limits of corporate responsibility: OPI-NCBS-ESRC workshop series* OPI, Oxford (www.opi.org.uk)

appears to be one of the most important factors facilitating corporate investment in public sector capabilities. The support of senior company managers seems to be particularly important since it can help ensure the commitment of other employees. But also individuals at the operational level who take the initiative on certain projects can be crucial in determining whether such investments will be made or not. NGOs, international organisations and governments can all provide leadership by placing certain issues on their agenda and suggesting how companies might contribute to their resolution. Companies can themselves act as leaders by demonstrating how corporations can help improve government capabilities and promoting 'best practices'.

Corporate strategies for improving governance and public sector performance

Companies have used a range of strategies to effect change in governance and public sector management. They can be categorised in different ways. For instance, they can be divided into activities that constitute a direct transfer of *resources* to the public sector versus activities that seek to improve government performance through the promotion of *ideas* about 'good governance'. The first category might include activities such as ...

- providing financial and technical support for building capabilities to design and implement specific policies such as labour, environmental, health or mining legislation;³
- providing expertise and training for government personnel in specific skills, such as IT, accounting, project management and audit.

The second category might include activities such as ...

- demonstrating the adherence to codes of good conduct in areas such as the environment and labour standards, anti-corruption measures and human rights;
- demonstrating financial transparency by contributing to initiatives such as the Extractive Industries Transparency Initiative (EITI); and
- investing in research on governance-related issues.

Another way of categorising modes of corporate investment in public sector capabilities is through the kind of organisational arrangements companies choose for their engagement. Collaboration may take place...

- between an individual company and a government agency;
- between a business association and a government agency;
- in a multi-stakeholder forum consisting of representatives of business, government and other interested parties such as NGOs and donor agencies.

Yet another way of distinguishing modes of corporate investment in public sector capabilities is according to the level of engagement which can be:

- the local government;
- the national government;
- international governance arrangements.

The categorisation of different modes of corporate investment in public sector capabilities is useful in order to provide some structure to a myriad of phenomena. Moreover, it can help illuminate similarities and differences between different kinds of activities and point to interesting angles for further research. For instance, a categorisation according to the organisational framework highlights the potential problem of divergent interests and rising transaction costs as the number of parties involved increases. A categorisation according to the level of engagement emphasises the environment in which the initiative is situated and how this may affect its chances of success.

It takes two to tango: changing boundaries of corporate responsibility

The boundaries of corporate responsibility are complex and subject to negotiation and re-negotiation between companies, governments and non-governmental actors.

³ The boundaries between providing policy-related advice and lobbying may be quite fluid.

The stance adopted by a company may be influenced by factors such as its business ethic, by the business culture of its home country, by its ownership structure (e. g. private or state-owned), and by features of the specific industrial sector the company operates in (e. g. there is some evidence that oil and gas companies may see the extent of their involvement in the public affairs differently from mining companies). The boundaries of corporate responsibility are also shaped by the host government's stance. For example, a putative host government can decide not to allow mineral, oil or gas development if the terms of the investments on offer do not suit it, or wait to find a company willing to accept its conditions. The first case study below illustrates how governments can shape the strategies companies adopt in influencing economic and social development. Finally, the boundaries of corporate responsibility are influenced by public debate. The NGO advocacy for greater transparency illustrated in the second case study is a case in point.

Case Study: BP's sustainable development strategy in Trinidad and Tobago

BP's Sustainable Development Strategy in Trinidad & Tobago illustrates the role that a government can play in defining and re-defining the boundaries of corporate responsibility. The goal the Sustainable Development Strategy is to fulfil the potential of Trinidad & Tobago's most important sector, the energy industry, to promote the development of a local private sector which can be internationally competitive. To achieve this aim, the company, the government and the local Centre for Energy Enterprise Development (CEED) identified a number of upstream activities which offered both sustainable business opportunities for smaller companies and provided a high impact on national development through the transfer of skills and technologies used in extraction operations. BP agreed to purchase the required services from local suppliers rather than to import them - as is common practice in most upstream operations in developing countries. While the initial investments by BP to enable the transfer of know-how to local suppliers will exceed international costs, it is estimated that this investment will pay off in a just few years. If so, the investment will turn into a win-win solution for both the company, which will be able to purchase local services more cheaply than importing them, and for the national economy, which will benefit from additional employment, economic diversification and, above all, from familiarity with new skills and technologies.

This kind of corporate contribution to national development, if it were to succeed, will have been largely the result of a clear government vision for the use of the country's resource endowment for socio-economic development. The government's Vision 2020 and the Strategic Development Plan for the country's energy sector were both published in 2005. They define similar strategies for using the sector's outputs, including raw commodities extracted, human capabilities created and financial revenues earned, in ways that would capture and transfer those benefits to other sectors of the economy in order for the economy to sustain itself beyond the life of the resources. Under the heading "Strategic Issues in Energy", the government report finds that "the local energy sector offers superb opportunities for nationals of Trinidad and Tobago, both at home and abroad, to develop and utilise internationally competitive strategic business skills. This can redound to the benefit of the country, but only if the skills are employed within Trinidad and Tobago, and *if the business model of the multinationals changes*"⁴ (emphasis by the author). This formed the basis for the integration of a local content policy into the terms of the BP investment project. The clear policy stance of the government, in turn, facilitated the development of an appropriate strategy by BP. It was the basis for a framework of expectations and conditions that could be integrated into the company's investment calculations.

Case Study: Lifting the lid on foreign investment contracts

A foreign investment contract is an agreement between a foreign company and a state for the purposes of an investment project in that state. The agreement sets out the terms applicable to the investment project. In recent years, there has been increasing interest in

⁴ Cumberbatch, Nigel: Vision 2020 energy strategy tabled, The Trinidad Express, Wednesday, January 26th 2005.

foreign investment contracts on part of civil society organisations concerned with the impact of business operations on sustainable development, especially in developing countries. The terms of the investment set out in the contracts can have major implications for the way the investment projects affects the natural environment and the livelihoods of local people. It has been argued that there can be major mismatches between claims that are made about the positive impacts of foreign investment at the macro level and their actual impacts at the local level.

Organisations like the International Institute for Environment and Development (IIED) have brought forward concerns at three levels:

“Transparency: many contracts are not publicly available or are only made public once they have been signed. Few contracts provide opportunities for public input during the process of negotiation.

The content of the contracts: particularly the balance that they reflect between the concern of foreign investors for stability for their project, and the provisions that are agreed to by host states responsible for upholding public policy goals.

The incidental impact of the contracts on sustainable development in the countries where investment projects take place may not be specified or foreseen. These typically result from legal or other processes that, although not part of an investment contract as such, are directly linked to that contract. For example, incidental impacts may include changes to national legislation specifically to clear the way for controversial projects.”⁵

Foreign investment contracts are a relatively new item in the corporate responsibility debate. Most business representatives today argue that demands for public disclosure are impossible to realise since they would endanger a company’s investment stability and the protection of confidential information from competitors. However, research and advocacy of NGOs have introduced foreign investment contracts into the discourse on corporate responsibility as they clarify relationships between investors and host countries by specifying their relative roles and responsibilities, including the investment of natural resource revenues in ‘sustainable’ economic and social developments. As with many other earlier innovations, this may well lead to a re-definition of where the boundaries of corporate responsibility lie and entail a modification of business practice.

Questions for further research

The consultations during the workshop series raised as many intriguing questions as they provided answers. These questions, together with feedback from the workshop participants, provide the basis for a possible research agenda. In part, the questions arise because the above findings are the result of a preliminary exploration of a very limited number of case studies based on the experience of a few, mainly private, multinational corporations, almost all with headquarters in OECD countries. The scope and nature of the discussion reflected these limitations and this bias.

Conceptual issues

Research and debate from the analytical and the normative perspective are equally valuable and justified. An analytical approach might advance our understanding of why there is an increased interest in the question of corporate responsibility today, and how the current discussion differs from similar debates in the past about the place of business in society. More analytical research might also shed light on how business responsibilities are defined and re-defined at different times and in different places. Finally, it might illuminate the factors and social groups that shape this discourse. From a normative angle, some of

⁵ IIED (2005): Lifting The Lid on Foreign Investment Contracts: The Real Deal for Sustainable Development, Sustainable Markets. Briefing Paper, No. 1 September 2005.

the main questions to be addressed are: What *should* be the boundaries to corporate responsibilities? Should they be the same in all places or should they be context-dependent? Who should decide about the limits to corporate responsibility?

Whether analytical or normative, the approach underlying the debate needs to be made explicit. Firstly, a clear differentiation will enhance the analytical value and thus the outcome of research and debate. Secondly, reflection on these questions may facilitate the appreciation of different positions between groups and individuals that seek to achieve understanding or even collaboration on questions involving the role of business in society.

Further conceptual clarity may also be required in order to distinguish corporate investments in 'public sector capabilities' from other Corporate Social Responsibility activities. More research is also needed to identify which public sector capabilities are most relevant to this debate.

More comprehensive and quantitative data

The case studies presented provided an interesting but incomplete and biased picture of corporate activity in the public sector. They were, on the whole, qualitative in nature. It is not clear, for example, what proportion of total project investment in different circumstances is being applied by different types of corporations to investments in public sector capabilities. A more comprehensive database, with greater emphasis on quantitative data, would provide a more robust basis for an analysis of corporate behaviour and trends. There is particular interest in documenting more evidence of corporate investment strategies that have worked well in different circumstances and why.

Questions of legitimacy

An underlying concern is the legitimacy of corporate involvement in public sector capability-building. There is evidence that corporate managers seek collaboration with local and international NGOs or IFIs in order to legitimise their interest in public sector probity and competencies. However this raises questions about the legitimacy of NGOs and IFIs in the host country. Furthermore, we need to understand better how relevant the kind of legitimacy offered by NGOs and IFIs is to corporate investment decisions of this kind.

Determining boundaries of corporate responsibility

In general terms, the 'limits of corporate responsibility' are determined by a complex process of negotiation between companies and governments. The process is influenced by domestic and international non-governmental organizations and by political and ideological debates in both policy and academic circles. The nature, complexities and dynamics of corporate-state relationships and how they vary in different circumstances, warrants much greater study. Some specific questions include:

- How does the host country stance with respect to natural resource exploitation affect corporate decision making?
- How important are the policies and the legislative framework of the company's home country in determining corporate investment decisions in this area?
- How much and what kind of public sector capability needs to exist already for such investments to be effective?

Changing world: changing boundaries of responsibility

The analysis of similar debates in the past, their causes and consequences, may enrich our understanding of the current debate. It appears worthwhile to investigate more fully how different types of business-government relations have influenced the development of state capacity in areas such as policy design, budget management and the provision of public services.

During the workshop series, there was little discussion about possible future trends. However, recent events will almost certainly shape how boundaries of corporate responsibility will be drawn in the future. Important events in the energy sector, are, for example, rising prices, partly as a result of increased demand from 'BRIC' economies, and an increasing production share by nationally owned companies, which is partly the result of new off-shore investments by Russian, Chinese and Indian extractive industries and the re-nationalisation of extractive industries in Latin America. These developments suggest that, overall, industry concerns for public sector capabilities may wane, refocusing the boundary of corporate responsibilities closer to core profit maximizing objectives. On the other hand, increasing national interdependence arising from global markets in energy, increasing international attention to natural resource conservation and increasing concern for environmental stability might call for renewed international efforts to agree norms and conventions which modify business models and reset state-corporate responsibility boundaries.

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