ADVANCING SUSTAINABLE COMPETITIVENESS OF CHINA’S TRANSNATIONAL CORPORATIONS

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About this paper

This paper examines how the Chinese business community can best use international sustainability standards to enhance their competitiveness in global markets and more effectively place themselves on a sustainable economic pathway.

It highlights the opportunity for Chinese businesses, supported by enabling public policies, to become a force in shaping the next generation of sustainability standards in global markets as a competitive strategy consistent with China's broader interests. Doing so will require deeper engagement in existing standards initiatives, and a more explicit role amongst the communities that have developed and now govern them. Effective engagement in such standards is a means of off-setting competitive disadvantages, and creating competitive advantages when businesses and nations choose a more sustainable development path.

This paper sets out both strategic options for businesses and policy options for the Chinese government to realise sustainable development and competitiveness goals.

This work is part of the research project on China's “sustainable trade strategy” organised by the International Institute for Sustainable Development (IISD), the State Council’s Development Research Center, and the Chinese Ministry of Commerce. The work is funded by the Swiss State Secretariat for Economic Affairs (SECO) and also partnered with the Chinese Central Party School, the Chinese Academy of Social Sciences, St. Gallens University, and the International Centre for Trade and Sustainable Development. The work remains the copyright of SECO and was commissioned by IISD. Research and writing by AccountAbility and the DRC. The full volume of work from this research is published in its entirety and is available for sale or upon request.
Section 1: Sustainability, Soft Power and Competitiveness

“Responsible competitiveness... blends forward-looking corporate strategies, innovative public policies and engaged and vibrant civil societies. It is about creating a new generation of profitable products and business processes underpinned by rules that support societies’ broader social, environmental and economic aims.”

Pascal Lamy, Director General of the World Trade Organisation

For China to maintain a fast pace of economic growth, it must forge international competitiveness strategies, underpinned by increased resource efficiency and ‘harmonious development’. This is relevant both domestically and in relation to the needs and perspectives of other communities and nations. Chinese business and government roles in promoting sustainable development are increasingly important in the global economy and global trade. Assuring the international community of the consistent and balanced application of this two-fold, interdependent pathway requires its consistent and demonstrably effective practice by China’s increasingly visible business community. Failure to achieve global recognition of China’s commitment to develop sustainably will accentuate the negative and threatening aspects of the China brand, which will in turn lead to restrictions in the scope of China’s business community in global markets, and so limit China’s economic success and its harmonious development, at home and internationally.

Credible and demonstrable sustainable development practices are, in short, a pre-requisite for China’s transition to a major economic and political global player. This requires the Chinese business community to, at a minimum, demonstrate compliance with environmental and social performance criteria enshrined in both inter-governmental agreements and national legislation of those countries in which Chinese businesses operate. Compliance with international and national law however, whilst necessary, is not sufficient for Chinese transnational corporations (CTNCs) to succeed in global markets, or for China to establish an acknowledged, benign presence and global role. Beyond these traditional legal frameworks are a more complex and dynamic category of rules evolved on the basis of norms, expectations and interests articulated by a wide variety of global citizens, including consumers, employees, investors...
and those active participants in more formal political processes. These interests are increasingly voiced through blended market signals and political processes that can be unfamiliar and uncomfortable for Chinese business. These blended processes can impact the financial bottom line of a business, in addition to being part of a wider evolution of the role of business in society, and thus the relationship between business strategy, public policy and citizen action. Pascal Lamy, Director General of the World Trade Organisation, summarises the essence of this new trading environment by saying, “Responsible competitiveness...blends forward-looking corporate strategies, innovative public policies and engaged and vibrant civil societies. It is about creating a new generation of profitable products and business processes underpinned by rules that support societies’ broader social, environmental and economic aims.”

Many of the rules that Mr. Lamy refers to are non-statutory sustainability standards that have been negotiated between businesses seeking to stabilise their operating environment, and civil society organisations seeking ‘civil regulation’ to govern international businesses beyond the scope governments are willing or able to legislate for. Governments and other public institutions are often involved, but in convening, mediating and financing roles, not as statutory agents overseeing the application of the law. Despite much debate, the WTO Technical Barrier to Trade (TBT) committee agreement has no guidelines on how such voluntary international standards bodies seek to influence market conditions through non-statutory means. The WTO has so far not reacted to such standards, with some scholars suggesting the WTO and members create “a norm of leaving ‘transnational regulatory space’” for sustainability standard setting.

Most prominent are those sustainability-related standards developed through the International Standards Organisation (ISO), including ISO14000 environmental standards, and the ISO 26000 Social Responsibility Guidelines that are currently in development. But over the last decade, a new generation of sustainability standards has emerged to cover everything from global trade to extractive industries, carbon emissions, labour standards and sustainable forestry. The institutions that create and often subsequently steward these standards are mostly governed by coalitions of businesses, civil society organisations and public institutions. Due to their growing scale and wide convening power, these standards bodies increasingly play ‘gatekeepers’ to decide the legitimacy of international businesses that seek to operate profitably in global markets. For example, accessing consumer markets, especially
higher-value segments; purchasing premium branded foreign companies; and securing natural resources or international capital through public listings or private equity, all depend in no small part on a company’s ability to demonstrate its visible support of, and adherence to these standards. Further, many of these standards have moved out of the margin into the mainstream of global markets. Forestry, fisheries, textiles, mining, pharmaceuticals, finance and chemicals are but a few of the sectors that now embed such standards in the heart of their respective international markets in pursuit of one or other aspects of sustainability.

Voluntary sustainability standards, often developed and stewarded by business with civil society, labour organisations and the state are, in this sense, a primary route through which businesses, and so the nations they are associated with, exercise ‘soft power’ in global markets in pursuit of international competitiveness and broader societal goals.

This paper focuses on how CTNCs can best engage in these ‘soft’ dimensions of international operations, and specifically how to deal with voluntary sustainability standards in securing competitiveness in global markets and fulfilling China’s broader policy aims. The ‘harder’ dimensions of China’s competitiveness, such as finance, information, technology and infrastructure, are perhaps better researched and understood, and are clearly necessary enablers of success in international markets and in furthering sustainable development objectives. However, these ‘softer’ dimensions, and crucially their relationship to these harder dimensions, are less well understood as a potential for enhanced competitiveness, but also for their potential restrictive impacts.

Avoiding adherence to such standards is the current pathway taken by most Chinese businesses. In many instances, Chinese businesses see these standards as inappropriate or difficult to adopt given the ‘residual’ markets open to Chinese late-comers. Centrally, however, most Chinese businesses do not engage because of unfamiliarity with the rules of the game, weak networks with the relevant organisations, and a lack of guidance from the Chinese Government, especially for state-owned enterprises. Furthermore, these initiatives are perceived by Chinese businesses as barriers to entry to global markets. Indeed, whilst in the main not designed to prevent a new generation of businesses from emerging nations establishing themselves as global players, these standards have been developed and are mostly
stewarded by Western businesses, acting with largely European and North American civil society organisations and public institutions. So whilst seeking, for example, to protect workers or forests, or reduce drug prices to poorer communities, they are in practice dominated by incumbent institutions and could become, or in some cases may be, ironically, actual impediments to sustainable development.

Emerging economy companies from other nations are increasingly gaining knowledge and overcoming suspicion about these voluntary mechanisms and the organisations behind them. For example, Bolivia offers key lessons with its twelve years of using the Forest Stewardship Council standard to enforce its mandatory legal forest management, motivated by robust and credible verification, access to new markets and reputational gains.\(^\text{13}\) South Georgia uses the Marine Stewardship Council to certify the sustainability of its fish products, largely in response to an international campaign by the international NGOs that effectively convinced US restaurants to stop serving fish from this region.\(^\text{14}\) Increasingly, some emerging economy companies are becoming players in the design of new sustainability standards, notably in the case of the ISO 26000 standard, but also in the field of sustainability reporting and assurance through their engagement in the development and promotion of the Global Reporting Initiative’s G3 Sustainability Reporting Guidelines and AccountAbility’s AA1000 Assurance Standard. Chinese businesses are, however, at a significant disadvantage to their emerging economy competitors in this regard. Compared, in particular, to companies in Brazil, India or South Africa, Chinese businesses lack experience, domestically, in engaging with civil society and creating active community partnerships that go beyond philanthropy in shaping market conditions.

**Overall, avoidance of engagement in such standards initiatives is not a considered strategic option, but a default. As a result, Chinese businesses often automatically adopt immature strategies for themselves and China’s broader good.**

China’s global prominence requires that it makes clear and visible decisions as to how to deal with such standards. But deciding whether to engage in any specific standards initiative must be informed by a broader strategic framing that places each initiative in relation to one of three possible pathways that China pursues in aligning its approach to sustainability, economic growth and associated competitiveness drivers:
1. **Normalisation (Compliance)**: where it serves China’s interest to comply with prevailing sustainability standards, indicating a strategy of engagement on terms already established in international markets.

2. **Exceptionalism (Opting out)**: where China’s optimal strategy is, in the short or longer term, to avoid compliance with prevailing international standards, relying instead on its own standards tailored to its own needs and preferences.

3. **Transformational (Engaging and Influencing)**: where China’s interest are best served by seeking to reshape international sustainability standards, whether by becoming active participants in existing initiatives, or by promoting alternatives as new international norms.

That is, China’s response to specific sustainability standards should be based not on pre-conceived judgments, but on each according to their merits in relation to one or more of these pathways.

The paper concludes that:

- Sustainability standards are a means of off-setting competitive disadvantages or creating competitive advantages when businesses and nations, like China, choose to develop more sustainably.

- Chinese businesses, supported by enabling public policies, will pursue varied approaches between differing standards, but over time will become a force in shaping the next generation of sustainability standards in global markets as a competitive strategy aligned to China’s broader interests.

- Doing so requires deeper understanding and engagement in existing standards initiatives and the players behind them, and a more prominent Chinese role amongst the communities that have developed and now govern them.
Practical means for realising this are set out as both strategic options for businesses, and policy options for the Chinese Government.

The paper has been organised into the following sections:

- Section two briefly outlines salient aspects of the broader and policy historical contexts of CTNCs.

- Section three summarises major opportunities and threats that face the Chinese business community as it emerges onto the world stage.

- Section four discusses ‘responsible competitiveness’ and the place of sustainability standards in global markets.

- Section five presents a framework for strategy and policy analysing specific sustainability standards.

- Section six draws out broad conclusions and specific recommendations.

The significance of the topic covered cannot be over-estimated for China and the global community. China’s development will require access to technology and raw materials, and a continued will of the international community to maintain open markets for China’s products, services and international investment flows. Sustaining this will require facets of the international community to overcome perceptions of a ‘China threat’. This in turn requires that Chinese business engages fully in advancing a more responsible competitiveness. For China and the broader global community, the increasingly apparent weaknesses in our inter-governmental, multilateral frameworks pose huge risks to our efforts to secure a sustainable development path for one and all. Sustainability standards developed by state and non-state actors are essential to overcome both this governance failure and the inability of the capital markets to provide adequate market-based solutions.
Section 2: Globalising Chinese Business

“Competition between multinational corporations has already transformed from hard competitiveness to soft competitiveness, from simple reliance on technology and product competitiveness to reliance on concepts like Corporate Social Responsibility (CSR) and social ethics. Advanced corporate responsibility ideas and practices already constitute the heart of business competitiveness.”

Wei Jiafu, President, COSCO

2.1 China’s competitiveness challenges

Chinese transnational corporations are becoming a major influence in China’s next stage of development. The formative stages of this development over the last three decades witnessed the growing importance of Chinese businesses accessing global markets by exporting domestic production and taking advantage of China’s underlying cost advantages. This strategy has been, however, constrained by the country’s severe foreign exchange shortages. Since the late 1990s, however, China’s situation has shifted to one of both excess production capacity and growing foreign exchange reserves. These factors, combined with a growing unwillingness of communities around the world to absorb an ever-increasing flow of ‘Made in China’ products, despite corresponding consumer gains, have underpinned a ‘go out, go global’ strategy for Chinese businesses to invest abroad, first articulated explicitly by the Chinese government in 2001.

In short, sustaining China’s pace of economic development would be difficult if not impossible without an effective ‘going out’ strategy to gain improved access to international markets, technology, raw materials and talent. At the same time, actual or perceived threats to employment, and apparent links to falling real incomes of lower-income communities in Europe and North America, have combined to create unfavourable circumstances to maintain such exports as the primary growth engine. Fluctuating commodity prices compound the pain. Reinforcing this is the basic economics of increasing nominal wages in Chinese principal economic regions, and increasing real wage effects in the composition of export product costs as the Chinese Yuan appreciates against the currencies of China’s major trading partners and competitors.
China’s challenge and imperative is to move up the value chain, increasingly capturing a greater portion of the total product value through deepening engagement in research and development (R&D), ownership of intellectual property, upgrading labour value-added through the application of greater technical and managerial expertise, and securing a higher proportion of the brand value through brand acquisition and development. Such a move, whilst essential, comes with risks. Notable is that domestic employment growth, particularly at the unskilled levels, has to be sustained at the same time that unskilled labour value-added is falling as a proportion of exported value. Further, the conditions for competing effectively in premium markets require an aligned reputation of individual Chinese companies and the broader China Brand. Achieving this reputation is in part a matter of traditional business excellence, such as technical features, product quality and effective marketing and distribution. However, an aligned reputation also requires that broader expectations are addressed, in particular the discerning attitudes towards social and environmental issues increasingly prevalent in premium markets. This need is all the more important where Chinese business strategies require partnerships with existing global businesses seeking to protect their own premium brands, access to international capital that discounts opportunities in the face of social and environmental risks, or the mobilisation of global talent to build expertise and secure long-term competitive advantage in knowledge-driven markets.

Motivation for Future Outward Direct Investment (ODI)

![Motivation for Future Outward Direct Investment (ODI)](image)

Source: China Goes Global, September 2005
Securing reputations aligned to premium market expectations requires, however, considerable investment in improved conditions of production and distribution, at both enterprise and governmental levels. Such investments require not only considerable resources, but must develop along with existing enterprises whose competitiveness will for some time continue to depend on low-cost factors of production, including labour and environmental resources, both for domestic production and in accessing for example natural resources in Africa, Latin America and elsewhere in Asia. To some degree, premium reputations can be individualised to specific enterprises. Increasingly, however, they are ‘collective’ in their nature. Diageo, the world’s leading alcoholic beverages company, has sought to advance ‘responsible marketing’ practices across its industry, gaining a collective reputation that it must protect in order to secure its own license to operate. Similarly, the US business community suffered collectively in the face of the collapse of WorldCom and Enron, with a risk premium imposed in capital markets, which in turn drove the establishment of the Sarbanes-Oxley Act that has since added significant costs to all US-based enterprises. China’s own reputation, and in turn foreign consumers’ confidence in Chinese products, has suffered because of product and food safety scandals.

China’s challenge is therefore to pursue a strategy for securing a greater portion of value-added in global markets whilst not undermining the existing generation of Chinese enterprises that are needed to sustain existing employment, and absorb the huge annual numbers of low-skilled entrants onto domestic labour markets. Sustainable development, the challenges of securing sustainable trade, and strategic choices and decisions, crucially, need to be formulated and made with a very clear understanding of this context.

2.2 China’s internationalisation experience to date
The Chinese business community is already well into the “go global” phase, increasingly focused on establishing international operations as a means of bypassing growing restrictions to trade, and also a means of upgrading technologies, establishing global brands, and accessing raw materials. By the end of 2006, China’s non-financial investments totalled US$73.33 billion spread over more than 160 countries.
### The Trade Distribution of the Chinese Overseas Investment Stock
#### (Up to the End of 2006)

<table>
<thead>
<tr>
<th>Industry</th>
<th>Amount</th>
<th>Proportion (%)</th>
<th>Main Trades</th>
</tr>
</thead>
<tbody>
<tr>
<td>Business Service Industry</td>
<td>194.6</td>
<td>21.5</td>
<td></td>
</tr>
<tr>
<td>Mining Industry</td>
<td>179</td>
<td>19.8</td>
<td>The mining and selecting of petroleum, natural gas, ferrous metal, non-ferrous metal</td>
</tr>
<tr>
<td>Finance Industry</td>
<td>156.1</td>
<td>17.2</td>
<td></td>
</tr>
<tr>
<td>Wholesale and Retail Industry</td>
<td>129.6</td>
<td>14.3</td>
<td>The import and export trade</td>
</tr>
<tr>
<td>Transport and Communication Industry</td>
<td>75.7</td>
<td>8.4</td>
<td>Water transport industry and air transport industry</td>
</tr>
<tr>
<td>Manufacturing Industry</td>
<td>75.3</td>
<td>8.3</td>
<td>Communication equipment, computer and other electronic equipment, textile industry, transport and communications equipment manufacturing industry, medicine manufacturing, ferrous metal smelting and pressing industry, non-ferrous metal smelting and pressing industry, electrical equipment, machinery and apparatus manufacturing industry</td>
</tr>
<tr>
<td>Real Estate Industry</td>
<td>20.2</td>
<td>2.2</td>
<td></td>
</tr>
<tr>
<td>Architecture Industry</td>
<td>15.7</td>
<td>1.7</td>
<td></td>
</tr>
<tr>
<td>Information Transmission Industry</td>
<td>14.5</td>
<td>1.6</td>
<td>Telecom and other information transmission service industries</td>
</tr>
<tr>
<td>Resident Service and Other Industry</td>
<td>11.7</td>
<td>1.3</td>
<td>Other service industries</td>
</tr>
<tr>
<td>Technical Service and Geology Surveying Industries</td>
<td>11.2</td>
<td>1.2</td>
<td>Professional technology service industry</td>
</tr>
<tr>
<td>Water Conservancy, Environment and Communal Utility Management Industries</td>
<td>9.2</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>Agriculture, Forestry, Animal Husbandry and Fishery</td>
<td>8.2</td>
<td>0.9</td>
<td></td>
</tr>
<tr>
<td>Others</td>
<td>5.3</td>
<td>0.6</td>
<td></td>
</tr>
</tbody>
</table>

Source: 2006 Statistical Bulletin of China’s Outward Foreign Direct Investment
**Sectoral Characteristics:** Chinese overseas direct investment touches upon regional trade; production and value-add; resource development; transportation; contracted engineering; agricultural production and related development; healthcare and sanitation; tourism; hospitality consulting; other services. Of these, business services, extractive industries, wholesale distribution and sales account for 70% of investment. In 2006, flow of investment in extractive industries and business services accounted for 40% of total overseas investment.

**The Distribution of the Chinese Foreign Investment Subject (Up to the End of 2005)**

![Distribution Chart]

**Ownership:** Chinese overseas direct investment is being undertaken by private and public enterprises. Large companies like CNPC, Sinopec, COSCO, Sinochem, Haier, Kangjia, China Construction, the New Hope group, Lenovo Group, Wanxiang, Zhongxing, Huawei, Huafan, Chuangwei, and TCL are leading the way, demonstrating strong ability to open new markets. Private and limited liability stock companies based in provinces like Guangdong, Fujian and Zhejiang make up the majority of the groups of foreign invested companies. SMEs, while expanding internationally, make up only a sliver of overall overseas investment.

**Investment Diversity:** Chinese overseas investment has transformed over the last two decades from mainly being trade-based to now focusing largely on manufacturing and production. China’s transnational business today can mainly be divided into five parts: (a) professional trade companies; (b) industries with specific strength in manufacturing;
2.3 Competitiveness strategies driving Chinese internationalisation

CTNCs invest abroad and acquire foreign companies for four main reasons:

- **Market access.** Opening up international markets is without a doubt the main motivation for Chinese overseas investment. Chinese companies, through buying or investing in factories, gradually create ways for China to gain the necessary experience in international distribution channels. For example, TCL, through purchasing the French company Thomson, became the world’s biggest producer of televisions, and in one stroke acquired massive distribution channels in Europe and North America. Lenovo Group, through buying IBM’s PC division, did the same in North America. Overseas investment brings export opportunities, and according to World Bank statistics, from 2000-2004, Chinese overseas investment brought exports of equipment, pre-assembled parts and other materials from China worth over US$75 billion. According to 2004 Ministry of Commerce figures, income of Chinese subsidiary companies reached over US$148.7 billion. More importantly, great strides made by China in international distribution channels in this relatively short time means shared benefits with downstream service industries and even more opportunities.

- **Securing natural resources.** Chinese companies have already made long-term energy and resource investments in more than 30 countries, including Russia, Kazakhstan, Saudi Arabia, Sudan, Australia, and India. Others have made great breakthroughs in long-term cooperation with Western Europe, North America, South Africa, the Middle East, and Southeast Asia. For example, CNPC acquired Canada’s PK Petroleum Company, while the CITIC Group invested in Canada’s Nations Energy Company Limited and bought 94.6% of the rights to the Kazakhstan’s Karazhanbas oil fields. Chinese companies also have overseas investment in steel, copper, aluminium, chromium, zinc and other types of minerals. In 2005, China imported 127 million tons of oil and 280 million tons of iron ore, of which 20% was owned by Chinese companies. Additionally, Chinese companies have had success gaining rights to forest materials and fisheries industries.
Technological upgrading. From a developing country perspective, improving technological innovative capacity is a major motivation for overseas investment. By buying overseas industries or building overseas research centres, Chinese companies are creating new sources of technology development and improving their own technical capabilities. For example, Shangggong Group’s purchase of the German company DA, which was ranked third globally in industrial sewing machines, gained global levels of technological sophistication. In 2003, by means of purchasing the thin-film transistor LCD business of a modern Korean enterprise, BOE greatly increased its own competitive power in this rising industry. Huawei established research centres in Sweden, Russia, India, and the US, among other places, and uses these global research resources to increase its core R&D competencies. SMEs, also through foreign investments, have improved their ability to innovate, like, for example, Siwei Johnson Company, which became a leading bank note transport company after merging with the UK’s Johnson Company.

Establishing brands. Chinese companies have achieved considerable improvements through overseas investment, to the point that their international brands and competitiveness grow stronger by the day. In 2005, there were 16 Chinese companies in the Fortune
Global 500. 49 Chinese companies now rank among the world’s largest 225 international contracting firms. Haier, Lenovo, Quidway, ZTE, TCL, Hisense and Wanxiang, are maturing CTNCs with growing global brands.

In addition to these four core commercial reasons, the Chinese Government has also encouraged international investment as part of its own foreign policy, related to the spread of Chinese government aid abroad to actively bring about corporate social responsibility and develop win-win relationships between China and other countries. For example, Chinese companies are encouraged to share and use suitable technology in host countries, strengthen the manufacturing of host countries and bring about employment opportunities there. Chinese companies help host countries exploit resources and help the host country quickly shift from being import-oriented to export-oriented, thus increasing the host country’s foreign reserve earnings potential. Mutually beneficial relations not only make corporate globalisation more effective, but also improve China and the host countries’ relations. Foreign investment becomes a more and more important method for China to develop and improve relations with developing countries.

An overlapping but distinct perspective on CTNCs is provided by the World Bank which divides ownership of CTNCs into the following categories:

- Large resource-seeking state-owned enterprises (SOEs) fulfilling national goals with few cost considerations.
- Non resource-seeking SOEs following the “going out” strategy.
- Publicly listed companies following stakeholder interests.
- Large or small private companies such as Huawei pursuing entrepreneurial and corporate strategies.

The World Bank also uses a “strategic intent” methodology to divide CTNCs by the goal of their investments:

- Firms focused on global expansion and domestic dominance, such as Lenovo, Huawei and Haier.
- Those looking to offset competitiveness weaknesses, such as Nanjing Automotive.
- Domestically oriented firms looking to compete with foreign MNCs in China.
Trade-oriented firms that seek trade gains in the short term and possible production gains in the long-term, such as Sinochem and Minmetal.

Niche market players that seek to expand in a certain market.\textsuperscript{18}

Taken together, we can conclude that Chinese enterprises are likely to pursue one or more of several international investment strategies as a means of enhancing international competitiveness and profitability:

\textbf{a) Market-opening investments.} Companies in this category often have large domestic production scales, with relatively stable core technology, highly labour-intensive production, and fierce market competition in manufactured products. For example, in industries where China has the greatest comparative advantages, like household appliances, textile and apparel, toys, and others, Chinese foreign investment is a key. Similarly, large-scale retailing companies are the vanguard of China's key foreign invested service industry.

\textbf{b) Resource-seeking investments.} Resource and energy sector investments, high energy or resource-consuming companies, focus on resource acquisition. Investments in energy include petroleum and natural gas extracting industries, forest resource industries, mining, coal and others, while resource consuming companies include refined oil products, steel, forest product processing and similar industries. The former should focus on resource-rich countries, both stressing the host country’s cooperative prospects and focusing on purchasing methods to acquire new resources. It is important to judge primary grade products’ long-term international price fluctuations and avoid price hazards, paying attention to dealing properly with host country government relations, and striving to achieve host country government support. Companies should pay special attention to relations with media, civil society groups, and competitors in international markets. Many host countries do not share China's stable governance system. Thus, companies must cautiously consider the host country's political situation and avoid country hazards, paying particular attention political stability, harbour access, and investment environment for primary material processing. Companies should consider ways in which investments help host countries’ economic development, employment, and assuring domestic resource supply, and spurring sustainable development.
c) **Innovation-seeking investments.** For activities with strong manufacturing ability and weak R&D, like IT, machinery, chemicals, and other sectors, the most important goal should be gaining technology and R&D capacity through foreign investment, combining this with Chinese domestic manufacturing capability, raising domestic manufacturing levels and competitiveness. The most important methods are:

- Creating R&D centres like IT companies clustered in Silicon Valley to bring together technology, information and technical human resources.
- Buying technologically-oriented SMEs in developed countries, and coordinating technical ability with domestic manufacturing capacity.
- Establishing joint ventures with R&D-oriented companies.

d) **Efficiency-oriented investments.** Efficiency-seeking foreign investment form a very low portion of China’s total foreign investment. With China’s emphasis on low-cost production and the rapid increase in Chinese labour costs, some labour intensive Chinese sectors will inevitably move to countries that simply have lower manufacturing costs. Others will seek other traditional efficiency-oriented gains from trade. When doing so, companies selecting countries to invest in should firstly pay attention to positive political relations. Secondly, the country should have a low-cost and good investment environment. Thirdly, the company should enter the host country through cooperative relationships and technology transfer, improving government and business relationships. Fourthly, the country should have signed investment agreements with China to protect investments and avoid taxes. Fifthly, especially for SMEs, the country should support the construction of “overseas economic and trade cooperation zones”, which can be beneficial in reducing SMEs’ foreign investment risks.
Section 3: Strengths, Weaknesses, Threats and Opportunities

Chinese enterprises face significant competitive challenges as well as opportunities. These vary considerably over relatively short periods of time, for example being impacted significantly by prevailing economic and political conditions, by sector, and ultimately by specific enterprise. Despite this diversity, and before overlaying the sustainability challenge, it is worth spelling out some of the prevailing opportunities and challenges facing CTNCs.

3.1 Opportunities

Systems that open global markets to international investment are constantly improving. A basic enabling framework, TRIMS, is provided by the multiple systems negotiated during the Uruguay round of the WTO. Regional integration is unfolding and there are already 200 free trade areas with cooperative systems, with most emphasising free trade, which greatly advances the system of international investment. From the perspective of host countries, (although some countries, including the US, recently strengthened Foreign Direct Investment (FDI) security checks) the world’s various countries’ FDI rules are, on the whole, increasingly friendly. According to the UN’s World Investment Report statistics, around 90% of policy adjustments have been beneficial for foreign investment.\(^\text{19}\) CNTCS increasingly operate globally within a framework developed by the Chinese government and now include bilateral trade committees which cover 178 countries, 117 bilateral investment protection accords, along with a range of associated inter-governmental agreements covering everything from mutual tax avoidance to social security agreements.\(^\text{20}\)

Secondly, several trends in global cross-border investment have emerged recently. Research and development is multinationalising. Additionally, changes in developing countries’ foreign investment come to the fore. Outward FDI flows from developing economies increased from 6141 million USD in 1989-1991 to 91638 million USD in 2004-206.\(^\text{21}\) Of the 100 largest TNCs from developing economies, 76 are from South, East and South-East Asia and 10 from Latin America. Of those, Hong Kong (China) has 26, with 9 operating mainly in Mainland China.\(^\text{22}\)
Thirdly, the great drop of the market value of Western companies, caused by the global financial crises beginning with sub-prime crises, provides an uncommon opportunity for Chinese companies’ overseas investment. Chinese companies are pursuing international market channels, natural resources, innovative capacities and world-class brands. The financial crises give a good chance for Chinese companies to reach their goals through M&A with foreign companies.

Fourth, China’s international investment opportunities have been accelerated by its growing foreign reserves, which have reached over US$2 trillion in the first quarter of 2009. Indeed, Chinese companies have been encouraged to make use of these reserves for international investment, especially in the light of the internationalisation of the domestic market, which has led to Chinese companies facing ever-stronger competition from foreign firms. The competitiveness of Chinese firms in tomorrow’s markets will increasingly depend on the scale and quality of their overseas investments.

3.2 Threats

Chinese companies face considerable threats in their efforts to scale up their international investments. Overseas Chinese firms often face disadvantages as late-comers to many markets. Moreover, there is no doubt that Chinese companies have and continue to face many barriers by (potential) host countries to entering new markets. Increasingly open avenues for cross-border investment should facilitate favourable conditions for Chinese overseas investors. But for many reasons, when Chinese companies invest internationally, they face discrimination. This is particularly the case in the US, where, for example, CNOOC’s US$18.5 billion bid for Unocal, Haier’s bid for Maytag, or the 2007 attempt by Huawei to buy 3Com were all thwarted by a combination of negative US public and political opinion. CTNCs face unusual scrutiny as potential foreign investors. US Securities and Exchange Commission Chairman, Christopher Cox, pointed out that Chinese SOEs in particular, face the hurdle of having to answer the question, “Will the behaviour of this company be motivated strictly by economic considerations of profit and loss? Or will it instead be driven by political considerations?”

Likewise, international political and civil society groups attempt to thwart Chinese banking and mining industry activity on similar political grounds, stating that they “just don’t know” what criteria Chinese firms are using to finance loans or ensure social or environmental crite-
ria; which leads to ethical questions in addition to questions of financial security. National oil companies in particular face scepticism about whether they’re part of government agencies, behaving on behalf of governments or according to government policy, or whether these companies have political or geopolitical objectives.

These internal threats are exacerbated by the lack of knowledge and basic information available to CTNCs through traditional sources, such as the Chinese government’s foreign investment management and service systems. After years of reform, the Chinese government’s overseas investment management system has already been improved considerably, but does not accord with firms’ current overseas investment management needs. Some of this is fairly basic, including tax law, corporate governance or analysing and addressing risk areas across diverse potential investment target countries. But such institutions are in any case not the best suited to providing the more nuanced types of knowledge and expertise concerning culture, norms of behaviour, and who and how to make friends with. This of course is a central issue to which we will return in our discussion of sustainability standards.

3.3 Strengths
Chinese overseas investors have many strengths. Firstly, Chinese companies have relatively strong manufacturing capabilities, with China’s manufacturing and value-added manufacturing gross value forming a much higher proportion of the economy than other countries. China has 170 product types that rank as the highest output in the world. In 2006, manufactured products made up 94.5 percent of exports. China’s 774 categories of product exports stand at number one in the world and make China a key product manufacturing country. Chinese companies have attracted top equipment. Product quality is generally quite high, and because of the high performance-price ratio in international markets, the proportion of Chinese goods in those markets has continued to grow.

Secondly, Chinese companies are good at controlling costs. Chinese products have been successful because of low prices due to relatively low Chinese cost factors, such as labour costs that are still lower than developed countries and productivity rates that are higher than most other developing countries, even given the increased cost associated with China’s new labour law. Salary levels for mid-level R&D staff are still between an eighth and a tenth of
developed countries. Chinese companies engaged in overseas investment are entirely capable of combining technological ability and low costs to pursue developed market opportunities that strengthen Chinese companies’ competitiveness in international markets. The Ministry of Commerce’s survey of several hundred foreign enterprises reveals that low costs are seen as one of China’s great overseas investment strengths.

Thirdly, Chinese companies have a relatively strong learning ability to improve technology. Chinese company’s technology levels are still lower compared to cutting edge international technology levels, and thus, Chinese companies must attract new foreign equipment and technology to improve their own levels. In this process, Chinese companies have made gains by paying attention to the best management experience and technology innovations, thus clearly increasing their management levels and R&D capacity. Chinese companies show relatively strong research ability, but poor ability to bring this to market. Through overseas investment, they will be able to continue strengthening their R&D capacity, management levels, and quickly improve their overall technology and management levels to a new level. This emphasis on R&D correlates with the success identified by the Boston Consulting Group’s analysis of “Global Challengers”, which emphasises the importance of Research and Development, but which does not explore how companies use voluntary standards and other networks or “clubs” to access international markets.26

Lastly, Chinese companies have the advantage of a vast domestic market. China has already become the world’s fourth largest economic system and the third largest import market with an immense domestic market scale for Chinese companies to master their own innovative and branding bases. With regard to resource development, overseas successes in resources can easily sell to market. Domestic market scope helps attract Chinese companies’ and foreign companies to collaborate. Some resource-exporting countries welcome Chinese companies to exploit their resources and work with Chinese resource development companies. Many foreign countries are willing to work with Chinese companies because of the attraction of China’s domestic market.

3.4 Weaknesses
Chinese companies have only just started to make large-scale investments abroad and thus companies in the main lack overseas investment experience and international operations
personnel. Chinese cross-company cultural integration needs to be strengthened. Buying foreign MNCs is increasingly the main vehicles for outward-facing Chinese investment, and to bring about success, the key is whether CTNCs can coordinate their resources to bring together new competitive advantages. From a global perspective, after-purchase integration success rates are not high. Chinese enterprises currently lack the international operational experience, human resources and cross-cultural coordination for post-purchase relations to work effectively, and thus need to actively explore new methods. Many companies understand very little about investment destination country laws, markets, and business customs, and at the same time, because there is a lack of government and intermediary group information services, many Chinese companies make rash decisions about international investments because they lack the systematic analysis of professional organisations. After making overseas investments, Chinese companies face difficulties attracting international management talent and effectively aligning domestic resources with international resources. Still, some companies with successful overseas operations have effectively localised management talent, such as Lenovo group. Research indicates that CTNCs lack comprehensive risk management systems and the World Bank reports that one third of Chinese foreign joint ventures end in failure, with 85% of managers listing management as the main cause.\(^{27}\) Leading Chinese companies such as the China Ocean Shipping Company (COSCO) have implemented comprehensive risk management systems linked to third party assurance and internationally recognised standards like the AA1000.\(^{28}\)

Secondly, Chinese companies’ R&D ability is relatively weak, lacking internationally competitive brands and international channels. The technological innovation of Chinese enterprises is not based on their own ability to research and develop, but is reliant on their ability to attract technology and equipment. Many large and medium scale enterprises have their own R&D departments, but as a whole, Chinese corporate R&D expenditure stands as a low percentage of revenue compared to international levels. The ratio of R&D compared to income stood at 0.76%. Under this comparison, many MNC R&D expenditures stand at 8%. Even so, in 2005, Chinese large and medium scale industrial companies spent $US125.03 billion, which is 31% greater than 2004.\(^{29}\) One World Bank report emphasises how global competitiveness hinges on the ability to create and use technology; while China is good at processing technology, it lacks strong indigenous innovation capacity, whereas India appears
stronger. Further, China’s R&D productivity is weak; links across government, business and university R&D institutions is also weak.  

Thirdly, Chinese companies often carry disadvantageous domestic characteristics into global markets. For example, companies’ governance structures await improvement, as operations are not yet sufficiently up to standard. China is a developing country, so some SOEs, whether facing inadequate supervision by principals, or bureaucratisation through SOE leaders’ fixed-term appointment system, can face short-termism, with the result that education about investment in long-term profit making activities like R&D, branding, international channels, and others lack vigour. This is true especially as related to international investment, where inadequate inspection and control of foreign-invested subsidiary companies can bring about hazards. Private firms are mostly run through clan network style management systems, which do not suit MNC operations. Domestic market environments are not perfect. These and additional non-standard operating procedures can extend into host countries and harm Chinese companies’ ability to make long-term profits, can bring about disputes, and often harm the image of Chinese companies. Additionally, Chinese firms often focus too much on short-term profits, have a reputation for telling customers what they want instead of listening, lack a focus on quality and design and are learning through experiences (like recent milk scandals) that bad publicity can sour a brand forever. Other domestic concerns, such as low overall educational attainment, an underperforming state business sector, and deep but narrow financial institutions, contribute to Chinese companies’ weakness in international markets.

Lastly, Chinese enterprises need to raise their guard against investment risks. Overseas investment carries political, legal, and business risks. Keeping a watch on overseas investment hazards is crucial. When Chinese companies invest abroad, large hazards abound. These spring from the lack of investment bank assistance, shallow understanding of host country laws and markets, incautious decision-making, and, moreover, the high hazard of unstable political systems. The burning of Chinese shoes in Spain, workers’ strikes in Latin America and Africa, incidents of East Asia of attacks against Chinese, without exception lay bare the problem of the low ability for Chinese companies to manage overseas crises.
Section 4: Responsible Competitiveness

“The evidence is there to support the proposition that Environmental Safety and Governance (ES&G) risks are material to the performance of a company in our portfolio over the long run and that clients across all sectors and all markets that manage these risks will perform better from a credit perspective. This powerful data is what is driving our sustainability approach.”

International Finance Corporation

4.1 Sustainable development and competitiveness

Sustainable development is becoming a material factor in the competitiveness equation of companies and nations. The reasons for this are many, and the weight of each argument varies considerably over time, geography, market segment and sector. The implications for business are ultimately universal and profound, but complex and contingent for any specific sector, market or enterprise. Businesses recognise that climate change affects financial performance, especially in sectors most affected by severe draught, rising sea levels, and fierce storms, such as insurance and finance; but also as a business opportunity to make money by anticipating a low-carbon economy.33 Carbon emissions may count because of mitigation costs associated with regulatory enforcement, or opportunities linked to ‘clean development mechanisms’. Labour standards, similarly, might count because of the downside threat of reputational damage associated with

Sustainability Counts

- Products and services are designed, produced, and marketed to meet changing customer expectations, regulatory demands and the potential cost efficiencies and productivity enhancements derived by embracing social and environmental factors.

- Labour markets where more talented and sought-after employees are increasingly taking account of the alignment of the employer’s interests and actions to their own values.

- Financial markets, where investors are increasingly concerned about the risks of getting sustainability wrong, and the opportunities that can be realised by smart companies and dynamic and forward-looking nations and communities.

ADVANCING SUSTAINABLE COMPETITIVENESS OF CHINA’S TRANSNATIONAL CORPORATIONS 29
brand-linked negative media, or because of the productivity gains that come with improved labour-management relationships needed to satisfy the needs of just-in-time supply chain management. Sustainable water management might count because it enables beverage companies to gain licenses to access community water resources, and demonstrable honesty in all transactions might create the conditions for technology licensing, or reduce the costs of capital on international markets.

Chinese companies like COSCO, as the winner of many United Nations Global Compact awards, are leaders globally. According to COSCO’s president’s Wei Jiafu, “competition between MNCs has already transformed from hard competitiveness to soft competitiveness, from simple reliance on technology and product competitiveness to reliance on concepts like CSR and social ethics. Advanced corporate responsibility ideas and practices already constitute the heart of business competitiveness.” SASAC’s guidelines on SOE CSR implementation and the Ministry of Commerce’s (draft) guidelines on CSR implementation for foreign invested enterprises also signal the importance of this concept to China’s future competitiveness. The Global Reporting Initiative’s “Amsterdam Declaration on Transparency and Reporting”, released in March 2009, highlights the important link between irresponsible company action and the current global financial crisis, calling on governments to follow China’s lead in “Introducing policy requiring companies to report on ESG factors or publicly explain why they have not done so”.

With rising awareness of these shifting patterns has come a new generation of innovative business strategies and practices that deliver profits from more responsible behaviour. At the minimum, they protect companies’ reputations and brands: reducing the risks of consumer boycotts, recruitment bottlenecks in the face of bad press, or restricted or more expensive access to capital. Beyond this, companies have enhanced productivity through improved working conditions, and driven product innovations by engaging with communities and better understanding their issues and needs. Global leaders like General Electric have built multi-billion dollar businesses offering energy-efficient products, and last year UK consumers alone purchased around US$60 billion worth of goods and services marketed with ethical virtues, such as child labour, human rights, and arms control.
Although it is too early to see the full effects of these new business models and markets, some analysts make a clear case for social and environmental considerations. Company-level rankings like the Accountability Rating, or performance-aligned stock exchanges like the Shenzhen Taida Index, provide tools for analysing the financial performance of companies against social and environmental concern. Other Chinese contributors to this field include the Chinese Ministry of Commerce WTO Tribune’s “Golden Bee” corporate social responsibility roll call, the Downons Institute’s “Green Companies Initiative”, and the Chinese Federation for CSR’s “China Responsible Companies 50 Index”. For the International Finance Corporation, “...the evidence is there to support the proposition that Environmental Safety and Governance (ES&G) risks are material to the performance of a company in our portfolio over the long run and that clients across all sectors and all markets that manage these risks will perform better from a credit perspective. This powerful data is what is driving our sustainability approach”.

Sustainability, and responsibility, is not, furthermore, only an issue for developed, wealthier markets. Benefiting ‘host countries’ to Chinese investment is imperative in sustaining these increasingly important, but still fragile, sources of competitive advantage. Investment-starved countries, and those with a history of relying exclusively on a small number of investment sources, can derive considerable advantages to having China as a new and competitive source of capital. Chinese investment can drive host country manufacturing exports, which in turn generates domestic employment opportunities; such investment can stimulate value-added production through trade, establish value-added relationships linked to existing production processes within China; it can raise commodity prices, generate employment and wage income; it can also provide a route to host country business communities gaining a deepening understanding of emerging markets and associated opportunities.

In addition, Chinese investment, whether through private or state-owned Chinese enterprises, can be and often is associated with broader developments in diplomatic relationships between China and host governments, which, for developing countries, are increasingly linked to trade and investment agreements and inter-governmental financial arrangements. Chinese businesses and the Chinese government have choices about the degree to which these investments embrace sustainability or whether they follow the old developed country model.
of exporting pollution to less developed countries. As China raises its labour standards and the population ages, it must stem the flow of jobs to countries with lower labour costs. Delivering sustainability to China’s partners is one way to avoid repeating the mistakes of colonialism. Delivering on sustainability is, however, a challenge. China’s emerging transnational corporations, in common with other international business players, face a complex market environment. On the one hand, international markets are intensively competitive, especially in lower sections of the value chain where products are largely commoditised and offer slim margins at best. The economics of these markets, then, make it difficult to ensure acceptable conditions for workers and economic regions. On the other hand, the much-sought-after higher margin market segments are increasingly associated with demonstrable adherence to ever-more challenging social and environmental market rules. Getting these standards of practice right, and visibly so, is a costly exercise that draws on scarce managerial and technical expertise. Whilst few Chinese business managers would doubt the ultimate need to embrace sustainability standards, the greatest challenge lies in the pathways these enterprises take in doing so. Chinese enterprises are in the main still focused on lower value chain opportunities, and so have to cope with the fierce and inevitable competition in these markets. The challenge then is whether and how CTNCs can, in pursuit of strategic realignment that moves them up the value chain, embrace social and environmental performance issues without losing competitive advantage and in doing so explore new sources of competitiveness along the way.

**Chinese Companies: Growth in Chinese Sustainability Standards**

**Green Series:** The Green Credit and Green Securities programmes restrict money to high-polluting industries and promote environmentally friendly investment. These reflect many international environmental criteria in the Equator Principles. Several more “Green” programs will soon be launched by the Chinese Ministry of Environmental Protection. [www.mep.gov.cn]
Awards and Indexes: The Golden Bee CSR Roll Call, Green Companies Initiative, and Chinese Federation for CSR’s Shanghai 50 Sustainability Index, and other indexes seek to evaluate Chinese companies’ ability to embed sustainability in their business practices.

Local standards: Many Chinese cities, provinces, and ministries have developed guidelines on responsible corporate behaviour. Shanghai’s Pudong District is experimenting with responsible competitiveness strategies, especially around innovation, and is linking this research to similar international indexes on responsible competitiveness. Zhejiang Province and many of its cities are conducting CSR and responsible competitiveness pilot projects.

Chinese sectoral standards: The CSC9000T is a Chinese management and corporate social responsibility system for the Chinese textiles sector that interfaces with many international standards groups and has initiated dialogue in other textile producing countries like Cambodia and Vietnam.

Green Building Standards: China’s largest residential construction company Vanke, recently built the first building in China with materials that meet Chinese China’s Green Building. This was the first building with energy-efficient materials sourced entirely from China. [“Building Energy Efficiency in China,” Ruidong Jin, Fan Rui, www.boalt.org/elq/PDF/C35.03_02_JIN_08.10.30.pdf; www.cngb.org.cn; www.wanke.com]

Sustainability Reporting: In December 2008, the Beijing-based consulting company Syntao launched “A Journey to Discover Values 2008, China Corporate Sustainable Reporting”. Some key findings are that: Half of China’s sustainability reports were done by SOEs, but growth in publicly listed company reports grew; there is a great potential for the reports to use voluntary frameworks like the GRI or AA1000. The report also notes that lack of high-level management recognition remains an obstacle for companies releasing reports. [www.sustainabilityreport.cn]
Trends: Form fatigue or fear of information disclosure?

Researchers in the Chinese sustainability index space note that Chinese companies are less likely than MNCs to report facts on forms. [personal interviews]

Government takes the lead in China.

In the UK, real estate companies pushed to develop the LEEDS certification for green buildings. Marks & Spencer pushes for the higher labour and environmental standards expected by customers. The Chinese government, while working with industry to develop green building standards, has largely done so out of the perceived need to create Chinese national standards.

Some Local Standards Promote Competitiveness, Others Glory:

The domestic Japanese forestry sector is well-protected by legal frameworks, but Japanese companies abroad have been accused of cutting wood unsustainably, often harming their brands. Japan’s strong domestic forestry standards are disconnected from international standards that allow Japan to fully trade in internationally certified sustainable wood products.

Consumer attitudes: Chinese Consumers have very low recognition of product sustainability labels, but show a relatively high willingness to pay for environmental attributes. 31% of Chinese consumers rate the environment as a higher priority than economics, compared to 17% in the US. [GreenBiz, Sept ’08, “Chinese Consumers Rate the Environment a Higher Priority Than Americans, British”, www.greenbiz.com/news/2008/09/19/chinese-consumers]. 63% have a list of “favourite brands” that they would like to buy when they go to a store. High income earners are willing to pay premiums of up to 60%. [“What’s new with the Chinese consumer”, Sept ’08, mckinseyquarterly.com]

4.2 China’s emerging responsible competitiveness

Responsible competitiveness strategies by nations and regions, as well as at the enterprise level, is a relatively recent phenomenon, but is rapidly emerging as a significant lens through which to plan and implement policies designed to enhance competitive outcomes. Approaches taken at this early stage vary between countries depending on their economic structure and stage of overall development. In common is an appreciation of the competitive
advantage afforded through improved social and environmental performance of enterprises, sectors and the economy as a whole. Cambodia, for example, is seeking to enhance its competitiveness in the garment and textiles sector by advancing improved labour standards as a distinct competitive advantage in what is otherwise relatively commoditised markets, formalising this in its latest bilateral US trade agreement.\textsuperscript{40} Saudi Arabia’s ‘10x10’ stated policy aim of placing itself amongst the top ten most competitive nations by 2010 has as one key implementation platform the ‘Saudi Arabian Responsible Competitiveness Initiative’ in recognition of the role of social and environmental performance in growing a generation of global businesses. Similarly, the European Community has declared its competitive strategy to remain and deepen its lead as the most energy efficient developed economy, and seeks to promote international agreements and technologies that will consolidate the competitive advantage of this position. China’s economic success has to date been largely underpinned by exports made competitive by virtue of low labour costs, often poor working conditions, and weakly enforced environmental regulations. The impact of this is captured and measured by AccountAbility’s Responsible Competitiveness Index (RCI), which tracks the progress of 108 economies in embedding responsible business practices into their respective economies.\textsuperscript{41} 

China’s comes in 87th place in the most recent RCI. This low score, especially against other ‘BRICS’ countries (Brazil, Russia, India, China, and South Africa) where China lags behind the other four, should be a source of concern as China looks to moving up the value chain. That is not to say that China is universally a poor performer on this index. China, for example, scores well on wage equality between men and women, above average for its class on occupational fatalities, just below average on the strength of auditing and accounting standards and staff training, and poorly on corruption and CO\textsubscript{2} emissions. Comparing China’s performance against the other BRICS across the three principle domains (policy, business, and societal) reveals that it performs best in the policy domain and poorest on social enablers, whilst India and South Africa outperform the other BRICS on the business action domain. This low ‘social enabler’ score turns out to be of critical importance when it comes to the matter of entering global markets, because it means that Chinese business is inexperienced in dealing with civil society organisations at home, and so are poorly prepared to deal with them in international markets, especially as these groups play increasingly bigger roles in shaping sustainability norms and rules across the global economy.
Poor business practices and an overall low performance in responsible competitiveness will become a hindrance to China’s strategy to produce sophisticated products and establish a first generation of multinationals with global markets and brands. Chinese government policy clearly reflects this, as manifested in the forced closures of factories producing contaminated food, strengthened labour laws, and harsh penalties for corruption among senior officials. Official Chinese responses to environmental concerns by the international community are shifting from defensive references, to claims of responsibility. As an example, a handbook recently produced by the Chinese Forestry Ministry “positively guides and standardises Chinese companies’ sustainable forestry activities overseas, promotes the sustainable development of forestry in those countries, [and] protects the international image of our government being responsible”. These are early days, and China’s problems and shortfalls continue to outweigh its record of good practice, but the stage is certainly set for China to steward and advance responsible business practices at home and internationally.42

4.3 China’s policy challenge

CNTCs’ strategies on how to orient toward sustainable development are not, of course, purely a matter for private actors making self-interested decisions. Such strategies, whilst commercially pragmatic, will be influenced by the Chinese Government’s own policy guidance and suggestions. This will be especially important for state-owned enterprises, but also for other parts of the Chinese business community through a variety of policy instruments that impact on everything from their access to information and finance, to prevailing international regulations and norms.

Chinese trade and investment strategy is essentially a macrocosm of this CTNC challenge. China’s engagement in the international economy needs to move away from pure labour value-added, and towards the higher economic gains associated with more sophisticated technology, gains from intellectual property ownership, and premiums associated with globally valued brands. This strategy faces major competitive challenges from incumbent businesses supported by their respective governments’ policies and practices. Equally, however, there is huge pressure to move in this direction to offset the trend towards protectionism against Chinese and other emerging economies, whether framed in terms of restrictions ‘in the national interest’, to ‘protect industries and workers in transition’, or to prevent ‘social and
environmental dumping’. Any move towards border carbon taxes by major export destinations will further accentuate the importance of this development.

The China Brand will be associated with the values exemplified by the activities of high profile companies, fairly or otherwise, just like the US brand after Enron and WorldCom, the Italian brand after Parmalat, the British brand given the circumstances of BAe Systems, and the German brand in the face of the corruption scandals associated with its iconic Siemens brand, as well as those companies at the heart of the global financial crisis. Nations, as well as businesses, compete with each other, for example through enabling policies, public investments in the broader underlying drivers of business competitiveness such as good infrastructure, education and health care. Nations also embody communities or ‘clusters’ of businesses, which leverage each other’s competencies and create business climates and cultures that can support or restrict international competitiveness. The expectations and demands of citizens also impact the basis on which nations compete, for example, in what products and standards of behaviour they demand from companies they buy from, work for and invest in.

The key difference, then, between the Chinese Government’s policy context as compared to a specific CTNCs’ strategic landscape, is that CTNCs can act independently but are interrelated, whereas the government has to make more unified policy decisions to address diverse economic and political landscapes. The aggregate effects, however, are similar. Any specific CTNC will decide the best pathway from the low to the high-value economy. These means will differ depending on the sectors and market they occupy and which they wish to enter. China’s broader profile in international markets and political economy are, however, a result of all of these actions combined. If one CTNC, in pursuing clear commercial interest, chooses low social and environmental performance, this will negatively impact the opportunities and fortunes of other CTNCs. Similarly, higher environmental standards may work for some CTNCs, but be commercial suicide for others given the state of the markets in which they operate. In short, what is commercially sound practice for any one CTNC may not be in the best interest of others, or China as a whole.

Until China enacts a deliberate stance toward enhancing its responsible competitiveness through participation in international voluntary standards, its “going out” strategy will remain incomplete.
Section 5: Sustainability Standards and Competitiveness

5.1 Civil regulation

China is by no means alone in facing the limitations of an over-reliance on statutory compliance, but in many ways lags some of its key competitors and export and investment destinations. In Europe and North America, for example, the value of so-called ‘voluntary standards’ that are beyond legal compliance is increasingly recognised as crucial to enabling norms and standards. These standards are often developed, stewarded, and enforced through non-statutory means. The reasons for this are well-documented, and include the cost of statutory approaches, the clumsiness and backward-looking nature of many legal approaches, and the unintended consequences of the over-use of the law, such as the US’s over-litigious environment. The German government’s Ministry of Economic Cooperation rates voluntary standards as “high” and recommends “intense commitment in this field”.44

On the broader global stage, the damaging fate of the Doha Trade Round exemplifies the limitations of inter-governmental agreements of substance, and we see as a result a surge of not only bilateral and regional inter-governmental agreements, but also non-statutory agreements between private actors that frame market transactions by ‘sustainability’ standards and norms. Even the European-wide carbon trading system (ETS), widely-quoted to demonstrate the potential for innovative inter-governmental solutions, leaves much work to be done, and arguably would not have come into existence if its predicted substantive impact in the short to medium term had been significant. Again, we see private voluntary initiatives both enabling the ETS to function more effectively, such as the Carbon Disclosure Project, and filling in gaps not covered by the ETS.

When it comes to developing and applying the rule of law around sustainable trade, the difficulties and limitations are numerous. Beyond the basics that should have been agreed as part of the Doha Round, many dimensions of sustainable trade involve cross-border issues where jurisdictions can be unclear or involve inter-jurisdictional issues with weak or non-existent regulatory enforcement mechanisms in practice. Furthermore, many issues are not, and perhaps in some instances cannot be, adequately covered by the rule of law, such as the share that peasant farmers get of the final value of their product, the responsiveness of global
companies when accessing water resources to community concerns, or the employment of locals or nationals in the exploitation of their own resources.

Such factors, combined with considerable asymmetries of power between global businesses and local communities and even governments, have led to the organic emergence of a ‘civil regulatory’ framework of non-statutory initiatives covering everything from internet privacy to human rights abuses committed by security forces guarding extractive industry sites, to anti-corruption initiatives to the greening of cotton.\textsuperscript{45}

Creating such standards, let alone enforcing them, poses considerable challenges. Until the early-1990s, global businesses, largely European and North American, found themselves more or less exclusively in opposition to campaigning organisations, again largely from these continents although increasingly also from parts of Asia, notably India, Sub-Saharan Africa and across Latin America. Governments played an ambivalent role, often quietly supportive of business whilst increasingly having to respond positively to challenges to corporate power in the face of the growing popularity of campaigning organisations. From these largely dysfunctional beginnings has emerged a new generation of standards developed by ‘collaborative standards initiatives’ (CSIs), often involving hundreds or thousands of interested parties, businesses, non-profit organisations, as well as public institutions acting as conveners and conveyers of the public interest rather than in their regulatory role.\textsuperscript{46} For example, standards covering cross-border project finance by financial institutions has been established as the Equator Principles,\textsuperscript{47} stewarded by the International Finance Corporation. The most widely recognised and applied sustainable forestry standards are the Forest Stewardship Council (FSC).\textsuperscript{48} Standards of behaviour for security forces guarding extractive and energy sites are stewarded by the Voluntary Principles on Security and Human Rights; labour standards were first covered by the SA8000 overseen by Social Accountability International and then by civil society organisations like the Fair Labour Organisation and the Ethical Trading Initiative. There are literally hundreds of these initiatives, many of the most visible being global but with many of those adopted by businesses emerging at the national and regional levels.\textsuperscript{49}

These initiatives have not been driven exclusively by civil society organisations. Businesses and governments themselves promote these international voluntary standards as part of their
own competitive advantage. The Extractive Industries Transparency Initiative (EITI), for example, was sponsored by several global oil majors, just as the Fair Labour Association (FLA) was sponsored by the US Government together with leading US apparel companies. Even where civil society organisations’ actions are the drivers of such initiatives, such as the ‘Publish What You Pay’ campaign in the case of the EITI, and student action in the case of the FLA, companies and governments very often develop a leadership role as the resulting initiatives mature. Many forest product companies support the Forest Stewardship Company as its core, labelling strategy has become a real basis for commercial competitiveness in the sector.

5.2 Sustainability standards as a competitive advantage

Collaborative Standards Initiatives provide a major opportunity to overcome the combined failure of global governance mechanisms and market-based solutions to deliver conditions in which businesses and nations can deliver sustainable development.

Without the forest-to-consumer stewardship of initiatives such as the FSC, the world’s forests would be in a worse state than they are. And without initiatives that commit apparel and footwear companies like Nike to improve labour standards in the factories from which it buys, workers in their supply chains would get a worse deal than they do. Countries like the UK in the 1990s faced situations similar to China today, where jobs were moving overseas, media was driving sustainable development, the government and business saw the need to promote sustainable development outside the country’s borders, and civil society was calling for more responsible business behaviour. It was in this context that global standards emerged.

Private voluntary standards today do represent a potential barrier to entry for emerging business communities and nations. Indeed, through the concerned eyes of Chinese business leaders, and indeed business leaders from most emerging economies, these standards are seen as, in the main:

- Controlled by western companies, NGOs, and governments.
- Having unattractive access conditions for emerging economy businesses.
- Involving standards that are not suitable for emerging market firms and their competitive context.
It is true that most are dominated on the business side by existing global companies, largely European and North American, and create in effect non-technical barriers to trade. Many make it difficult to operate in high-risk countries, and yet as stated above, Chinese businesses often find themselves confined to high-risk markets, especially when competing to access raw materials. Whether stimulated and created by any combination of active international civil society, governments, or business, these standards have in the main become, or are in danger of becoming, exclusive clubs for erstwhile enemies, that is, incumbent global businesses working with campaigning organisations.

Scale of Private Sustainability Standards

<table>
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<tr>
<th>Standard</th>
<th>Scale</th>
<th>Chinese trade</th>
<th>Drivers</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Forest Stewardship Council:</strong>**</td>
<td>Percentage of global paper pulp market certified by FSC (2007): ~10%</td>
<td>Import of wood products: $15 billion [FAO, 2007]</td>
<td>Commitment from Home Depot and Wal*Mart; Harry Potter printed on FSC paper, only enough supply to print 65% of books printed on FSC certified paper; Public procurement commitments from UK, Netherlands, Denmark, Germany, Belgium, France; Companies choose FSC: Improved reputation: 82%; Access to new clients: 74%; Access to new markets: 66%. [Conroy]</td>
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<td></td>
<td>Forests under FSC certified management: &gt;10%, or 105,450,874 hectares (three times the size of Germany)</td>
<td>Export of wood products: US$14.4 billion. [FAO, 2007; [IISD Global Supply Chains Study, Forestry Sector, 2008]</td>
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<tr>
<td><strong>Fairtrade Labelling Organisation:</strong></td>
<td>75% UK residents recognise “fair trade” logo. As of 2005, Fairtrade sales increased 37% annually, accounting for €1.1 billion in sales worldwide, including over one million producers and direct benefits to over five million people. [<a href="http://www.fairtrade.net">www.fairtrade.net</a>]</td>
<td>China has minimal trade in fair trade coffee and tea; some speciality goods sold foreign supermarkets, collaborating with the WWF.</td>
<td>Competition among retailers like Tesco and Marks &amp; Spencers to see who can have the most fair trade. Low level of recognition in China, but some partnerships formed between businesses and NGOs. Starbucks announced in October doubling purchase of fair-trade coffee, becoming largest buyer. [<a href="http://www.fairtrade.net">www.fairtrade.net</a>]</td>
</tr>
<tr>
<td></td>
<td>In the first three quarters of 2008, over 18 million units of fairtrade cotton were sold at a value of GBP67.1 million. [<a href="http://www.fair-trade.net.uk">www.fair-trade.net.uk</a>]</td>
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Underlying these concerns, or more properly the difficulty in overcoming them, are two further crucial factors:

- Low trust between western ‘members’ and emerging economy businesses block collaboration.
- Many emerging economy businesses, especially from China, have little experience in engaging in such initiatives, and in particular with civil society organisations.

### Standards and Drivers

<table>
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<tr>
<th>Standard</th>
<th>Scale</th>
<th>Chinese trade</th>
<th>Drivers</th>
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<tr>
<td><strong>Marine Stewardship Council:</strong> the world’s leading certification and eco-labelling program for sustainable seafood.</td>
<td>Certifying 10% of global wild caught fish [<a href="http://www.msc.org">www.msc.org</a>].</td>
<td>China is world’s largest producer: 16-17 million tons of wild capture; (Peru, # 2, has 9.6) 13 million fisher people; (31% of world’s total).</td>
<td>McDonalds and Wal*Mart, aim to have 100% of fish stocks under FSC certification; Vietnam and South Georgia are working with fisher people to certify stocks. Wal-Mart: “When you’re big enough, what was an externality is now an internality.” [Conroy]</td>
</tr>
<tr>
<td><strong>Initiative for Responsible Mining Assurance:</strong> social, environmental standards for mining.</td>
<td>Five mining association members; five mining companies; dozens of NGOs.</td>
<td>20% of Chinese trade [MOFCOM].</td>
<td>After campaign from NGOs, the Principles gain support from companies like Tiffany’s and Wal*Mart. [Conroy]</td>
</tr>
<tr>
<td><strong>Principles for Responsible Investing:</strong> 2006 UN initiative: make environmental and social governance part of investment analysis.</td>
<td>444 signatories and US$18 trillion under management [PRI].</td>
<td>China Investment Corp and China Banking Corp became signatories. Motivation: become part of norm on investment and pension funds [PRI].</td>
<td>Investment institutions want to become part of normal investment community; Supply chain issues; Companies use disclosure to accelerate innovation, identifying waste, driving more efficient investment; [PRI].</td>
</tr>
<tr>
<td><strong>Extractive Industries Transparency Initiative</strong></td>
<td>24 candidate countries with high foreign investment in extractives sectors; 40 companies signed up; 11 extractive importing countries support.</td>
<td>No Chinese companies.</td>
<td>Chinese brochure available: [<a href="http://www.eti2.org.uk/Z/abteti/ETI-brochure_zh-cn.pdf">www.eti2.org.uk/Z/abteti/ETI-brochure_zh-cn.pdf</a>].</td>
</tr>
<tr>
<td><strong>Voluntary textiles initiatives like SAI, ETI, FLA, FWF, WRAP and BSCI</strong></td>
<td>In March 2008, SA8000 certified products made by 875,052 workers in 64 countries, and 61 sectors.</td>
<td>China accounts for over 50% of global textile trade.</td>
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</table>
There are important exceptions. The International Standards Organisation (ISO) provides a forum and process that is more familiar to Chinese players. But with the exception of the standards environmental management standards (the ISO 14000 Series), and the current ISO 26000 guidance on social responsibility, most of ISO’s focus areas are at present not core to the sustainability agenda. Gradually, order is coming to the wider landscape of voluntary sustainability standards. The ISEAL Alliance, for example, has developed a Code of Best Practice for developing such initiatives.

Sustainability standards do not confer costs and benefits equally across companies or nations. On the down side, markets for talent, finance, goods, and services do not automatically reward companies that work to improve aspects of sustainability performance. For example, some aspects of sustainable development appear to have no affect on western consumer purchasing, unless two goods of similar cost and quality are compared, according to one study. In that case, environmentalism is slightly correlated, but traditional aspects like corporate governance and diversity were more important, which is also important to investors. Also, there is not a statistically significant relationship between the financial performance of the world’s largest companies, the Global 100, and their score on the Accountability Rating. This fact may be for any one or more of three reasons:

- Firms often do not know how to exploit the business opportunities of enhanced sustainability performance;
- Even when they do, the gains have not yet fed through to reported financial performance;
- Most importantly is that markets are often ‘backward looking’ and do not yet reward sustainability performance that over the longer term could provide significant financial gains.

Similarly for nations, the distribution of competitiveness gains from these standards is often location-specific rather than global. Leadership in improved emission standards for vehicles produced in Europe may deliver competitive advantage to the region, as such emissions are internalised into markets through legal pollution limits, or when emissions contribute to a product’s “embedded carbon” as priced, say through cap and trade or carbon taxes. But, as long as costs remain largely externalised, the higher-costs for achieving lower emissions may well render the sector uncompetitive, especially in the high growth markets of India, Brazil
and China. International pressure on Chinese apparel, textiles and footwear producers to improve standards certainly point the way towards desirable markets where businesses and nations are rewarded for enhanced sustainability outcomes. However, as long as purchasing practices by international buyers from global retailers are so heavily weighted towards price-point competitiveness, this pressure remains too often at odds with the realities of sustained competitiveness.

*Sustainability standards are a means of off-setting competitive disadvantages or creating competitive advantages resulting from the adoption of sustainability pathways by businesses and nations.*

The Equator Principles, which sets out sustainability principles to be applied for cross-border project investments, was advanced in particular by global financial institutions like Citi and ABN Amro to enable them to apply such standards without facing competitive disadvantages. The Extractive Industry Transparency Initiative (EITI), similarly, was established to help companies like BP and Shell respond to growing societal pressure to publish data on royalty payments to host governments and avoid the threat of exclusion from those same governments. Acting alone, BP reasoned, would leave them vulnerable to them being excluded from access to resource opportunities in favour of their competitors which were willing and able to ignore pressure to be more transparent in their dealings. Collaboration can also at times lead to reduced costs disadvantages or even absolute cost savings. Supply chain social and environmental auditing has added multi-million dollar expenses that, adopted by vulnerable premium brands alone, can leave them with a significant cost disadvantage in fiercely competitive markets. Furthermore, through initiatives such as the Ethical Trading Initiative, opportunities are being developed for sharing such costs to reduce their absolute levels.

The competitive dimensions of sustainability standards, following the well-documented history of regulatory competition, is therefore especially related to where enterprises and nations find themselves in a disadvantageous competitive position as a result of their adoption of relatively better sustainability practices than their competitors. In such so-called ‘first-mover disadvantaged’ situations, it becomes in their interests to encourage their competitors to reach the same standards, and so at minimum, offset the original competitive
disadvantage. In these cases, sustainability standards can be competitively smart for the enterprises of one nation only when others also join the standard. Game theory says these ‘prisoners’ dilemmas’ are likely to be overcome during repeated interactions such as trade. In such cases, it benefits sustainability leaders to help laggards move toward mutually beneficial development outcomes through participation in voluntary sustainability standards. Sustainability standards offer the chance to overcome these dilemmas. It is in this context that we can turn to a brief review of China’s approach to sustainability standards for enterprises.

**Chinese Business Leaders Adopt Private Sustainability Standards**

**The Carbon Disclosure Project:** Developed in 2002, the CDP is the largest investor coalition in the world on climate change issues, with 385 signatories and $57 trillion in assets. Globally, 1550 companies of the total 3000 companies surveyed have responded. In China in 2008 for first time, 20% of the largest 100 listed companies responded, with an additional 5% providing complete information and 17% declining. Comparatively, 77% from G500 responded; 90% from the FTSE100; 321 from the S&P 500; China has two signatory members, Industrial and Commercial Bank of China (ICBC) and China Investment corporation. [http://cdp.syntao.com]

**United Nations Global Compact** 139 Chinese members. [www.unglobalcompact.org]

**International Standards Organisation 26000** Corporate Social Responsibility standard: involvement from State Grid Corporation of China.

**China Ocean Shipping Company:** COSCO is one of China’s most active participants in international voluntary standards initiatives, having signed up to the United Nations Global Compact and its “caring for climate initiative”. It also uses the Global Reporting Initiative and the AA1000 Assurance Standard to ensure quality and accountable sustainability reporting. [www2.sasac.gov.cn/zyqy/jykx/200704060098.htm, www.gov.cn/ztzl/200807/07/content_1038051.htm]
5.3 China’s current stance on sustainability standards

Chinese businesses going global are facing this new generation of sustainability standards in international markets, at times statutorily framed, but often and increasingly as collaboratively-developed voluntary standards. The strategic question is not whether, but how to respond to them. In many respects, the answer depends on the business, the sector, the markets being addressed, and so many of the factors set out in preceding sections of this paper.

Chinese businesses and government officials’ wariness does not always prevent Chinese businesses adopting such standards, particularly process-focused standards such as the Global Reporting Initiative’s Sustainability Reporting Guidelines and AccountAbility’s AA1000 Assurance Standard. On the other hand, there is a strong sentiment that imported standards will not be appropriate for Chinese enterprises. “We should make CSR standards with Chinese characteristics”, said Li [Hongyan], General Secretary of the 2006 Building a Harmonious Society and CSR (Shenzhen) Forum.57 In response to such sentiments, the Chinese Academy of Productivity Science has drafted a universal CSR framework called ‘Chinese Corporation Social Compliance’.58 Similarly, China-branded sustainability and responsibility standards are emerging in textiles and other sectors as well. Adding a country’s characteristics to standards or creating entirely new standards can be appropriate in many cases, but the process becomes counterproductive if associations or ministries gain prestige through standard creation at the expense of international competitiveness. Creating standards with Chinese characteristics should be measured against many criteria, including necessary policy goals and competitiveness.

Chinese companies, working with the Chinese Government, have a real choice in responding to prevailing sustainability standards in international markets. The issue of labour standards in textiles and apparel is a case in point. Several standards have emerged and are widely used by international business, notably those promoted by the Ethical Trading Initiative, the Fair Labour Association and Social Accountability International (home of SA8000). The Chinese response to this has been to develop and promote the CSC9000t (see panel above). The Chinese approach in the textile sector has clearly been to engage with existing international initiatives, rather than trying to shape existing standards, whether because of problems
with the substantive conditions of the codes being promoted, the participants, the process and associated governance, or some combination of these.

**Labour Standards in Chinese Supply Chains**

The Responsible Supply Chain Association (RSCA) of the China National Textile and Apparel Council (CNTAC) created the CSC9000T voluntary standard and management system to suit, in its view, the situation of China’s textile sector as a self-disciplinary, industry-specific, voluntary association that puts special emphasis on protecting workers’ rights and enhancing capacity for business to develop sustainably. This standard has the support of the Chinese Federation of Labour Unions and accords well with many international systems like the ISO 14000 Environmental Management System. Aligning the CSC9000T to other standards gives Chinese industry the potential to influence the development of these standards, but this is not an explicit goal.

This national standard, combined with management training, initially had a mixed reception by international organisations, which questioned whether China is seeking to uphold or undermine existing standards. There is, however, clearly potential, given the huge importance of Chinese suppliers in many global supply chains, of CSC9000T to become part of a global norm. This is especially significant because CSC9000T researchers started cooperation with the BSCI, ILO, and WRAP, and have begun dialogues with the FLA. The CSC9000T organisers are also exploring the system’s applicability in other textile-intensive economies such as Vietnam and Cambodia. [personal interviews]

Sustainable forestry is an area where Chinese enterprises have adopted a ‘join and promote’ approach to existing international sustainability standards. Sustainable forestry is a widely acknowledged issue for which national legislation in most countries where major forestry industries reside is largely inadequate. As a result of this, and widespread activism by international campaigning organisations, the Forest Stewardship Council (FSC) evolved to become the world’s leading sustainable forestry certification system. According to Heiko Liedeker, until recently Executive Director of the FSC and Chairman of the European Forest Team of the
World Wildlife Fund, “The FSC has shown that it improves forest management substantially and provides credible certification. The world’s forests now need better management to achieve the standards of the FSC rather than more certification schemes or mutual recognition frameworks.” Such certification schemes, with their strong chain-of-custody, may prove powerful for China as it seeks to overcome new statutory barriers to trade in timber suspected to have come from illegal sources (such as the United States’ recently amended Lacey Act) which would ban many manufactured products made from raw wood materials that have been harvested in countries where illegal wood harvests take place. This newly amended act means some US companies trading in Chinese forest products could face forfeiture, penalties, and even imprisonment.

Chinese stakeholders are already learning the value of automatic branding through certification by the FSC and Chinese companies have made the FSC the fastest growing forestry certification scheme in China. As of Sept 2008, China had 730 active certified members, with the first being certified in 1998. In June 2007, when the International Board of Directors of the Forest Stewardship Council announced the accreditation of the Forest Certification Working Group in China as the official FSC National Initiative in China (FSC China), Chairman Grant Rosoman said, “China is a key player in global wood products trade and manufacturing. There is an enormous opportunity for Chinese businesses together with FSC to transform the national and international wood products trade into a responsible trade, while at the same time capturing additional value and protecting the world’s forests.” And yet, even with the FSC’s certified forests approximately three times the area of Germany, there was only enough supply to print two thirds of the latest Harry Potter book on FSC certified paper. China, as the world’s largest processor of wood products, can do much to correct this imbalance.

The development of sustainability standards through the International Standards Organisation (ISO), although at its early stages, provides further insights into China’s existing and possible options and strategies. Chinese researchers, including China’s leading SOEs, have become active participants in the ISO’s work on its ‘Social Responsibility’ guidance, ISO26000. In this instance, faced with a ‘known and understood’ process, namely the ISO, Chinese enterprises and standards bodies have been more willing to engage constructively in the development of the standard, despite the considerable differences between its views and those of many labour
and civil society organisations engaged with them in the process. The learning from this case is as simple as it is important. China’s will to engage has, rightly, a lot to do with the institutional pathway on offer, not so much those involved or the topic, but more its governance and transparency and so Chinese participants’ confidence that they both can exert influence effectively on the outcome, meanwhile understanding and reasonably predicting the process.

China, Collaborative Voluntary Standards, and the Distributive Benefits of Globalisation

The UK Government's Minister of International Development, Lord Malloch-Brown, in a speech on 30th August 2007, commented that “China's full support for and engagement with the Extractive Industries Transparency Initiative would not only be hugely symbolic but would make a real practical difference. It would be a big push towards much greater transparency in…oil markets. The point is that a common approach will only be effective if it is just that – common. It is bound to be weakened if we apply different standards as donors and partners on working conditions, labour conditions or debt sustainability or standards of governance in different individual countries. But for none of us, least of all China, working together in this way, shouldn’t be seen as a sacrifice of agenda.”

The Chinese Ambassador to the United Kingdom, Zha Peixin, emphasised the importance of what many actors are beginning to see as the opportunities afforded by collaborative voluntary standards said, “All countries, big or small, poor or rich, strong or weak, should have the right of equal participation in international economic affairs, and the formulation and revision of ‘rules of the game’ should not be determined by only a small number of countries or groups of countries.” He urged “that the benefits of globalisation are shared more widely and equitably’ and that globalisation should be ‘conducive to narrow the gap between the North and South’. [China and Globalisation 2003/10/10 Speech by H.E. Ambassador Zha Peixin At Chinese Economic Association Annual Conference (14 April, 2003); Quoted in Yongjin ZHANG, “China Goes Global” Preface by Bo Wang and Liz Padmore, April 2005, Foreign Policy Centre; Also available: www.chinese-embassy.org.uk/eng/dsjh/t27161.htm]
As a final example, the case of extractive industry sustainability standards is worthy of note. Numerous sustainability standards have been developed in efforts to address aspects of the extractive industry footprint, which can be and often is extensive and negative in social and environmental terms. A business coalition, the International Council on Minerals and Mines (ICMM), has sought to establish principles and oversight approaches in consultation with others, covering the entire business footprint of its business members. The ICMM operates in China, but Chinese company uptake of these standards is low compared to other countries. The EITI has established voluntary means of engaging host governments, together with mining and energy enterprises, to reduce the incidence of corruption and misuse of public funds associated with concession-related royalties. The Voluntary Principles on Security and Human Rights, again comprising a coalition of businesses, governments and human rights organisations, has established principles for guiding the activities of security forces mandated to protect extractive and energy sites.

What is interesting about these initiatives is that there has been virtually no engagement in any of them by Chinese enterprises or the Chinese Government. In the case of the EITI, one possible explanation is that it is seen to cross the line in interfering with the internal affairs of other sovereign states, which it clearly does. In the case of the Voluntary Principles, one reason could be that China rightly sees it as in the main antagonistic the human rights community, which would make it difficult if not impossible to realise membership, let alone do anything constructive within it. In the third case of the ICMM, made up exclusively of enterprises, one might speculate that it would be very hard for a Chinese company to join an initiative made up almost exclusively of Western companies.

The US Senate’s approach to EITI, on the other hand, strongly encourages the US government and businesses to systematically address the connection between extractives, corruption, reporting and poverty reduction, and encourages the G-8 to mandate “publish what you pay” rules for the cost of extractive resources. Whether or not to join this and similar voluntary standards frameworks is not a simple question for developing countries. China, because of its size and strengths, has more strategic options than most developing countries.
5.4 Strategic competitive framework for sustainability

Sustainability standards, therefore, can be perceived as barriers to doing business when the opportunities they bring are ignored or if the crucial actors do not engage; however they also present opportunities to enhance competitiveness. In fact, these options are mirror images of each other, since the former to the Chinese business community is the effect of sustainability standards providing competitive opportunities for its competitors. By implication, Chinese businesses, and the Chinese Government, have the opportunity to frame this question with pragmatic analysis, namely by asking what China can do about this standard to deliver enhanced competitiveness.

In addressing this question, China and its business community, individually and working together, is faced with three broad pathways to choose from in addressing any sustainability standard.
Normalisation (Compliance): where CTNCs effectively ‘sign up’ to the standard and compete on the same terms as other international business organisations.

Exceptionalism (Opting out): where CTNCs assert their desire and need to remain distinct in the way they deal with specific sustainability issues, and so ignore or seek to get around prevailing standards.

Transformational (Engaging and Influencing): where CTNCs seek to shape sustainability standards in global markets to suit their circumstances and interests.

Which pathway makes more sense to pursue depends on two crucial variables, the:

- Actual or potential impact of any particular standard on CTNCs competitive position.
- Capacity of CTNCs to influence the standard.

Putting these two variables together with the three pathways provides the basis for a simple strategic framework offering four options:

- Ignore: if a standard, and its proponents, are of little or no importance to Chinese competitiveness and China is poorly placed to influence the standard.
- Mitigate: finding ways to reduce the impact of a standard that Chinese cannot influence but, if effective, could reduce Chinese competitiveness.
- Leverage: seeking to enhance the impact of a standard on global markets if its success would enhance Chinese competitiveness.
- Promote: enhancing a standard over which China has influence and that could enhance China’s competitiveness.

5.5 Using the framework

The key message from the preceding analysis and framework is that CTNCs can and should make active decisions about specific sustainability standards based on their commercial interests and strategies. In this way, they can behave using the same rules in order to compete with incumbent international business organisations. Similarly, the Chinese Government should frame its response to prevailing sustainability standards in global markets based on its broader national policy to move China’s internationally traded goods and services up the
value chain, with the associated need to meet associated standards, norms and stakeholder expectations.

Pursuing sustainable trade and investment does not, therefore, mean the passive acceptance of existing sustainability standards, nor does it mean a strategy of ‘avoidance where possible’. Promoting the FSC standards for sustainable forestry might well be in the interests of the leading CTNCs in this sector. The Chinese Government may choose to promote this standard in exchange for an agreement with international organisations to mitigate, for a period, its negative competitive effects on smaller or less advanced Chinese companies. Similarly, there is scope for the Chinese Government, working with CTNCs, to embrace international standards initiatives, such as the Ethical Trading Initiative, that focus on learning and collaboration in advancing workers’ conditions in global supply chains, rather than a rigid compliance approach to issues that would be difficult for CTNCs to sign up to, such as the rights of independent trade unions to associate freely and engage in collective bargaining. In efforts to stimulate rural incomes, promote sustainable domestic consumption and spur fairer south to south trade, China may choose to work with organisations like the Fairtrade Labelling Organisations\textsuperscript{65} to establish guidelines suitable in the Chinese context. Indeed, it might be in the interests of key CTNCs to actively promote such labour standards in current circumstances where Chinese labour costs are increasing relative to many Asian and even Latin American competitors because of a combination of key labour shortages and an appreciating domestic currency, perhaps in combination with regional trade agreements, or with these voluntary standards built into trade agreements.

These standards can also create micro-climates that not only provide new responsibly competitive market signals in trading areas, but can help prepare CTNCs with the right atmosphere domestically. Government procurement of goods with voluntary sustainability standard labels, as the Swiss government does, can further prepare consumers and companies for these standards outside borders, as well as providing spillover effects to disadvantaged communities. Fairtrade standards especially may spur domestic consumption, especially if tied to statutory measures, and may be conducive to south-south trade and overcoming Chinese domestic savings and investment gaps. This is especially important as well, in moving up the value chain where companies may want to capture higher value consumer markets at home, and align their nascent brands to international standards that are more easily recognised abroad.
The Chinese Government, moreover, may well choose to support key sustainability standards initiatives because it no longer feels able to alone monitor and control the activities of CTNCs that may be pursuing commercial strategies that are damaging the broader interests of China as a whole. Initiatives such as the Equator Principles and the Extractive Industry Transparency Initiative provide means for the Chinese government and business leaders to extend their scope of control over their own business community and so the risks facing the broader Chinese development process. Aspects of such standards that threaten to damage CTNCs reasonable foundations for competitiveness can, and can only, be mitigated if the Chinese Government is to be directly involved in the future development of such standards. China’s active engagement in the development of the ISO 26000 Social Responsibility Standard shows that China can play an active role in the governance of international standards and may choose to use these as policy instruments for sustainable development.

It seems likely the balance will tip toward (voluntary) collaboration between relevant governments and international bodies, enterprises, and civil society organisations rather than statutory standards in many if not most areas. There are exceptions to this of course. The Chinese Government’s own moves to raise the bar on workers’ contracts are evidence of statutory shifts. But even here, China may choose to promote collaborative means of establishing comparable conditions in other producing nations to prevent competitive disadvantages, or even to increase adherence to domestic labour standards. Indeed, rather than seeing it in ‘either-or’ terms, the more interesting perspective is to understand the complex dynamic between statutory and collaborative initiatives.66

Collaboration, of course, requires engagement from many sides, and there is ample anecdotal evidence to suggest that many participants in existing collaborative standards initiatives are reluctant to engage with China, despite the risks of becoming irrelevant over time by not doing so. The entry conditions to the Voluntary Principles have been the subject of intense debate, with human rights organisations being reluctant to adopt the ‘big tent’ approach advocated by participating governments and companies, that would enable and encourage emerging economy governments and enterprises to engage. Similarly, the governance of these initiatives is dominated by Western companies and civil society organisations which, whilst often erstwhile enemies, find themselves with common cause in wanting to
sustain the underlying values and associated personal and institutional solidarity that underpins many of these initiatives.\textsuperscript{67}

In conclusion, then, China has variously developed, adopted or ignored sustainability standards across different sectors at different moments in their development sometimes advancing statutory solutions, and at other times voluntary. Whilst such diverse responses is in a sense to be expected given the heterogeneity of circumstances, it is less clear whether such diverse responses result from clarity and focus, or rather ad hoc interventions within a policy vacuum. It is in this context that we turn to the final section that concerns strategic options for advancing China’s sustainable trade.
Section 6: The Next Steps

6.1 Framing the policy context

Competitiveness is made up of many factors. Some are present (or absent) purely at the enterprise level; such as specific technologies, unusually attractive terms of access to capital, a premium brand on which to build high-value sales, and so on. Others are a function of broader factors, like public policies that may advantage specific forms of enterprise, shifts in societal expectations, and of course changing market prices such as in commodities and carbon based products. In most instances, the critical link between the micro and macro level concerns the capacity of the enterprise to respond flexibly and effectively to changing market conditions, and the ability of enterprises, often working with governments and others, to manage market risks and opportunities through managing the collective brand of the relevant business community, and by setting new market rules, i.e. regulatory competition.

Sustainability standards are of course only one facet of this complex equation. However, these standards are, in many sectors and circumstances, an increasingly important element. Indeed, the success of many of the traditional aspects of competitive behaviour, such as those set out in the earlier sections, depend on sustainability factors. For example, acquiring premium brands as a means of accelerating moves up the value chain, with Lenovo’s purchase of the IBM PC brand and technologies being a case in point, will be ever-harder if attempted by Chinese companies with a poor sustainability record. Similarly, securing access to natural resources, even in concert with exceptionally attractive financial terms, will become more difficult if Chinese enterprises have a demonstrably poor track record on employment of nationals, management of community issues, and handling of environmental footprints. The links between competitiveness and sustainability performance along the value chain is also hard to separate. For example, establishing research and production facilities in Europe for the pursuit of scarce talent will be likely to fail if the same enterprise is acting elsewhere in its value chain in ways that such talent deems unacceptable.
That is, competitiveness strategies cannot be understood, let alone successfully formulated or implemented, without an integrated approach to credible sustainability practices, which means developing strategies towards sustainability standards, both at the enterprise and the China-brand levels.

Collaborative standards initiatives have become commonplace in the development of sustainability standards for enterprise operating in global markets. These initiatives, governed by non-state actors and public institutions acting in their non-statutory roles, seek to create de facto regulatory enforcement through a blend of citizen-based campaigning, capital market risk-based responses, peer to peer business pressure and, in some instances, the threat of statutory regulation in key markets. These initiatives have developed in an ad hoc manner, and are fragmented in scope, coverage and quality. Nevertheless, they are, taken together, a global phenomenon, and are increasingly finding ways to ‘join up’, at the technical, governance and financing levels. Going forward, collaborative standards initiatives offer a credible option for filling the gap left by shortfalls in inter-governmental solutions.

Chinese enterprises, and the Chinese Government, are in the main uncomfortable engaging in non-state processes of standards development, with the exception of more structured institutional processes such as those led by the International Standards Organisation. Many of the actors involved are business competitors or non-profit organisations with a history of antagonism towards China. In addition, the content, and the manner in which it is treated, especially in the social sphere, appears from both sides to effectively exclude Chinese participation. As a result, China has in the main sought to ignore, and if necessary evade, prevailing standards designed and governed through collaborative means. The impact of this default positioning erodes trust in Chinese businesses and the China brand overall, creating the grounds for more overt protectionism and moralising by the global community. This, in short, provides the basis for a vicious circle with no winners.

Collaborative initiatives advancing sustainability standards in global markets are a long-term phenomenon, and China’s economic competitiveness and broader interests are best-served through engagement in the development of the next generation of these standards and the manner in which they are governed.
6.2 Policies to Enable and Create Incentives
The Chinese government should signal its commitment to engaging in collaborative initiatives promoting sustainability standards in global markets, as one pillar of its underlying strategy for advancing China’s harmonious development and ‘going global’. The focus would be on enterprise-level engagement in selected existing standards, with the Chinese Government taking an active role where other governments are involved in advancing reviews of their content, positioning and governance.

Beyond such broad policy framing and engagement, the Chinese Government has the opportunity to incentivise effective enterprise-level engagement in the development and application of sustainability standards, by introducing such engagements as one criteria associated with the following instruments:

- Provision of preferential income tax arrangements for companies embedding sustainability strategies into their international investment.
- Operation of one or more International Investment Funds to offer seed or parallel public funding to support international investment, such as the newly-established China-Africa Development Fund.
- Encouragement of suitable public or privately-delivered insurance products to encourage international investment.
- Access to foreign exchange reserves, a key instrument available as long as the Renminbi is not freely convertible.

6.3 Knowledge development
Chinese enterprises remain in the main unaware of the history or place of collaborative standards initiatives in global markets, relying on their own, often poorly-informed knowledge networks to guide them in associated perspectives and decisions. In fact, this situation is part of a broader gap in knowledge provision to Chinese enterprises as they emerge into global markets covering the basics such as country data, market analysis, and information on the legal context.
Overcoming this knowledge gap therefore, needs to be part of a wider upgrading of what the Chinese Government either directly provides, following examples such as the Japanese JETRO, or else ensures that private service providers emerge to deliver what is required. Areas where Chinese Government interventions might be especially useful include:

- Establishing an institute for promoting international Investment, drawing in part lessons from other successful experiences such as the Japanese JETRO, but adding on a significant component that covers sustainability standards.

- Easing restrictions to ensure the availability of key personnel to support international investment activities, and as part of this strengthening the training of Chinese managers to operate effectively in managing international investments.

- Improving effectiveness of China’s diplomatic service in supporting CTNCs in their international investment activities, following examples where Commercial Attachés have undergone in-depth training in sustainability issues as they relate to foreign investment and trade.

6.4 Aligning the brand

Lastly, policy needs to be directed towards the actual improvement of the conditions within which CTNCs can make international investments. CTNCs face many potential obstacles to making such investments, some merely bureaucratic, some nationalistic, and others purely commercial. Interestingly, as we have argued extensively in previous sections, ‘sustainability’ is not just another possible obstacle, but is often the vector through which many other concerns and issues can be expressed. Leveraging some of the recommendations made above, ways in which policy in action might assist in overcoming obstacles might include:

- Diplomatic means will become increasingly important if concerns increase over Chinese investments per se, as they will do if the responsibility of Chinese enterprise in general terms is placed in doubt. Similarly, diplomatic means and activities to enhance the profile of responsible Chinese enterprise will be important and effective as long as diplomatic teams are provided with the requisite knowledge and training (see above) and are aware of the actual practices of CTNCs (also see above).
Leveraging Chinese foreign assistance to further international investment has been a well-used avenue by other investing nations, including the US, Europe and Japan. Foreign assistance can best provide a sustainable competitive advantage to CTNCs if it is visibly effective in benefiting the host country, and so not wasted on prestige projects or leaked through corrupt practices along its value chain. China’s embracing of the Paris Declaration regarding aid effectiveness, and ensuring its linkage to sustainable international investment, will help in this regard.

Bilateral and regional trade agreements can facilitate sustainable trade and international investment, especially in the face of disappointing progress on the Doha Development Round. Whilst negative conditionality links to labour and environmental standards are ill-regarded by most trading and investment partners, incentives linked to such standards would certainly establish China’s credentials as being committed to sustainability. Cases such as the US trade agreement with Cambodia illustrate also how collaboratively developed standards, in this case on labour standards in textiles and apparel, can be dovetailed into such inter-governmental agreements.

Sustainable trade and international investment should be treated as an integral element of the Chinese, and indeed any, government’s strategy for advancing its nation’s development. The right course of action is not to have a ‘sustainability strategy’, but a sustainability perspective embedded at the heart of its strategy for trade and investment. This paper has tried to advance thinking on this as it relates to the specific circumstances of China’s next stage of development, where Chinese enterprises are going global in every respect. In some senses, the same arguments could be presented for any country at any stage of development. However, China has a unique opportunity to get it right the first time, in contrast to most nations that have had to struggle to retrofit policies and practices with a sustainability focus. To that end, the recommendations made in this section are intended to be pragmatic, aligned to China’s current circumstances and needs, whilst at the same time seeking to establish a basis for China and CTNCs needs and opportunities going forward into the future.
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Footnotes


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41 The RCI 2007 includes 21 data streams covering for example measures of corruption, environmental management, tax avoidance and the ability of civil society to effectively challenge corporate behaviour. The data is all drawn from authoritative sources as diverse as Amnesty International, the International Organisation for Standardisation, the ILO, Transparency International, the World Economic Forum, and the World Bank


45 ibid

46 Several groups have grown to support the integration of these collaborative standards initiatives, most notably the International Social and Environmental Accreditational and Labeling Alliance (ISEAL Alliance), founded in 2000, which, according to the German BMZ, is an organisation “in charge of organising the most important standard initiatives as well as the international knowledge management with regards to standard-setting, and which promotes the exchange of its members on the topic of best practices in this context, have significantly contributed to public awareness-raising”
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Any mistakes, omissions or errors are the sole responsibility of the authors.
About the organisations

AccountAbility

AccountAbility (www.accountability21.net) works to promote accountability innovations for sustainable development.

AccountAbility, founded in 1995, is a global, not-for-profit self-managed partnership with bases in Beijing, Geneva, London, Sao Paulo and Washington D.C., and country representatives in Brazil, Canada, China, Jordan, Spain, Sweden and the US. AccountAbility is a global network of leading business, public and civil institutions working to build and demonstrate the possibilities for tomorrow's global markets and governance through thought leadership and advisory services. We work to:

- Enable open, fair and effective approaches to stakeholder engagement
- Develop and reward strategies for responsible competitiveness in companies, sectors, regions and nations
- Create and develop effective collaborative governance strategies for partnerships and multilateral organisations that are delivering innovation and value
- Set and influence sustainability standards

The International Institute for Sustainable Development (www.iisd.org), established in 1990, is a Canadian-based not-for-profit organisation with a diverse team of more than 150 people located in more than 30 countries. Through our dynamic portfolio of projects, we partner with more than 200 organisations throughout the world. IISD is in the business of promoting change towards sustainable development. As a policy research institute dedicated to effective communication of our findings, we engage decision-makers in government, business, NGOs and other sectors in the development and implementation of policies that are simultaneously beneficial to the global economy, the global environment and to social well-being.

In the pursuit of sustainable development, we promote open and effective international negotiation processes. And we believe fervently in the importance of building our own institutional capacity while helping our partner organizations in the developing world to excel.
Chinese State Council’s Development Research Centre (DRC) (www.drc.gov.cn) is a policy research and consulting institution directly under the State Council of the People's Republic of China. Its main function is to undertake research on the overall, comprehensive, strategic and long-term issues related to the national economic and social development and provide policy suggestions and consulting advice to CPC Central Committee and the State Council.

The State Secretariat for Economic Affairs SECO (www.seco.admin.ch) is, among others, with its economic development division the competence centre of the Swiss Federal Administration for the promotion of the economic development and trade of developing and transition countries.

We firmly believe that domestic economies geared towards growth and globalization contribute to sustainable development and efforts to combat poverty.

In addition, SECO supports the principles of the market economy and sustainable economic growth based on private initiative, entrepreneurship and the development of trade. We feel that mobilisation of the know-how, skills and resources of the private sector, both in Switzerland and in partner countries, can make a fundamental contribution to the development process.

SECO is active in the following countries: Peru, Colombia, Vietnam, Indonesia, South Africa, Ghana and Egypt as well as in Tajikistan, Kyrgyz Republic, Uzbekistan, Azerbaijan, Serbia, Bosnia Herzegovina, Albania and Macedonia.

Priority areas of SECO supported activities are:

- Sustainable Trade Promotion
- Private Sector Development
- Urban Infrastructure
- Macro-Economic Support
- Cooperation with the World Bank and Regional Development Banks
ADVANCING SUSTAINABLE COMPETITIVENESS OF CHINA’S TRANSNATIONAL CORPORATIONS

Long Guoqiang – The Development Research Center
Simon Zadek & Joshua Wickerham – AccountAbility

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This paper is freely downloadable from www.accountability21.net
This paper examines how the Chinese business community can best use international sustainability standards to enhance their competitiveness in global markets and more effectively place themselves on a sustainable economic pathway.

It highlights the opportunity for Chinese businesses, supported by enabling public policies, to become a force in shaping the next generation of sustainability standards in global markets as a competitive strategy consistent with China’s broader interests. Doing so will require deeper engagement in existing standards initiatives, and a more explicit role amongst the communities that have developed and now govern them. Effective engagement in such standards is a means of offsetting competitive disadvantages, and creating competitive advantages when businesses and nations choose a more sustainable development path.

This paper sets out both strategic options for businesses and policy options for the Chinese government to realise sustainable development and competitiveness goals.

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