
The ISO and Corporate Social Responsibility

Issue Briefing Note:

Small and Medium-Sized Enterprises

May 2004

iisd International Institute for Sustainable Development / Institut international du développement durable



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This is one of three Issue Briefing Notes produced by a partnership of six sustainable development-oriented non-governmental organizations, including three international organizations and three organizations based in developing countries.

The partners are the International Institute for Sustainable Development, the International Institute for Environment and Development, IUCN – The World Conservation Union, the African Institute of Corporate Citizenship, Development Alternatives and Recursos e Investigación para el Desarrollo Sustentable.

The Issue Briefing Notes present a general overview of three issues that deserve particular attention in discussions on the possible development by the International Organization for Standardization (ISO) for international Social Responsibility standards. They address issues related to small and medium-sided enterprises (SMEs); stakeholder capacity to engage in corporate social responsibility (CSR); and national differences in CSR definitions and priorities. While written with an international focus, the papers are drawn particularly on insights from Chile, India and South Africa. For more information, please visit <http://www.iisd.org/standards/csr.asp>

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Published by the International Institute for Sustainable Development

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This paper was produced with the financial assistance of the Swiss State Secretariat for Economic Affairs.



Summary of key points

- Although their significance is difficult to measure, it is clear that small and medium-sized enterprises (SMEs) are the mainstay of most economies, particularly in terms of employment and overall development impacts.
- Although their individual social and environmental impacts are small, the cumulative impacts of SMEs are highly significant, offering the potential for significant progress towards sustainable development if the SR agenda can be made more relevant and applicable for SMEs.
- Currently, the greatest driver for SMEs to engage with SR is within the supply chain of larger companies. The “linkages” theme, in which support for SME development is an element of the social responsibility of large companies, is gaining prominence within the SR agenda.
- But otherwise, the existing SR debate, both in terms of the business case and the tools, is often not conducive to the engagement of SMEs. And even supply chain-based SR initiatives can act against the interests of SMEs.
- While a future SR standard offers the opportunity to engage SMEs, it also runs the risk of acting as a barrier to their market entry, hence undermining livelihoods and broad-based development.
- An international SR standard needs to consider SMEs in relation to both the content of a standard, and the incentives for SMEs to implement it.

Introduction: social responsibility and small enterprises

The existing social responsibility (SR) debate almost entirely focuses on large enterprises. The drivers of the debate, including NGOs, investors and regulatory authorities, naturally tend to focus on large, high profile companies. Where the debate does touch on small and medium-sized enterprises (SMEs), this is usually in a reactive sense, either as suppliers to larger companies, or as beneficiaries of SR initiatives. Small enterprises are less likely to have formal policies on SR issues—for example, over 90 per cent of large South African companies have implemented an HIV/AIDS policy, as opposed to 13 per cent of small companies.¹

There are some exceptions, where the SR debate relates specifically to SMEs. For example, a Chilean policy that promotes a national approach to cleaner

¹ BER 2003 *The Economic Impact of HIV/AIDS on Business in South Africa*, commissioned by SABCOHA.

production places particular emphasis on SMEs, providing training, information and financial support through a Centre for Clean Production, and there are examples of export-oriented initiatives that target SMEs (Box 1). But SR in Chile nevertheless remains an issue that has been tackled basically by large enterprises, whether state-owned, transnational or national. In most cases, this is a response to international supply chain requirements. This pattern is replicated around the world. The development of an SR standard provides an opportunity to address this imbalance, in doing so supporting the potential for organizations of all sizes to improve their social and environmental performance.

Box 1: CSR in SMEs in Chile

The Inter-American Development Bank has provided US\$1.25 million for the project “Adoption of CSR by SMEs in Chile.” The project is carried out by the “Vincular” centre,² part of the Catholic University of Valparaíso. The objective is to enhance Chilean SMEs competitiveness through the implementation of CSR initiatives, increasingly demanded by international markets. The project lasts four years and is expected to involve around 150 SMEs from key economic sectors, starting in 2004 with fruits, wine and manufactures.

Classification and terminology

Although the term “SME” is frequently used, it is seldom defined—yet this is essential to understand the significance of the sector, and the implications and limitations of the SR agenda in relation to it. What constitutes a small, medium or large company is by no means clear or uniform, even within individual countries. In Chile, companies are generally classified according to annual turnover; in South Africa, by turnover, gross asset value and the number of employees (see Box 2). In India, any industrial undertaking with fixed assets less than 10 million Rupees³ is classed as small-scale. In many cases, these classifications are enshrined in legislation, e.g., in South Africa by the National Small Business Act (1996) and related Amendment Bill (2003).

The SME and micro-enterprise (ME) sector encompasses a very broad range of firms, from established traditional family businesses employing over a hundred people to “survivalist” self-employed people working in informal micro enterprises. While the upper end of the range is comparable across developed

² <http://www.vincular.org>

³ As at April 2004, US\$1 is worth 44.68 Rupees, making this equivalent to roughly US\$224,000.

Box 2: Classification of enterprises in Chile and South Africa⁴

Category	Chile	South Africa ⁵		
	Annual sales in UF currency (US\$ equivalent)	Employees	Turnover: R million (US\$ equivalent)	Gross asset value: R million (US\$ equivalent)
Micro	0 – 2,400 (0 – 70,000)	Up to 5	0 – 0.2 (0 – 30,000)	0 – 0.1 (0 – 15,000)
Very small	N/A	Up to 20	Up to 6 (Up to 0.9m)	Up to 2 (Up to 0.3m)
Small	2,400 – 25,000 (70,000 – 700,000)	Up to 50	Up to 32 (Up to 4.5m)	Up to 6 (Up to 0.9m)
Medium	25,000 – 100,000 (700,000 – 2.8m)	Up to 200	5 – 64 (Up to 9m)	5 – 23 (Up to 3.3m)
Large	100,000 + (2.8m +)	200 +	64 + (9m +)	23 + (3.3m +)

and developing countries, SMEs in the latter are concentrated at the lowest end. For example, in South Africa, the vast majority are black, survivalist firms.⁶

The picture is blurred further by the distinction between the formal and informal sectors. The term SME usually refers only to firms operating within the formal (legally registered) economy, and attempts to relate the SR agenda to SMEs are likely to be restricted to these enterprises. Micro enterprises may be in either the formal or informal sector. However, it is not unusual for statistics to group these enterprises together, where data are available. The informal sector is significant in many developing countries. For example, it is estimated that 38 per cent of total employment in Chile is in the informal sector.⁷ In South Africa, it is estimated that at least two-thirds of small, medium and micro enterprises are informal. It is, therefore, important to avoid the risk of overestimating the

⁴ The US\$ equivalents in this table are approximate, as at April 2004. The UF (Unidad de Fomento) is a way to account for devaluations of the Chilean Peso. In April 2004, one UF corresponded to about US\$28, and US\$1 was equivalent to about 6.9 South African Rand.

⁵ According to the National Small Business Act (1996) and the National Small Business Amendment Bill (2003), SMEs are classified on a sectoral basis, across 11 sectors. The figures in this table do not attempt to reflect the sectoral variations; some sectors have lower thresholds than presented here.

⁶ Berry, A. *et al.* 2003 "The Economic Rationale for SMME Promotion in SA," *Trade and Industry Monitor*, September: p.6.

⁷ OIT (Organización Internacional del Trabajo): *Panorama Laboral 2003. América Latina y el Caribe*, 2003.

influence and applicability of SR standards, where data on SMEs refer both to the formal and informal sectors.

The significance of SMEs

However they are classified, and despite the difficulty of obtaining reliable data, it is clear that the SME sector is highly significant in most economies. For example, in Chile, SMEs account for about 100,000 out of a total of nearly 650,000 production units. Together with MEs, they account for 99 per cent of Chilean enterprises. MEs and SMEs account for about 50 per cent of Chilean employment, but less than four per cent of exports, which means that SMEs are less likely than larger companies to be influenced by the requirements of export markets—including SR-related requirements where they exist. In India, the small scale industrial sector accounts for 95 per cent of all industrial units, 49 per cent of manufacturing output, 34 per cent of exports, 50 per cent of GDP, and 65 per cent of employment. In South Africa, it is estimated that about 80 per cent of the formal business sector and 95 per cent of the total business sector (including informal) can be considered to be SMEs or MEs, accounting for about 46 per cent of total economic activity, 84 per cent of private employment⁸ and 97.5 per cent of all newly registered businesses.

Although their individual social and environmental impacts are small, the cumulative impacts of SMEs are highly significant. SMEs are often over-represented in industrial sectors with high environmental impacts—in Chile, over two-thirds of SMEs are in the manufacturing and metallurgy, food, drinks and tobacco, and textile and leather sectors. In South Africa, small-scale activity in various sectors—including mining—is associated with numerous negative social and environmental impacts. In the U.K., 60 per cent of commercial waste is generated by SMEs.⁹ This offers the potential for significant progress towards sustainable development if SR can be made relevant and applicable for SMEs. This applies at two levels—creating the incentives for SMEs to adopt SR practices, and building the capacity to implement SR.

Although it seems logical that changing the practices of relatively simple, small organizations is less of a challenge than those of complex, bureaucratic, large

⁸ Viviers, W. and W. Soontiens 1998 *South Africa SMEs: Obstacles to Export to Southern African Development Community (SADC)*.

⁹ Grayson, D (2003) Presentation to EU Multi-Stakeholder Forum CSR: Roundtable on SMEs, 30 June 2003, available at http://www.europa.eu.int/comm/enterprise/csr/roundtables2_30062003.htm

companies, the disparate nature of the SME sector remains a barrier. For example, in principle, environmental and social regulations are of universal application, and do not absolve SMEs from a responsibility to comply. But public authorities naturally tend to focus their enforcement activities on large companies, where the marginal impact of each is greater. The other pressures that often contribute to a business case for SR practices, including the attention of civil society organizations, and “ethical” consumers and investors, follow similar patterns. Nevertheless, the standardization of SR provides an opportunity to ensure that SMEs don’t represent a “blind spot” in which exploitative and environmentally-destructive practices flourish, if it can help to create sufficient incentives for SR that are applicable to SMEs.¹⁰

SMEs and SR-related standards

Any attempt to engage SMEs in the SR agenda must take into account the harsh business context in which many operate. In Chile, the diagnosis shows a critical situation in which SMEs have not been able to carry out initiatives beyond fulfilling their immediate survival needs. The challenges of efficiency and financial stability override all other objectives. Likewise, in India, the majority of SMEs operate at marginal profitability, initiating reform only when there is a direct bearing on profitability, quality or market benefits. Because the government sets the interest rate for SMEs lower than prevailing market rates, lenders are reluctant to provide loans, so access to credit is an issue. In South Africa, barriers to the adoption of SR among SMEs include a lack of mentorship and skills transfer; communication gaps and lack of awareness of support networks; the cost of red tape and bureaucracy in complying with existing regulations; a lack of information, especially regarding tendering procedures; crime; poor infrastructure; low savings rates and poor access to financial services; and the quality and availability of staff. Many of the investments that SR requires will simply not be undertaken by a business that is not confident that it will still exist in the near future. Bringing the SR agenda to SMEs must, therefore, inevitably be combined with other support and measures to ensure that SMEs have a stable business environment (Box 3). Alongside all these barriers is a lack of direct financial benefits—SMEs simply don’t have many of the incentives for SR that apply to larger, more high-profile companies.

Given these barriers and the lack of incentives, SR discourse has frequently identified the challenge of making the SR agenda more relevant for SMEs. For example, one of four themes within the EU Multi-Stakeholder Forum on CSR is “fostering CSR

¹⁰ See Raynard, Peter and Maya Forstater 2002 *Corporate Social Responsibility: Implications for Small and Medium Enterprises in Development Countries*, UNIDO, Vienna, a seminal report on CSR and SMEs in developing countries, which discusses this issue among others <http://www.unido.org/en/doc/5162>

Box 3: Measures to support SMEs

The significance of SMEs for employment and income generation has led to various government attempts to support their development. For example, a 2000 law in Colombia obliges the public sector to favour procurement of goods and services from SMEs. In India, there are various schemes, including exclusive procurement of certain products and a price preference for others when procured from SMEs, streamlined registration procedures, and extension and support services. In South Africa a framework for government policy is provided by the National Strategy for the Development and Promotion of Small Business in South Africa, and the subsequent Small Business Enabling Act (1996). This allows for several supportive structures and investment incentives. But there remains scope for building support for SMEs into other related policy areas. For example, aspects of the South African policies on black economic empowerment (BEE), which set targets that seek to increase procurement from black-owned businesses, do not give special consideration to SMEs, so the targets can be met by helping a few major suppliers to transform their ownership structure, rather than undertaking the more complex but higher-impact process of increasing sourcing from black-owned SMEs.¹¹ SMEs have also attracted private support. For example, in Chile, the industrial association SOFOFA has created a “Corporate for the Promotion of Small Enterprises,” which provides credit to micro enterprises to create employment, train workers and instil good management practices. The South African financial sector has developed a BEE charter, which includes a measurable focus on supporting black SMEs.

amongst SMEs.”¹² In Chile, the UNDP has called for greater emphasis on filling the gap between large, medium and small enterprises in relation to SR.¹³ Teixidó *et al.* (2002)¹⁴ note three ways that SMEs can engage with the SR debate—as providers of employment, providers of goods and services to large companies, and in their relations with the public. Of these, SMEs are most likely to encounter the existing SR agenda through supply chain requirements, particularly where they are involved directly or indirectly in international supply chains.

¹¹ The African Institute of Corporate Citizenship note that “it is increasingly accepted that targeted support for SMMEs (small, medium and micro enterprises) needs to be a core component of not only state policy, but also larger companies’ CSR policies and practices” (Ralph Hamann, pers. comm.).

¹² http://forum.europa.eu.int/irc/empl/csr_eu_multi_stakeholder_forum/info/data/en/csr%20ems%20forum.htm

¹³ PNUD and Fundación Prohumana (2002) *Los Chilenos Opinan: Responsabilidad Social de las Empresas; análisis de la encuesta MORI sobre “Responsabilidad Social Corporativa,”* Serie Políticas Públicas: Informe de Encuesta: Santiago, Chile.

¹⁴ Teixidó S., Chavarri R., Castro A. *Casos Empresariales en Chile. Responsabilidad Social*, Fundación PROhumana, Santiago, 2002.

A recent study revealed that 69 per cent of Chilean SMEs that are exporting have made investments in their environmental performance.¹⁵ In South Africa, SMEs that incorporate standards such as ISO 9000 or ISO 14001 almost invariably do so due to pressure from their customers further up the supply chain. Surveys suggest that the most likely reason for SMEs to introduce an environmental management system is “when it becomes essential to secure and retain business,” either with local or international clients.¹⁶ In this sense, the notion of such standards as “voluntary” can be misleading. It may be more appropriate to consider them as “market entry requirements” or “economic imperatives.”¹⁷

For SMEs that face such supply chain pressures, either from local or international buyers, there are a number of challenges:

1. The standards may themselves be inappropriate or particularly challenging for SMEs. For example, pollution prevention measures stipulated by environmental standards may require investment in technology that is not viable for SMEs. Particularly in developing countries, SMEs often find it difficult to access the new technology, environmentally friendly materials, credit, information and training that would help them to meet SR standards.
2. The process of demonstrating compliance with the standards may be a barrier. SMEs are less likely to have formal systems for measuring, recording and managing their impacts, and they may not have the capacity to deal with demanding paper trails.
3. The cost of audits and certification can be prohibitive. This is often the same however large the company, so large companies are able to spread the cost across their entire operations. Standards therefore often have a significant scale effect, which works against SMEs. In many developing countries, the high cost of certification is also in part due to a lack of local certifiers. In South Africa, the ISO 9000 and ISO 14000 standards are mostly viewed as a burden on an already struggling sector because of the prohibitive costs associated with not only the implementation process, but also the ongoing maintenance of such standards. Certification often acts as an “entry ticket” to markets,

¹⁵ Nuñez, G. 2003 *La responsabilidad social corporativa en un marco de desarrollo sostenible*, Serie Medio Ambiente y Desarrollo No. 72, CEPAL, December 2003.

¹⁶ Flourie, F. 1996 *A Survey of the Implementation of ISO 14001 and use of ISO 14004 by SMEs in South Africa*, South African Bureau of Standards. Of 11 possible answers, securing business with local clients was the most-cited reason, and securing international business in fourth place. Of course, it is possible that the local clients were themselves contractors to international businesses.

¹⁷ There is some evidence to suggest that the effectiveness of management systems is related to the attitude of the implementer—a sense of coercion may mean that the standard is less likely to have the desired effect. This suggests that it may be useful to consider alternative mechanisms for engaging SMEs in SR.

rather than a source of a premium, and even where there is a premium, this is unlikely to cover the cost of certification for SMEs due to low volumes.

4. As buyers adopt an SR approach, they may prefer to rationalise their supply base, sourcing from a smaller number of larger suppliers in an effort to reduce the risk of social or environmental problems being uncovered within their supply chains, and the transaction costs of audits and inspections across more disparate supply bases.
5. Approaches to allow access to standards have generally focused on group certification, which relies on institutional structures that allow internal coordination and control systems. Where cooperatives and other structures already exist, this can make the certification process viable. But bringing SMEs together in this way and building their capacity often requires huge investments, and can be politically challenging. More broadly, there is often a lack of coordination and representation among SMEs that could act as conduits for encouraging SR among SMEs (Box 4).

Box 4: Coordination and representation of SMEs in Chile, India and South Africa

A National Small Business Council was set up in 1996 to represent and promote the interests of small business in South Africa. However, it collapsed in 1998 due to management and financial difficulties, and the SME sector has had no official representative body since then. The StreetNet International alliance of street vendors was launched in 2002 to represent street, market and mobile vendors, who together make up a significant element of the informal sector. In India, there are numerous regional and national associations that represent SMEs, but few are effective. It is argued that those with a regional and sectoral focus are often the most effective. By contrast, in Chile, there are several well-organized SME associations, many at sectoral level. But they focus on lobbying to resist strict environmental and social controls for SMEs, so they are reluctant to engage in SR initiatives that they would regard as adding to the burdens already faced by small companies. Any SR initiative would need to actively engage these organizations.

The number of SMEs that have achieved certification to SR standards therefore remains low. For example, of the 80 enterprises in Chile that have achieved ISO 14001, very few are SMEs, and these have benefited from external support. Much of the work in relation to SR and SMEs has, therefore, been directed at increasing their access to voluntary standards.¹⁸

¹⁸ See for example the work of the ISEAL Social Accountability in Sustainable Agriculture (SASA) project at <http://www.isealalliance.org/sasa/>, which has examined mechanisms for enhancing access to social and environmental certification for smallholders; and the Ethical Trading Initiative's working group on smallholders at <http://www.eti.org.uk/Z/actvts/exproj/smlhldr/index.shtml>

Where large enterprises make demands of SMEs within their supply chain, e.g., on worker safety, environmental protection and employee benefits, there is scope to encourage those large companies to provide incentives and help for SMEs to meet the requirements. The “linkages” theme, in which support for SME development is an element of the social responsibility of large companies, is gaining prominence within the SR agenda, and could be strengthened through SR standardization. In Chile, there are interesting experiences of such support in relation to internal, ad hoc standards, and international standards such as ISO 14001 (Box 5).

Box 5: Supporting the certification of SME suppliers, Chile¹⁹

After achieving ISO 14001 certification for its own facilities in 1999, the mining company Escondida developed an initiative to supporting the ISO 14001 implementation of a selected group of supplier companies, including SMEs. With additional support from the government agency CORFO, Escondida supported the SME’s preparatory work and eventual certification process. As expressed by a manager: “We challenged the governing paradigm in the Chilean public sector of ISO 14001 being only appropriate for large companies.”

As well as from buyers, support for SMEs in relation to standards can come from public authorities. For example, some state-level governments in India help SMEs by subsidizing the use of testing facilities, and paying premiums for certified products. Also, national standards bodies are increasingly aware of the need to ensure that their standards are appropriate for SMEs. For example, although the Chilean national standardization body INN admits that the participation of SMEs in the design and implementation of new standards is quite limited, it is collaborating with the Ministry of Economy and the Chilean economic development agency CORFO to design a standard for the integrated management of SMEs. This includes environmental aspects, and has a marginal component on social issues. In South Africa, the lack of representative structures for SMEs means that they are not represented in ongoing standardization processes. However, representatives are occasionally involved in Technical Committee meetings on an ad hoc basis, regarding standards of particular importance to SMEs. Standards South Africa (SABS) has an SMME (small, medium and micro enterprises) Development Department, which provides training, subsidies and specialized services (Box 6).

¹⁹ Blanco, Hernán 2003 *How can large companies contribute to environmental improvements in SME suppliers and contractors? The case of ISO 14001 certification of five suppliers to Escondida Mining Company in Chile*, Case Study for the UN Global Compact presented in the Learning Forum, Belo Horizonte, Brazil, December 2003.

Box 6: Standards South Africa SMME Development Department

This department represents a pro-active effort to reach out to the SME and ME sector in South Africa, running among other services the Missing Link Program. This program includes training, subsidies and the provision of specialized services for SMMEs in order to ensure that SMMEs use standards to gain entry into the market place and to exploit their niche markets. The department facilitates access to the following services through a 50 per cent subsidy to qualifying SMMEs:

- Product certification (mark scheme)
- System certification (ISO 9000/14000)
- Capability assessment
- Product testing
- Sign-posting/referrals
- Missing Link Programme (e.g., welding, clothing, timber, and other industries)
- Interpretation of Specifications
- Consignment of Inspections

For an entity to qualify for support, it must have been in existence for more than a year, and have an annual turnover of between R100 000 and R30m.

Conclusion: towards “best practice” principles for an ISO SR standard

Supply chain standards and other tools of the current SR agenda are shaped to suit the interests and capacities of large enterprises, with little recognition of the barriers to implementation that SMEs face. Even where these barriers can be overcome, there is often little direct financial incentive for SMEs to comply, as many of the drivers that make up the conventional business case for SR (including pressure for higher standards from regulators, NGOs, trade unions and international buyers) are more likely to apply to larger enterprises.

But for real progress towards sustainable development, the SR agenda needs to be more relevant to SMEs. SMEs are the mainstay of most economies, particularly in terms of employment and development impacts. In many sectors, their cumulative social and environmental impacts are greater than those of large enterprises. SR standards run the risk of acting as a barrier to market entry for SMEs, undermining livelihoods and development. Furthermore, there are concerns that ISO’s entry into the SR agenda could mean the “crowding out” of other social or environmental standards that are more appropriate and achievable for SMEs.²⁰ To maximize the potential contribution to sustainable development, any future SR standard should therefore be:

²⁰ An example is the OekoTex label for eco-friendly textiles.

- appropriate for a wide range of organizations, irrespective of their size and sector;
- sensitive to the barriers faced by SMEs, particularly in terms of capacity, access to finance and information, and timeframes for achieving compliance—where appropriate, allowing phased implementation;
- economically viable for SMEs, where necessary through mechanisms such as group certification and simplified conformity assessment procedures, and through the development of local certification and advisory capacity; and
- linked with support for SMEs to meet the standard, particularly by exploring opportunities to encourage larger companies to assist SME suppliers in adopting supply chain standards.

Clearly, this is not an agenda that ISO can tackle alone. Some of these activities will inevitably require the collaboration of other actors, particularly in relation to capacity building. But in developing an international SR standard, ISO should ensure that at a minimum, it does not work against the interests of SMEs, and it should actively seek to work with others to provide the opportunities and incentives for SMEs to adopt SR practices.