

# The Growth of Private Regulation of Labor Standards in Global Supply Chains: Mission Impossible for Western Small- and Medium-Sized Firms?

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**Abstract** Multinational corporations (MNCs) have come under pressure to adopt private regulatory initiatives such as supplier codes of conduct in order to address poor working conditions in global supply chain factories. While a well-known literature explores drivers and outcomes of such monitoring schemes, this literature focuses mainly on large firms and has ignored the growing integration of small- and medium-sized enterprises (SMEs) into global supply chains. Furthermore, the literature on corporate social responsibility (CSR) in SMEs primarily emphasizes domestic initiatives and not global challenges. Focusing on the Business for Social Compliance Initiative (BSCI), this article examines the positions of private actors, who demand and supply private regulation as well as the positions of those firms, who are the targets of such schemes. As the BSCI has grown its membership, MNCs increasingly request that SMEs meet BSCI requirements in global supply chains even though compliance is a “mission impossible” for many smaller firms. As a result of this development, the private regulatory system is facing growing strain.

**Keywords** Corporate social responsibility (CSR) · Small- and medium-sized enterprises (SMEs) · Global supply chains · Business for social compliance initiative (BSCI)

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## Introduction

Multinational corporations (MNCs) have come under pressure to adopt private regulatory initiatives in order to address poor working conditions in global supply chain factories (Bondy et al. 2004, 2008; Locke and Romis 2010; Locke et al. 2007, 2009). As Levy and Kaplan (2008) observe, it is indeed surprising how readily MNCs have adopted corporate social responsibility (CSR)<sup>1</sup> standards and reporting mechanisms, considering the lack of regulatory coercion. The emergence of private regulation as a component of global business regulation is primarily attributed to three related developments: economic globalization, the lack of inadequate regulatory mechanisms at both the national and international levels to govern global firms and markets, and a decline in state controls over business following privatization and deregulation (Vogel 2008; see also Berger 2000; Knudsen 2011).

While the literature on responsible global supply chain management has focused on large brands and retailers, it has failed to think carefully about small- and medium-sized enterprises (SMEs) as private regulators in *global* supply chains (for notable exceptions, see Andersen and Skjoett-Larsen 2009; Ciliberti et al. 2008; Tencati et al. 2007). According to Moore and Spence (2006, pp. 222–223), “The research which has been conducted on responsible business practice and SMEs is almost entirely in developed Western countries. While this is the same for the majority of research done on large firms, the gap is particularly pertinent since small firms are often a key part of the

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<sup>1</sup> The European Commission (2011) defines CSR as “the responsibility of enterprises for their impacts on society” (European Commission, Accessed 5 November, 2011, from [http://ec.europa.eu/enterprise/policies/sustainable-business/corporate-social-responsibility/index\\_en.htm](http://ec.europa.eu/enterprise/policies/sustainable-business/corporate-social-responsibility/index_en.htm)).

economy in developing countries” (see also Spence 2007, p. 543). However, as SMEs too have begun to source from or produce in less developed countries (Petersen et al. 2006), many large buyers and retailers now demand that western SME suppliers document that they adequately control the social and environmental performance of their own suppliers in less developed countries (Jørgensen and Knudsen 2006).

These demands pose significant challenges for many western SMEs (Raynard and Forstater 2002; Seuring et al. 2008). First, most SMEs do not have the economic resources to ensure proper documentation and to follow up with each of their suppliers or license holders. Second, SMEs often lack political clout vis-à-vis their suppliers. They may be just one of many buyers and the incentive for the supplier to improve the social and environmental performance can therefore be limited.<sup>2</sup> Third, in recent years, many MNCs have been consolidating their supply chain in order to increase efficiency so that they work with fewer and larger suppliers, and some experts have therefore concluded that “there is a trend of pressuring and excluding SMEs from global supply chains” (Jeppesen and Thorsen 2010, p. 34; see also Mayer and Gereffi 2010).

This article asks the following question: How does company size impact the willingness of western SMEs to engage in private regulation of labor standards in global supply chains?

This question is important from both a theoretical and a practical perspective. Theoretically, knowledge is lacking about how company size impacts the actions of western firms with respect to international private labor regulation. From a practical perspective, SMEs are becoming more integrated into global supply chains, and responding to demands for private regulation is turning into an increasingly important competitive parameter for SME managers seeking to meet buyer requirements. Furthermore, from a societal perspective, the international competitiveness of SMEs is a key issue. If large international suppliers increasingly avoid western SMEs, then many western economies could be negatively affected since SMEs account for a significant proportion of the economy. In fact, 99 % of all European businesses are SMEs, SMEs provide two out of three private sector jobs and they contribute to more than half of the total value-added created by businesses in the European Union (EU) (European Commission 2011).

<sup>2</sup> Many MNCs also find that they do not have enough leverage to change supplier practices, especially when they only purchase a small share of a factory’s overall production. However, MNCs have more resources than SMEs to demand social and environmental improvements in supplier factories, to influence local political actors, and to obtain information and advice.

I focus on the Business for Social Compliance Initiative (the BSCI) as a notable example of international private business regulation. The BSCI is a major international business-driven initiative governing working conditions in global supply chains. It has enjoyed tremendous growth in recent years, and more and more MNC members demand that their suppliers including SMEs sign a contract stating that their production processes are in accordance with BSCI specifications. Furthermore, in the last 2–3 years, more SMEs have joined the BSCI because large buyers and retailers have requested this. More than 700 out of close to 800 BSCI members have a turnover below EUR 100 million (correspondence with the BSCI, February 2012).

This article proceeds in the following manner. I begin by presenting my theoretical framework, which (following Büthe 2010) consists of three levels of analysis: a focus on rule-demanders, rule-suppliers, and rule-takers. Next, I discuss my research methodology and case selection. I then proceed to a presentation of findings, which is followed by a discussion and conclusion.

## Theoretical Explanations of Firm Interest in Private Regulation

The literature on CSR in large firms and the literature on CSR in small firms highlight distinctly different initiatives. The literature on large firms mirrors the internationalization process of companies such as Nike, the GAP, Adidas, and Hewlett Packard and how companies have had to deal with governance gaps as they operate outside their home countries (Locke et al. 2007, 2009; Mayer and Gereffi 2010; O’Rourke 1997, 2000). The literature on CSR in SMEs reflects that these firms traditionally have been less likely to operate abroad. Most theoretical articles on CSR in SMEs examine initiatives at home. Examples include a focus on local community development in Ireland (Sweeney 2007), environmental sustainability in Catalonia (Murillo and Lozano 2006), social capital in Italy (Perrini 2006), and environmental performance in England (Williamson et al. 2006).

As my theoretical framework for analyzing the role of SMEs as providers of CSR in global supply chains, I follow Büthe’s suggestion that an analysis of private regulation should include three major subsets of stakeholders: The first group of stakeholders consists of political-economic actors, who demand private regulation (*rule-demanders*). Frequently such demands are posed by third parties, who find that their non-material interests are negatively affected by missing or inadequate regulation. These actors can be social activists motivated by normative commitments that are altruistic (or perceived as such) and include, for example, NGOs or consumer organizations (Büthe 2010).

The second group of stakeholders consists of the private actors, who write, maintain, and disseminate regulatory rules for the global economy (*rule-suppliers*). As Büthe writes, “Why they supply private regulation needs to be explained because these activities are costly” (Büthe 2010, p. 8). The third group consists of the political-economic actors whose behavior private regulations seek to affect (*rule-takers*). The interesting analytical question for the third group is about implementation and why they choose to comply with private regulation.

Concerning rule-demanders, my focus is on those actors, who have demanded private regulation in the form of BSCI requirements. With respect to rule-suppliers, I address those large firms that impose BSCI requirements on key actors in the supply chain. Finally, with respect to rule-takers, I am interested in those firms that have to comply with BSCI requirements and in particular western SMEs.

Büthe suggests that this analytical approach is more useful than the application of economic models of demand and supply. According to Büthe, “In economic models of supply and demand, those who ultimately ‘buy’ a product or service are not only identical with those who subsequently ‘use’ it, they presumably purchase it in order to ‘use’ it” (Büthe 2010, p. 8). These approaches work less well in political models of regulations because those who call for regulation may diverge from those who are supposed to act according to those rules. Below I present theoretical literatures associated with each of these three areas (demanding, supplying and taking rules), identify limits of this literature for explaining SMEs in global supply chains and propose how my analysis will provide a theoretical extension of our current understanding of SMEs as private regulators in global supply chains.

#### Rule-Demanders

A functionalist account of market demand emphasizes how market actors request regulation if the efficient operation of markets requires the existence of such a system of rules. A decline in or a lack of the public supply of rules will encourage private actors to create such rules instead. Motivations that drive private actors can be to lower transaction costs, increase reliability, achieve efficiency, and ensure legitimacy (Locke and Romis 2010; Locke et al. 2007, 2009). Rule-demanders can be the participants of a commercial transaction but rule-demanders can also be a broader set of actors with an interest in rule-making. First, participants of a commercial transaction are key actors, who can demand rules or standard contracts that govern that transaction (Coase 1937; Williamson 1985). Second, governments may demand private regulation in order to substitute for costly and/or ineffective public regulation (Moon et al. 2005; Steurer 2010). Finally, societal actors,

who are not a party to a commercial transaction, may also demand private regulation for material reasons (Mayer and Gereffi 2010). Private actors such as NGOs, unions, or the media may also demand private regulation for non-material reasons because they are motivated by values, norms, or morals (Aguilera et al. 2007; Brown et al. 2010; Spar and LaMure 2003). However, to the best of my knowledge, this literature does not address SMEs as actors demanding private regulation.

#### Rule-Suppliers

Developing and institutionalizing international private rules is costly (Keohane 1984). Why then would private actors decide to supply regulation? One reason could be to preempt government regulation, while another reason could be to substitute for governance voids. First, private supply of regulation often occurs in the shadow of public regulation (Büthe 2010, p. 12). If the threat of less favorable regulation is credible, then preempting more demanding public regulation can be a powerful incentive for the supply of private regulation (Vogel 2008). Second, companies might prefer that the public sector provides regulation, for example, as a way of creating a level playing field, but if governments are unable to do so private regulation can be adopted as a second-best solution (Jackson and Apostolakou 2010; Matten and Moon 2008). While it is possible to have an ideal overlap between demanders and suppliers of private regulation, this happens rarely (Büthe 2010, p. 13). It is more common that private regulation is supplied because companies expect this to lead to private gains. Regulation may, for example, protect the supplier from the risk of violating social and environmental rights in supplier factories and this may increase supplier legitimacy. International private rules can also lower the cost of compliance because rather than having to comply with numerous private codes of conduct, companies only have to comply with one standard. However, private regulation is supplied by large firms mainly. The literature on preemption and substitution does not address SMEs as suppliers of rules.

#### Rule-Takers

While a vibrant and strong literature exists regarding CSR in SMEs, this literature primarily addresses domestic CSR initiatives and is more or less silent about CSR initiatives by SMEs in global supply chains. For example, the theoretical literature does not address MNC demands for responsible behavior imposed on western SMEs in global supply chains. In an interesting study, Tencati et al. (2007) address the impact of demands by western SMEs on suppliers in less developed countries. Tencati et al. (2007)

show that CSR demands imposed by western SMEs on their Vietnamese suppliers over time have become required for access to international markets and have in practice turned into a new kind of protectionism to the detriment of Vietnamese suppliers to western SMEs (Tencati et al. 2007). However, Tencati et al. (2007) do not examine the role of MNCs as rule-demanders.

In another study, Baden et al. (2009) find that for most SMEs the inclusion of social and environmental requirements as preconditions to supply goods and services increases their motivation to engage in CSR (82 % for environmental criteria and 55 % for social criteria). 25 % would be put off tendering and 12 % thought that such criteria would be counter-productive. However, this study does not distinguish between SME suppliers in advanced economic countries and less developed countries. Finally, Perrini et al. (2007) observe a positive attitude among SMEs in managing CSR strategies along the value chain. They argue that the reason for this attitude is that SMEs differ from large firms in a number of key respects. SMEs have strong owner–manager relationships with their suppliers and customers, and these relationships seem to drive the integration of CSR strategies and corporate strategy. However, Perrini et al. (2007) focus on owner–managers’ relationships with suppliers in Italy and the authors do not consider international supply chains. In short, while a literature is emerging on the role of SMEs in supply chains, the focus is primarily on *domestic* supply chains.

In sum, I have presented a theoretical framework for analyzing the drivers behind the BSCI, why MNCs request that suppliers meet BSCI requirements, and why SMEs comply with this framework.

## Case Selection and Methodology

### Case Selection

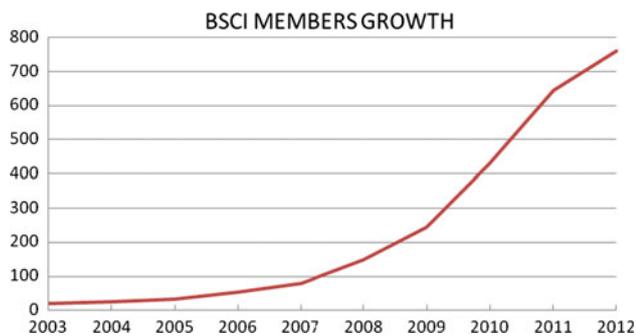
The BSCI is a business-driven initiative for companies committed to improving working conditions in the global supply chain. It was created in 2003 by some of the Europe’s largest retailers in order to audit and monitor the social performance of their suppliers world-wide by utilizing a common system (Egels-Zandén and Wahlqvist 2007; Merk and Zeldenrust 2005). The initiative started as a sector-based solution for retail but has since spread to furniture, building material, importers, discounters, and food companies (BSCI Annual Report 2009). The declared purpose of the BSCI is to implement ethical procurement practices and improve social standards in supplier countries on a voluntary basis in order to avoid duplication of monitoring efforts, confusion about requirements, lack of transparency and accountability, as well as high costs for

companies and their suppliers (BSCI Frequently Asked Questions from Producers, Accessed February 29, 2012, from <http://www.bsci-intl.org/>). The BSCI Code of Conduct is built on international conventions protecting workers’ rights, notably the ILO conventions and recommendations. All BSCI member companies agree to implement the code in their supply chains. By signing the BSCI Code of Conduct, companies commit themselves to the social and environmental standards of the code. The BSCI approach focuses on three key activity areas: (1) monitoring social compliance in the supply chain; (2) empowering BSCI members and suppliers through capacity building; and (3) engaging with stakeholders. Supplier companies, in addition, must ensure that the Code of Conduct<sup>3</sup> is also observed by subcontractors.

The driving force behind the BSCI is the Brussels-based Foreign Trade Association (FTA), which is a lobby organization for European commerce that focuses on foreign trade issues and is opposed to “any form of new protectionism” (FTA press release from 5 May, 2004 cited in Merk and Zeldenrust 2005: footnote 2). The FTA is opposed to the creation of binding rules on CSR and argues that a link between trade agreements and sustainability could serve as a trade barrier.

German retailers play an important role in the BSCI. They are organized in the Foreign Trade Association of the German Retail Trade (Aussenhandels Vereinigung des Deutschen Einzelhandel, AVE). The BSCI largely copied the AVE program titled “Sector Model Social Responsibility”, a CSR initiative supported by retailers such as Karstadt Quelle, Otto Group, Metro Group, and others. While NGOs such as the German Clean Clothes Campaign have argued that the BSCI program is an improvement compared to individual company approaches, they have criticized the lack of trade union and NGO influence in the verification process of the BSCI program. The only role for non-governmental organizations (NGOs) and unions was potentially through the BSCI Advisory Council. Its role is to advice member firms but it has no direct influence (Egels-Zandén and Wahlqvist 2007). The German Clean

<sup>3</sup> The goals of the BSCI Code of Conduct include: (1) respect for the freedom of association and the right to collective bargaining. In situations where the right to freedom of association and collective bargaining is restricted under law, the company shall allow workers to freely elect their own representatives; (2) prohibition of discrimination; (3) prohibition of child labor; (4) payment of legal minimum and/or industry standard wages; (5) a limit to working hours; (6) no forced labor and disciplinary measures; (7) workplace health and safety; (8) respect for the environment; (9) there is a policy for social accountability; and (10) there is an anti-bribery and anti-corruption policy (Business for Social Compliance Initiative Code of Conduct, Accessed 29 February, 2012, from <http://www.bsci-intl.org/our-work/bsci-code-conduct>).



**Graph 1** Increase in BSCI membership 2003–February 2012. Own calculations. *Source:* BSCI Annual Reports 2004–2010 and the BSCI (<http://www.bsci-intl.org/about-bsci/members>)

Clothes Campaign has therefore declined an invitation to join the advisory council of the BSCI.

The BSCI has enjoyed strong growth since 2003. From November 2009 to November 2010 alone, the BSCI grew from 250 members to more than 600 (BSCI, 29–30 November, 2010). An overview of the growth of BSCI members is presented in Graph 1.

Since 2003, BSCI membership has changed in three ways. First, country representation has broadened from including mainly firms from Germany, the Benelux countries, and Switzerland to firms from across Europe such as Austria, Denmark, France, Slovenia, and the UK (BSCI Annual Report 2008). Second, while the BSCI primarily included retail as well as textile and apparel firms, members now come from a greater variety of sectors such as food, electronics, household goods, and furniture (BSCI Annual Report 2008, p. 4). Third, SMEs today outnumber large enterprises (more than 85 % of members are firms with less than EUR 100 million in annual turnover according to personal correspondence with the BSCI February 2012). In 2005, seven firms were SMEs and 30 firms were large firms. In contrast, in 2 months alone (January and February 2011), 21 SMEs joined the BSCI while only 4 large firms joined.

## Methodology

The purpose of the research methodology was to gather information about three categories of actors and their positions on the BSCI: (1) rule-demanders including business, civil society, and governments; (2) rule-providers in the form of large corporations that are members of the BSCI; and (3) SMEs as rule-takers that face BSCI requirements. In order to obtain data about the positions of these different actors, a case-based approach was adopted (Eisenhardt 1989; Yin 2003), which included the examination of public documents and newspaper articles. The case studies were explorative (Yin 2003; see also Eisenhardt and Graebner 2007) and were not chosen to confirm

or disconfirm a theory. The cases were used to answer research questions that addressed “how” and “why” size mattered as a determinant of key actor positions on the BSCI.

The positions of key actors were examined since the formation of the BSCI in 2003 and thus it was also possible to pinpoint how positions have evolved over time. A main purpose of the case studies was to be sensitive to temporal dynamics because regulation preferences can change over time. As Fransen and Burgoon have pointed out, “the preference for private regulation from firms exercising power on others in the production chain (such as big retail firms) may, for instance, lead more dependent firms such as small brand firms to review their choices for regulation” (Fransen and Burgoon 2012, p. 240). In addition, the investigation made it possible to track the size<sup>4</sup> of BSCI members over time. The BSCI allows SMEs to become members but it has a lower limit in terms of size. Companies with an annual turnover below 500,000 Euro are not eligible for membership.

In order to determine the position of those who established the BSCI, publicly available documents were examined about the BSCI (academic papers, policy papers, and internal documents). A number of interviews were also conducted with a BSCI representative, and publicly available documents were examined to obtain information about the position of key governments and civil society organizations.

Concerning the position of large retailers and buyers in the BSCI, two interviews were conducted with Danish retail companies that were named by several SMEs as major customers who demanded that suppliers meet BSCI requirements. In addition, their annual reports were consulted as well as the annual reports of some of the founding BSCI members (e.g., Otto Group).

Regarding SME positions, interviews were undertaken with 10 Danish SMEs that produced high-end (industrial designer) consumer goods. Five SMEs were selected that have been asked by their large buyers to meet BSCI requirements and five SMEs that have not met such requirements. The purpose was to determine if SMEs that did not follow BSCI requirements had found other alternatives or if they simply faced less pressure from buyers. All 10 firms were concerned about how to manage overseas suppliers in a way that satisfied large buyers and retailers.

Access to most of these SMEs was facilitated by the author’s collaboration with several of these firms in a working group for SMEs on CSR in global supply chains. The author was approached initially by one of the SMEs to run a workshop with its license holders and suppliers about

<sup>4</sup> Firms are classified as SMEs that have an annual turnover of less than 50 million EUR (see also Accessed July 17, 2012, from [http://ec.europa.eu/small-business/policy-statistics/facts/index\\_en.htm](http://ec.europa.eu/small-business/policy-statistics/facts/index_en.htm)).

how to manage CSR in its global supply chain. This SME produced high-end industrial designer goods and it was concerned that its license holders and suppliers might not be sufficiently aware of CSR requirements. At the same time, the SME had begun to face BSCI requirements from large buyers and wanted to make sure that it could fulfill these demands. A working group of 10 SMEs in related sectors was subsequently established in order to explore how these emerging demands from large buyers could best be addressed. SMEs were included that sourced or produced in less developed countries (with the exception of two companies all companies operated in China). The group met four times and members during all meetings engaged in a frank discussion of challenges and opportunities for SMEs involved in managing CSR initiatives in global supply chains. In addition, individual interviews were held with each firm. All meetings and interviews were conducted in strict confidentiality with information only to be shared between participants. After each meeting, the author wrote a summary of viewpoints (minutes), which was distributed to all members. The summary included a list of identified challenges in global supply chains, views on the BSCI, and suggestions for alternative types of regulatory solutions in order to ensure responsible supply chain management. The distribution of the summary to participants served to enhance the robustness of key findings as it provided the opportunity to correct possible misunderstandings. Due to the sensitive business nature of the SMEs vis-à-vis their large buyers, the names and sectors of the SMEs could not be revealed to the buyers or to the BSCI.

The investigation of SMEs only involved Danish SMEs. The author was not aware of other fora or venues in the EU that addressed the issue of SME regulation of social and environmental issues in global supply chains (the BSCI was consulted as well as the EU Commission's CSR Unit in the Directorate General for Enterprise). Denmark was seen as a front-runner company for CSR (Gjølberg 2009)

and thus Danish firms including SMEs were expected to have well-developed CSR policies. If Danish SMEs—which can be expected to be a sort of “best case” in terms of CSR—found it difficult to meet BSCI requirements, then it is likely that SMEs in other countries will also have trouble meeting such demands. Table 1 provides an overview of the 10 Danish SMEs in the sample.

## Findings

### Rule-Demanders

#### *Business Demands*

According to the BSCI, “The Brussels-based Business for Social Compliance Initiative (BSCI) was launched in 2003 by the Foreign Trade Association (FTA), to establish a common platform for the various different European codes of conduct and monitoring systems and to lay the groundwork for a common European monitoring system for social compliance” (BSCI Internal Document 2010, p. 2). Founding firms included primarily large retail and textile and apparel firms from Germany, Switzerland, and the Benelux countries. As they moved production overseas to less developed countries, these MNCs wanted to ensure that business was conducted in a responsible manner. Among the founding firms were companies such as the German Otto Group, which is the largest mail-order catalog group in the world and which has long been seen as a leader in driving the sustainability agenda in Germany (interview, BSCI 2009 and 2010). For example, in 1996, Otto Group became the first mail-order company to sell carpets carrying the “Rug mark” seal, a labeling scheme launched by UNICEF to indicate that the product was not manufactured using child labor. One percent of the sale price went toward children's education in the country of

**Table 1** Company characteristics

Company	Gross profit DKK (million)	Employees 2010	Ownership structure	Form of private CSR regulation
1	151,539	248	Private ownership	Self-assessment tool and NGO collaboration in the supplier country
2	72,003	66	Private ownership	Self-assessment tool
3	44,223	51	Private ownership	Self-assessment tool
4	n/a	7	Private ownership	Self-assessment tool
5	42,337	58	Private ownership	None
6	73,995	63	Private ownership	BSCI
7	29,184	60	Venture capital fund	BSCI
8	123,961	174	Foundation-owned	BSCI
9	220,400	181	Private ownership	BSCI
10	108,229	171	Private ownership	BSCI

Source: Green Database

manufacturing. In 2000, the company's commitment to social responsibility earned it the corporate ethics prize by the German Network of Economic Ethics.

Otto Group is a mail-order company with an extensive product portfolio and it relies to a large extent on imports from developing countries, particularly clothing and furniture. Otto Group has collaborated with the Council on Economic Priorities, a non-profit watch-group of corporate behavior, to formulate a detailed set of measures for evaluating workplaces. The result was the international Social Accountability (SA) 8000 standard, modeled after the International Standard Organization (ISO) system. Other leading CSR companies were involved in this study including, for example, Avon, Body Shop, and J. Sainsbury (interview, BSCI, November, 2010).

The Charles Vögele Group, Switzerland's largest clothing retailer, is another example of a CSR leader that is a founding member of the BSCI. Already in 1996, Charles Vögele Group began issuing binding rules for its suppliers as part of its own Supplier Code of Conduct. Furthermore, Charles Vögele Group has been a member of the New York-based human rights organization Social Accountability International (SAI) since 2001, which publishes and administers the SA 8000 Social Standard.

#### *Government Demands*

In 2003, when the BSCI was formed EU governments did not focus on international CSR challenges but instead addressed domestic social and employment initiatives (Bertelsmann Stiftung 2007; Brown and Knudsen 2011; Knopf et al. 2011). Only later did governments in CSR frontrunner countries such as Denmark and the UK adopt CSR actions plans to enhance the competitiveness of firms (Brown and Knudsen 2011). Initiatives include endorsement of CSR (e.g., by creating a ministerial portfolio in the area), facilitation whether by subsidies and tax expenditures (e.g., to companies or business associations) or partnerships by encouraging and joining with business and other actors in order to deliver public goods. Government initiatives can also mandate CSR, e.g., in the form of mandatory non-financial reporting. However, governments did not play a role in the creation of the BSCI.

#### *Societal Demands*

Before the establishment of the BSCI, FTA members were approached by NGOs and consumer groups about creating a multi-stakeholder initiative rather than a business initiative. Several consumer groups promoted the British Ethical Trading Initiative. However, the FTA wanted a business-only initiative. Some of the FTA members had been criticized in anti-sweatshop campaigns including Metro Group and

Karstadt Quelle and these members found that therefore "something had to be done" to find solutions to social and environmental problems in the supply chain. However, companies hesitated to engage with NGOs that had recently criticized them (interview, BSCI, 2009). At the same time, the EU had initiated discussions about how to create a CSR policy at the EU level that addressed international competitiveness issues (Doh and Guay 2006). By creating its own platform for compliance, the BSCI could simultaneously resist pressure from above by the EU and pressure from below by civil society groups. According to Merk and Zeldenrust, the FTA launched the BSCI "to establish a common platform for the various different European codes of conduct and monitoring systems and to lay the groundwork for a common European monitoring system for social compliance" (Merk and Zeldenrust 2005, p. 7).

#### *Rule-Providers*

A key driver for the establishment of the BSCI was that the EU Commission as part of the Doha Trade Round negotiations was considering the inclusion of sustainable development requirements (social clauses) in trade agreements. Furthermore, the European Commission promoted a European CSR Framework. MNCs wanted to avoid binding rules on CSR as did the Foreign Trade Association of Brussels. The FTA's position was that "the broad spectrum of social issues connected with business cannot be controlled by legislation" (Merk and Zeldenrust 2005, p. 8). In short, a key driver for why MNCs and the FTA wanted to establish the BSCI was that they sought to preempt EU level initiatives regarding CSR.

The founding members of the BSCI also wished to provide a solution to the "governance gaps" in their international supply chains in order to avoid damage to their brand if suppliers were found to be violating basic social and environmental rights (interview, BSCI, November 2010). However, while the founding members were CSR leaders, some of the recent large members have less experience with CSR (they are CSR followers rather than leaders). For example, the two large Danish retail buyers that were interviewed both operate in the low-price segment and prior to joining the BSCI, these companies did not have a history of working with social initiatives in global supply chains in contrast to Otto Group and Charles Vögele Group. The new members ask their suppliers to meet BSCI requirements but do not work with them to ensure compliance. In contrast, Otto Group offers some limited assistance to SME suppliers to make sure that BSCI requirements are met (interview BSCI November 2011). According to the purchasing manager in one of the Danish retail chains, "at this current time SMEs are losing out. As buyers we are very demanding—all our suppliers

irrespective of size must meet the BSCI requirements and preferably be SA 8000 certified. It is our suppliers' responsibility to ensure that they do so. It is in everybody's interest—including SMEs—that standards are raised overall" (personal interview by author, February 2011).

Most suppliers do not engage in capacity building with SMEs nor do they pay a prize premium for an SA 8000 certification. The Danish purchasing manager explains: "This is the way capitalism works. If companies want us to buy from them, then they must meet our requirements" (personal interview by author, March 2011). These large firms have increasingly shifted the responsibility for meeting BSCI requirements onto their suppliers. In this way, large buyers expect to be "off the hook" if their suppliers are found to be violating basic labor rights.

This shift in responsibility appears to be characteristic of those MNCs that joined the BSCI late and that are more likely to be CSR followers rather than CSR leaders. The BSCI founders included several CSR leaders who viewed SME suppliers as an element of their own sphere of influence. While the CSR leaders see the BSCI as a government substitution strategy, followers are more likely to regard the BSCI as a low-cost risk management strategy. Several of the followers have joined the BSCI after facing media exposure for having a poor CSR performance. Examples include the low-end retailer JYSK and the supermarket chain Dansk Supermarked. Both have been negatively portrayed in a critical television program.<sup>5</sup> This television program was aired on Danish television on 19 June, 2006. The program heavily criticized JYSK and Dansk Supermarked for using Indian suppliers where working conditions were abysmal (e.g., the Indian suppliers had hired small children as labor) and environmental work conditions were also very bad (e.g., workers were inhaling dangerous fumes). This program led to substantial public criticism of JYSK and Dansk Supermarked. Subsequently, both companies in 2006 announced that they would join the BSCI. As a result, both companies now require that all their suppliers must meet BSCI requirements. Furthermore, all suppliers must accept regular visits from a third party accredited auditor.

#### Rule-Takers

The rule-takers are small companies with gross profits ranging between DKK<sup>6</sup> 29 million to DKK 220 million, while the number of employees ranges from 7 to 248. Two companies are owned by capital funds, one is owned by a foundation but most are privately owned with typically one

or two owners. In sum, these are small companies and there is no clear pattern linking ownership structure to the choice of regulatory scheme. All 10 SMEs reported in interviews that social and environmental supply chain issues are becoming increasingly important elements of their competitive performance. However, the five firms that do not follow BSCI guidelines have only very limited production in less developed countries although they expect that in the near future they will start outsourcing more production to China or India in order to save labor costs. These five firms also have a fairly narrow product range aimed at the high end of the market, which is less sensitive to price pressures. One SME collaborates with an NGO that is responsible for auditing suppliers in Thailand, and this collaboration is quite successful (interview with SME, March, 2011). This SME produces a quite limited range of high-priced products and thus has fewer suppliers to manage. It can pay suppliers well and is therefore less sensitive to price pressures from large discount retail chains. Four SMEs have adopted a supplier self-assessment tool that overlaps with BSCI principles. They would like to have the possibility to supply to large retail chains in Denmark and are therefore currently investigating if they should join the BSCI. One of these SMEs faces demands from public sector customers in Norway to document that it manages key social and environmental issues in its supply chain. So far it has managed to convince public sector customers that its self-assessment tool is adequate but is concerned that in the future customers will demand that it joins the BSCI or a similar international initiative. One SME has not adopted any initiatives in order to manage CSR issues in global supply chains.

Two SMEs reported that they send a local representative to visit their most important suppliers on a regular basis and also sometimes use external auditors. The SMEs also show up unannounced from time to time at supplier factory sites. They report that they always detect some violations such as failure to wear protective clothing, a broken ventilation system, child labor, or a roof that has fallen down. Local suppliers have their own suppliers as well and because these change often, it is difficult to ensure that CSR requirements are met.

The five firms that face BSCI requirements generally have a broader product portfolio and supply a relatively lower end of the market where price is more important. These SMEs all face demands from buyers in large retail chains to pay for independent certification of their supplier companies in less developed countries. Several suppliers also reported that they have been asked to provide the names of their suppliers abroad. All SMEs stated that they would not reveal the names of their suppliers in less developed countries because they feared that their MNC customers would "side-track" them by approaching the suppliers directly.

<sup>5</sup> "A Killer Bargain" produced by Tom Heineman, Accessed 4 April, 2011 from <http://www.youtube.com/watch?v=LZ0ylz1mguY>.

<sup>6</sup> One Euro is approximately worth 7.5 Danish kroner (DKK).

Contractual requirements for SMEs regarding responsible supply chain management represent a new trend. For example, in a 2006 study of Danish SMEs and buyer requirements for CSR initiatives, at least one in three among the surveyed SMEs received buyer requirements concerning environmental protection, health and safety, labor rights, human rights, and corruption (Jørgensen and Knudsen 2006). However, a majority of buyer requirements were neither contractual nor subject to verification.

The five SMEs that face BSCI requirements point out that their large customers are not willing to pay more for products or services even if SMEs undertake more costly initiatives such as external verification or unannounced inspections of supplier plants. The five SMEs find that they have to allocate substantial manpower resources in order to meet BSCI requirements and this is time consuming. The first steps such as screening the supply chain and providing commitment raise many questions about how to proceed and they would like the BSCI to offer some assistance in order to coordinate initiatives with auditing companies and eventually with consultants and trainers. SMEs would also like the BSCI to develop a priority matrix to help them determine which suppliers to focus on first (distinguishing, for example, between products, countries, and other key issues). They also find that a help desk function in major sourcing markets could be helpful in order to provide country specific information and support.

Summing up, all 10 SMEs report that they find it difficult to manage suppliers in developing countries due to their limited resources and express concern that it is impossible to control all suppliers.

## Discussion and Conclusion

### Theoretical Implications

The theoretical literature on CSR in SMEs focuses on domestic not international initiatives, while the theoretical literature on CSR in global supply chains focuses on MNCs not SMEs. This article seeks to remedy the gap in the literature by exploring how SMEs engage in private regulation of labor standards in global supply chains and in particular how they manage demands from large buyers. The case studies clearly show that a private solution such as the BSCI that is dominated by large firms does not work from the perspective of SMEs. While some of the founders of the BSCI such as the Otto Group has a long history of working with CSR issues and sees the BSCI as a way to deal with the inadequate labor and environmental regulatory environment in the countries where they source from or operate, some of the more recent BSCI members are CSR followers not leaders. In contrast to companies such

as the Otto Group, they have had less experience with CSR and view the BSCI as a low-cost risk management strategy. More and more large firms demand that SMEs join the BSCI. This way—to put it bluntly—large firms force their SME suppliers to bear the cost of living up to MNC supply chain requirements.

This development threatens to erode the societal benefits of private regulation as large buyers shift the burden of CSR demands onto SMEs, who are not able to meet these requirements on their own. A key finding is that both SMEs and the BSCI reported that large buyers need to be involved in helping SMEs meet buyer demands in order for long-lasting social change to take place. In short, buyers must collaborate with SME suppliers and assist them in meeting private regulatory demands in global supply chains. This conclusion is in line with ongoing work by Richard Locke and his research team at MIT (Locke et al. 2009). Locke and his collaborators found that supplier codes of conduct while important do not offer a permanent solution. In fact, suppliers were found to be drifting in and out of compliance with code of conduct requirements from Nike, HP, Coca Cola, etc. One of Locke's key findings was that for sustained social improvements to take place, large buyers need to collaborate with their suppliers. In short, buyers need to take responsibility for the demands they impose on their suppliers rather than leave suppliers to work out solutions on their own.

### Practical Implications

Focusing on SMEs and the BSCI, I now address some practical implications of these findings. First, what can SMEs do to improve their competitive situation when they operate in less developed countries? One possible solution is for SMEs to select suppliers that are already supplying other western MNCs and therefore have some experience in meeting such MNC demands. Furthermore, SMEs may benefit from engaging in networks with other SMEs where information about good suppliers can be shared (a challenge for SMEs is that such a strategy requires a high level of trust). SMEs can also sometimes share auditing costs. A second possibility is that SMEs lobby for mandatory regulation to ensure that large western firms assist SMEs in meeting BSCI requirements. For example, public procurement requirements could reward large firms that collaborate with SME suppliers to enhance CSR performance rather than simply impose demands on SMEs.

Second, what can the BSCI do to relieve organizational strain? The BSCI faces organizational strain caused by: (1) a large influx of SMEs; (2) different views on how to manage CSR requirements in leading firms and follower firms; (3) the likely short-term nature of pushing the CSR

responsibility onto SMEs; and (4) competition from alternative regulatory schemes.

It is difficult to achieve organizational coherence after receiving a huge increase in SME membership in the last 2–3 years (interview BSCI, November 2010). While on the one hand, it is a sign of success that membership is expanding, on the other hand, it is problematic to have many members who are dissatisfied with the arrangement (interview BSCI, November, 2010). In Scandinavia, SME membership of the BSCI has also grown. In Denmark, 43 members (84 %) are SMEs, while 8 members (16 %) are large firms. However, SMEs do not have a real choice whether to join or not. Most SMEs join because it is a requirement from large buyers and not because they see the BSCI as attractive.

The influx of low-end retailers with less CSR experience than the founding members creates tension between those members potentially interested in working with SMEs about how to meet BSCI requirements and those new members who leave the responsibility to the SMEs themselves.

Pushing CSR responsibility onto SMEs is not likely to be a viable solution in the longer term. For example, a television image of a large buyer's extensive head quarter contrasted with an unassuming small western supplier factory or office could quickly illustrate to television viewers the discrepancy in resources between a large buyer and a small supplier. The BSCI then risks being exposed as hypocritical.

Finally, business initiatives such as the BSCI that leave regulation to business actors can be criticized for leaving the fox to guard the henhouse, and the BSCI faces possible competition from multi-stakeholder initiatives. Multi-stakeholder initiatives such as the Ethical Trading Initiative (ETI) that award regulatory roles to societal groups build a watchdog and an empowerment element into the regulatory system (Fransen and Burgoon 2012; see Barrientos and Smith 2007 for an argument that the ETI has led to improvements in outcome standards but little change in process rights for workers). In terms of the stringency of private labor regulation, the ETI is stricter than the BSCI as it includes more control mechanisms (Fransen and Burgoon 2012, Fig. 1). Multi-stakeholder initiatives in the CSR field are believed to have the moral high ground over business-governed organizations and are expected to yield more positive results in the supply chain. According to the Clean Clothes Campaign, the BSCI represents an incomplete, minimalist model for compliance with labor standards that rely on weak auditing and is not accountable to the public (Clean Clothes Campaign, 24 November 2005). In contrast to the BSCI, the ETI has not experienced a massive influx of SME members in recent years. For example, the Ethical Trading Initiative in the UK has nearly 60 members and most

of them are large firms (UK Ethical Trading Initiative (ETI), Accessed July 26, 2012, from <http://www.ethicaltrade.org/>).

The BSCI is therefore very interested in finding new ways to develop partnerships between front-runner MNCs and SME suppliers. So far the BSCI has developed two new initiatives: (1) A large retailer set up a program where a neutral third party (a well-known accountancy firm) certified that suppliers meet BSCI requirements but without revealing the identity of suppliers to large buyers. The idea was to ensure that retail customers could be certain that the accountancy firm had certified suppliers; however, the certification scheme did not work because of cooperation problems; (2) The BSCI also set up a supplier database with information about individual suppliers without disclosing this information to individual buyers. However, the cost involved in managing this project has been excessive.

## Conclusion

A realistic assessment is needed about what global supplier codes of conduct can achieve and in particular how SMEs are affected. CSR in general (Porter and Kramer 2002, 2006, 2011) and supplier code of conducts in particular are seen as a magic wand by many consumers, governments, institutional investors, and the media. For example, the Danish government declares that “companies must organize supply chain management based on an assessment of the risk of violations of basic rights and principles in the supply chain and target activities and purchases in areas where such actions will have the greatest impact. The companies will pose demands and establish a dialog with suppliers about ongoing improvements including if necessary through monitoring of select suppliers' activities, cooperation, capacity building and/or education” (The Danish Council for Social Responsibility (Raadet for Samfundsansvar), Accessed April 4, 2011, from <http://www.raadeforsamfundansvar.dk/sw63329.asp>, author's translation). However, the Danish government's recommendation ignores the fact that large retail chains do not want to prioritize challenges but want suppliers to meet *all* BSCI requirements. This discrepancy needs to be addressed. Also, we should be careful in assuming that the presence of a supplier code of conduct equals a commitment to CSR (Bondy et al. 2008). Finally, codes do not always result in improvements of corporate social and environmental performance (Locke and Romis 2010). The challenges faced by SMEs in Denmark—a country known as a CSR leader—indicate that a frank discussion is needed concerning the limits of SMEs in managing labor standards in global supply chains and the possibility for cooperation between buyers and their SME suppliers and as well as how to develop solutions that are sustainable in the long term.

There is no doubt that demands are increasing for social and environmental programs in global supply chains. Recently, more and more governments have adopted non-financial reporting requirements focusing on CSR (Moon et al. 2012). These demands have to be met by large firms but as they struggle to meet the new requirements they also increasingly ask their SME suppliers to follow suit. Furthermore, public procurement in Denmark and in a growing number of countries also requires that suppliers including SMEs meet a range of social and environmental demands (often BSCI requirements or similar requirements). In order for SMEs to stay internationally competitive, they therefore need to find ways to meet these new demands—cooperation with large buyers seems a promising way to go.

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