COVALENCE INTERN ANALYST PAPERS

Effects of the global financial crisis on corporate social responsibility in multinational companies in kenya

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ABSTRACT

The global financial crisis has led to economic recession in different countries around the world. Multinational companies have been compelled by circumstances to search for ways of cubing spending including negating on their corporate social responsibilities. The purpose of this research was to identify the effects of the global financial crisis in regard to downsizing, funding of social projects and labor standards. The study carried out a two-pronged approach to identify the effects of the financial crisis. The first approach involved a telephone interview survey, while the second approach involved analyzing data from Covalence Company. The results indicated occurrence of downsizing attributed to the global financial crisis. Results also indicated an adverse effect on funding of social projects and minimal effect on compliance to labor standards. The study recommended further in-depth study on the effects of the global financial crisis.

1.0 Background

The global financial crisis that began in the US[1] has created a ripple effect that is having a devastating effect on the economies of other countries in the world. The financial crisis began with the bursting of the housing bubble[2] in the US as result of lax regulation, deregulation of government policies, and the increased Wall Street involvement in high-risk lending. Lending by financial institution evolved with the realization that there was demand for loans by high-risk borrowers who had a higher risk of default. This meant that lenders were exposing themselves to risks associated with lending to people with poor credit ratings or limited credit histories. Most of these loans were promoted as residential loans to assist low and medium income families build their own homes.

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1 United States of America

2 Tade in high volumes at prices that are considerably at variance with intrinsic values in the housing market (www.wikipedia.org)

In order to ensure that financial institutions had a constant supply of finances to lend to home buyers, the US government created government sponsored enterprises such as Fannie Mae and Freddie Mac to purchase and repackage mortgages as Mortgage Backed Securities. Mortgage Backed Securities consisted of pools of mortgage loans that were purchased from lenders, and then sold to investors in the secondary market[3] as bonds.

For a long time Wall Street investors financed home-buyers through the Mortgage Backed Securities. This facilitated the boom in sub-prime lending as many individuals who did not previously qualify for mortgage credit now could easily access credit. This created an upsurge in housing demand and inflated home prices.

There was a consistent lack of due diligence on the part of the lending institutions and the government agencies to adequately assess the risk of asset they sold. This was particularly prompted by the fact that these institutions could pass off the risk of an asset to someone else. The increasingly lax lending standards was sustained as long as house prices continued to rise and borrowers were able to refinance and were unlikely to default on their mortgages.

The eventual end of the housing bubble was triggered by a dramatic rise in interest rates and falling house prices. This lead to an upsurge in the number of loan defaulters and foreclosures[4] with greater adverse consequences to banks and financial institutions around the world. Securities backed with underlying sub-prime mortgages[5] that were held by many financial institutions lost most of their value. Exposing these banks to bankruptcy. The solvency and liquidity concerns regarding the financial institutions led the US government to commit huge amounts of funds to banks to encourage lending and restore faith in the stock market. Several governments around the world introduced economic stimulus packages to curtail the effects of the financial crisis on their economies.

The cascading effect of the global financial crisis from the financial institutions in the US to other financial institutions in other parts of the world indicates the interconnection of the world's financial systems. Fortunately, the US has adequate monetary reserves to bail out distressed financial institutions from sliding further into crisis. Most European countries undertook steps to nationalize most financial institutions that were characterized by difficulties with liquidity. Institutions such as the World Bank and the International Monetary Fund (IMF) found themselves with limited resources relative to the needs of other nations especially developing countries.

As the global financial crisis ensued, most companies in the US and Europe encountered difficulties accessing credit from banks. This credit crunch paralyzed operations of many companies as they depended on credit to support their business operations. Inter-bank lending was also affected to a large extent by the global financial

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3 Its a financial market where previously issued securities are sold and bought (Law, Share Price Accuracy and Econ. Performance, Durnev et al. 102 MICH. L. REV. 331 (2003)

4 Foreclosure is the legal and professional proceeding in which a mortgagee, or other lienholder, usually a lender, obtains a court ordered termination of a mortgagor's equitable right of redemption (www.wikipedia.org)

5 A type of loan granted to individuals with poor credit histories, who, as a result of their deficient credit ratings, would not be able to qualify for conventional mortgages (www.investopedia.com)

crisis. Banks in developing countries that depend on credit from other banks in the developed countries experienced hardship in accessing these funds. This restricted the flow of credit in developing countries thus affecting companies operating in these countries.

In Kenya, multinational companies are facing a myriad of problems due to the global financial crisis. As the parent companies are facing a liquidity shortage, most multinational companies have been forced to cut on spending. This has resulted in the multinational companies negating on some of their corporate social responsibilities.

The global financial crisis has created a slow down of the Kenyan economy. Coupled with the rise in inflation, many households in Kenya are experiencing a reduction of their disposable income. This has meant that people are spending less and hence resulting in low sales of goods and services. Faced with tumbling sales and declining support from parent companies, multinational companies in Kenya have been forced to overlook their corporate social responsibilities as they search for avenues of cutting costs. One of these avenues is downsizing. Many multinational companies in Kenya are registering a high employee turn-over rate, as they shed off employees. As a result there is a negative impact on society as the unemployment figure rises. This can be observed by the increase in poverty, more crime, increasing school dropouts, poor health of society and even more difficulties meeting the millennium development goals[6].

As part of their corporate social responsibilities, many multinational companies in Kenya are involved in various social projects that are meant to uplift the living standards of the community. Some of these projects include building of schools, digging of boreholes, scholarships to poor students, supporting HIV/AIDS organizations, supporting orphanages, supporting sports in the community, building hygienic latrines in the slum areas among others. Since the onset of the Global Financial Crisis, many multinational companies have relented on their commitment to social projects posing serious social challenges to the community. The effects of stalled or canceled social projects have been a deterioration of the living standards of the community, increase in poverty, decrease of hygienic standards, increase in sicknesses and thus increase in medical costs among others.

Most multinational companies in Kenya originate from developed countries where labor laws are more stringent and advanced. In order to remain profitable in the current harsh economic environment, the multinational companies are exploiting loopholes in the Kenyan labor laws and applying practices that they would not otherwise do in their countries of origin. Such loopholes include protective clothing for employees, compensation to employees for work related injuries or illness, hiring policies, conditions of women, discrimination of employees on the basis of their HIV status, whistle-blowing among others.

1.1 Research Objectives

This study undertook the following research objectives:

6 The eight Millennium Development Goals (MDGs) – which range from halving extreme poverty to halting the spread of HIV/AIDS and providing universal primary education, all by the target date of 2015 – form a blueprint agreed to by all the world's countries and all the world's leading development institutions (www.un.org)

1. Establish how the Global Financial Crisis is contributing to downsizing by multinational companies in Kenya.

2. Establish the effects of the Global Financial Crisis on the commitment of multinational companies to social projects in Kenya.

3. Establish the effects of the Global Financial Crisis on the adherence of multinational companies to labor standards in Kenya.

1.2 Importance of the Study

The aim of this study was to examine how the global financial crisis is affecting corporate social responsibilities of multinational enterprises in Kenya. The information gathered in this study will be of importance to investors in understanding how companies are dealing with the global financial crisis and corporate social responsibilities. Investors will be able to make informed investment decisions and also track the ethical reputation of companies.

This study will also be a useful tool to regulators of corporate social responsibility in Kenya. Government agencies and other private regulation companies will able to use this information as a guide on how the global financial crisis is affecting corporate social responsibilities of multinational enterprises in Kenya. In addition this study will be of importance to Covalence in monitoring ethical reputation of multinational companies.

This study will also be important to graduates and other potential employees in understanding how global factors are affecting different companies. Hence the potential employees will understand how companies are dealing with global problems and how this may affect jobs in different companies.

1.3 Scope and Limitations of the study

The study covered a cross-section of foreign multinational companies in Kenya. The limitations of the study included time and monetary constraints.

2.0 LITERATURE REVIEW

2.1 Global Financial Crisis and Downsizing by Multinational Companies

The Global Financial Crisis has distabalised operations of many financial instituions around the world and also contributed to the weakening of some currencies. De Bonis (1999) defines financial crisis to be a wider range of disturbances, such as sharp declines in asset prices, failures of large financial intermediaries, or disruption in foreign exchange markets. Due to the disruption of credit flow, multinational companies have been unable to support their overseas subsidiaries hence resulting in cost cutting measures.

The adverse economic climate has resulted in the reluctance of many multinational companies in pursueing their corporate social responsibilities. Gray (1987) defined corporate social responsibility as responsibilities of actions which do not have purely financial implications and which are demanded of an organisation under some implicit or explicit identifiable contract. The most observed evidence of such a situation is the undertaking of the downsizing strategy by many multinational companies. Cameron (1999) describes downsizing as a tactic within corporate strategy for shifting the organization structure from what it is now to what it has to be in order to sustain competitive edge and satisfy customers. Downsizing has been widely accepted by many multinational companies as a strategy of remaining in business in these hard times. The resulting effect is a net reduction headcount and usually accompanied by a net labor cost reduction.

The overall impact of downsizing has been a negative effect on the society. The loss of a significant number of jobs has led to an increase in poverty, crime, antisocial behavior such as prostitution, and consequently an increase in HIV/AIDS.

2.2 Global Financial Crisis and Social Projects

Corporate social responsibility has emerged as a global trend. Many organisations now have subsections in their websites with specific programs dealing with corporate social responsibility. Davis (1973) defines corporate social responsibolity as the voluntary efforts by business to achieve a balance of economic goals and societal quality of life. Many multinational companies in Kenya have established social projects that are meant to benefit the community. It is through such projects that multinational companies go beyond the individualism and utilitarianism goals of profit making and consider the well-being of the society.

There has been increasing demand on multinational enterprises to provide community development programmes and assistance for their host communities, in particular, in developing countries (Amaewhule, 1997). This is becauses development projects and other social infrastructure are not provided by the goverment. In order to be mindfull of the societys' well-being, multinational companies have initiated, funded and implemented significant community development schemes. Nelson (1996) further elaborates that multinational enterprises have a role in global development not only through capital investment, but more importantly, by investing in human capital and providing local people with the tools to drive their own economic development.

2.3 Global Financial Crisis and Labor standards

Corporate social responsibility (CSR) is of relevance to a broader section of people than just the host community. Seeking cheap labor and raw materials from emerging and developing countries, multinational companies utilise global and local sourcing in different parts of the world (Teuscher et al 2006). Corporate conduct which is informed by CSR can contribute to improvement of labor standards in the host country. This is observed where multinational companies contribute to the intergration of foriegn workers and local workers, thus promoting exchange of skills. In addition multinational companies, can improve the quality of local workforce through training and education hence promoting the transfer of knowlegde and skills. Hence through CSR, multinational enterprises can contribute in a major way to the welfare of their local employees and set standards for other companies in the host country.

Due to the lax labor regulations in developing countries, multinational companies may exploit the labor force in these countries. More critically, the current global economic hardship may prompt some multinational companies to exploit loopholes in the labor policies of the host country for their own economic advantage. Cases of such malpractises in Kenya usually include discriminatory hiring policies, poor working conditions, lack of compensation for injuries and lack of protection to whistleblowers. Such malpractises occur due to slow legislative process and corruption by the authorities.

The International Labor Organisation (ILO) is an agency of the UN[7] that brings together goverments and workers of member states in common action to uphold workers rights throughout the world. Member countries with weak labor laws and policies can rely on the on the policies passed by the ILO as a benchmark to ammend their own laws. Multinational companies operating in member countries have to abide to international labor laws passed by ILO or risk legal proceedings. Hence agencies such as ILO are of great importance during this time of economic crisis which puts workers at the risk of exploitation.

3.0 Research Design and Methodology

To address the three research questions, a two-pronged approach was used in the study. The first approach involved a telephone interview. This method provided the means of obtaining responses from a broad sample of senior executives in multinational companies in Kenya. A short questionnaire was developed to guide the interview. The telephone interviews gave the advantage of enabling the interviewees the opportunity to explain and clarify their responses. This was particularly important in eliminating ambiguity. A telephone interview was also selected because its less costly and fast.

The second approach involved an analysis of data from Covalence company. Data from relevant studies was provided by Covalence and incorporated in the study. The findings of this analysis provided a global outlook on ethical behavior of companies.

3.1 Pre-tests

The questionnaire was pre-tested with three potential interviewees to ensure that the subject matter was appropraite and that there was no ambiguity in the terminologies used. The questionnaire was then reviwed and minor amendments implemented.

3.2 Data collection

A sampling frame was obtained from the website of the registrar of companies in Kenya. Respondents were first contacted by telephone to inform them of the research and to obtain consent to their participation in the study. For those companies that agreed to take part in the survey, an interview was conducted on a number of employees in supervisory capacities to obtain a wide range of opinions from each company. Primary data was collected using a structured questionnaire. A questionnaire is a structured technique for data collection consisting of a series of questions, written or verbal, that a respondent answers (Naresh, 1996). A five-point likert scale was was used in the questionnaire. The scale consisted of a range from 1 – 5 (with 1 representing least likely affected attribute and 5 representing most likely affected attribute). In order to reduce interviewer bias, only one telephone interviewer was employed who was clearly briefed on the terminology to avoid ambiguity in the interviews, and to be able to offer clarification to interviewees (Oppenheim, 1992).

3.3 Data analysis and presentation

7 United Nations

The data collected was analyzed using SPSS[7]. The resulting information was presented in the form of a graph. The graph represented the mean score for all the responses obtained from each company on each question and the respective companies.

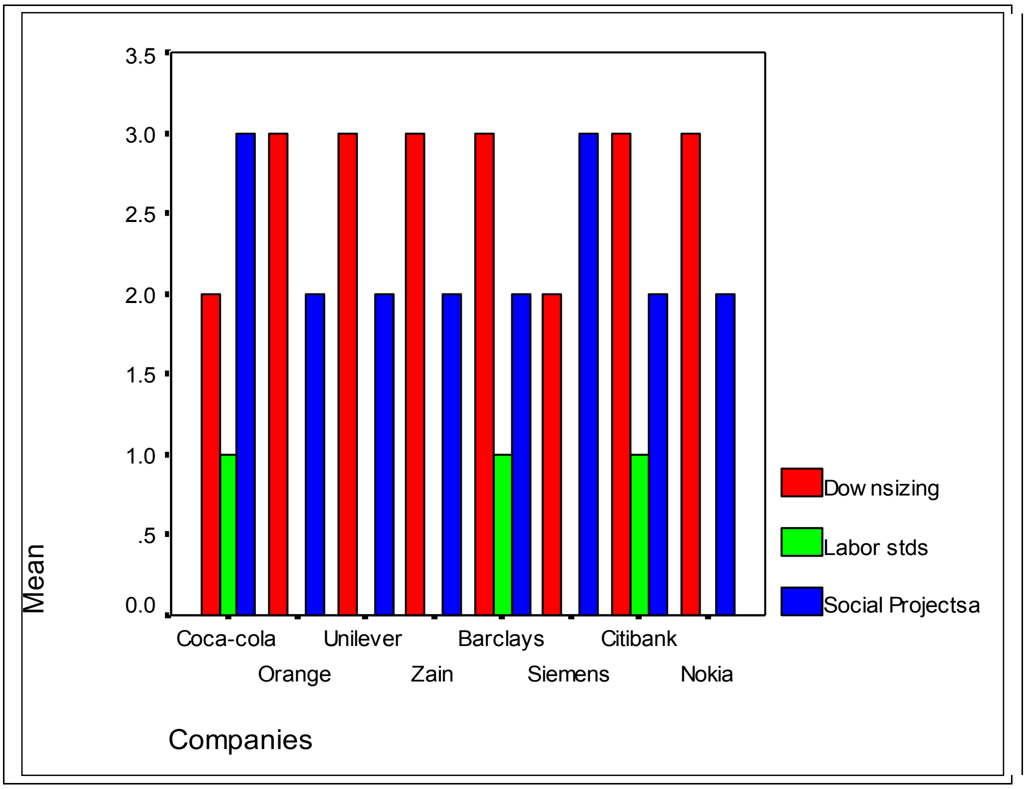
4.0 Findings

4.1 The first approach: Telephone Interview

The first approach involved a telephone interview with a number of repondents in each company. A total of eight companies agreed to participate in the research. The research questions were based on the objectives of the study. The chart below represents results from the first approach:

Chart 1

EFFECTS OF THE GLOBAL FINANCIAL CRISIS ON MULTINATIONAL COMPANIES



From Chart 1 above most of the companies interviewed indicated that downsizing would be the most affected variable by the global financial crisis. This coincides with reports in the news media of the large numbers of people loosing their jobs due to the financial crisis. The second aspect that would be most affected is social projects. As part of the corporate social responsibility many companies sponsor different projects in their host community to improve the living statndards of the members of that society. According to the results of the research, funding of many projects will be affected by the global financial crisis. The least affected aspect will

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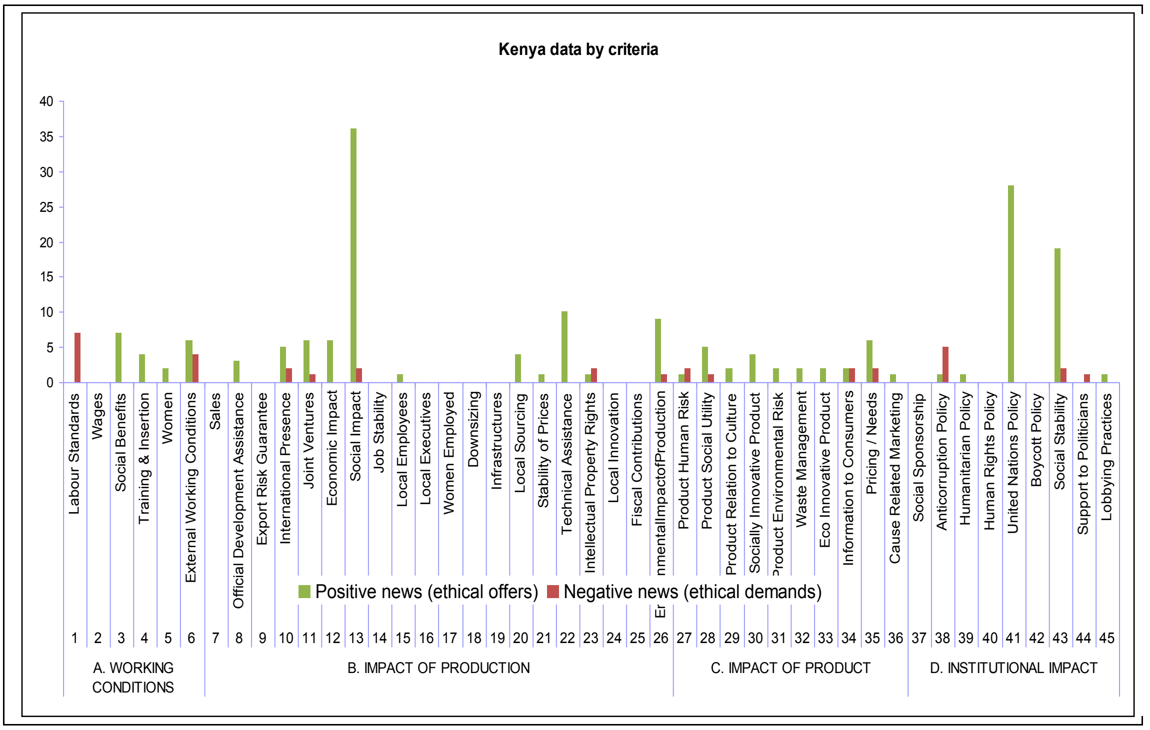
be the labor standards. From the results many comapnies indicated that the global financial crisis would not affect their labor standards.

4.2 The second approach: Analysis of data from Covalence company

The second approach involved analysis of data provided by the Covalence Company. The data acquired is represented in the charts below:

Chart 2



The above Chart 2 indicates rankings of different ethical issues as practised in Kenya. The findings are grouped into two clusters either as positive news (ethical offers) or negative news (ethical demands). The chart indicates that labor standards scored the highest ranking on negative news, followed by anticorruption policy which scored second in the negative news category. The chart also indicates that social impact scored the highest ranking on positive news, followed by the United Nationa policy. While social stability is ranked third in the positive news category.

Chart3

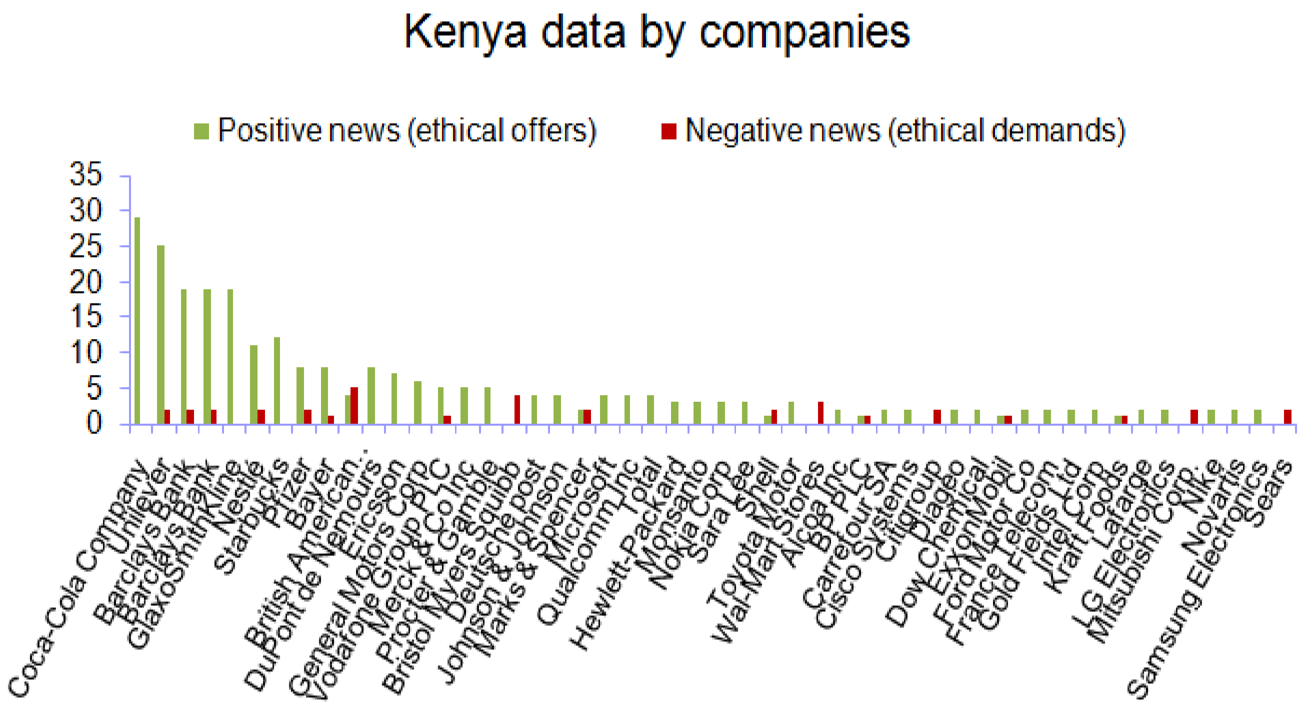


Chart 3 above was provided by Covalence. The chart indicates an analysis of ethical information on different companies. Ethical information has been analysed according to positive news (ethical offers) and negative news (ethical demands). The chart indicates the Coca-cola company as the highest ranking with positive news. Other companies such as Uniliver, Barclays bank, GlaxoSmithkline, Nestle, Starbucks, Pfizer and Bayer also had a high number of positive news. In contrast companies such as Sears, Samsung Electronics, Norvatis, Nike, and Mitsubishi Corp. had the least number of positive news.

5.0 Conclusion and Recommendations

The purpose of this study was to examine how the global financial crisis is affecting corporate social responsibilities of multinational enterprises in Kenya. The research objectives included to:

1. Establish how the Global Financial Crisis is contributing to downsizing by multinational companies in Kenya.

2. Establish the effects of the Global Financial Crisis on the commitment of multinational companies to social projects in Kenya.

3. Establish the effects of the Global Financial Crisis on the adherence of multinational companies to labor standards in Kenya.

The findings of the research indicate that the companies interviewed concurred that downsizing was the most likely consequence of the global economic crisis. These results were in tandem with news in the media on the large number of companies laying-off workers to survive the current economic hardship.

Companies that were interviewed were also in consensus that social projects were going to feel the effects of the global financial crisis. Possible consequences may include stalling of the projects, postponement, or cancellation of the social projects due to the global credit crunch.

Most companies interviewed denied that their labor standards would be affected by the global financial crisis. But the results in chart 2 indicate that labor standards in Kenyan companies had the highest number of negative news compared to other ethical issues. Hence companies in Kenya may already be exploiting loopholes in the Kenyan labor laws and may be using this advantage to shield themselves from adverse effects of the global crisis.

Hence it is recommended that it is imperative that companies continue to uphold their corporate social responsibilities to the host community they are operating in. Furthermore, the government of Kenya should be vigilant to ensure that the labor force is not exploited especially during the current period of economic crisis. It is also upon the Kenyan government to ensure that labor laws are in tandem with international standards and all loopholes are mended.

In addition this research recommends that further in-depth conclusive studies to be done on the effects of the global financial crisis on corporate social responsibility.

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