

global CSR casebook

ICEP | CODESPA

Business and Poverty

Innovative Strategies for Global CSR

How to develop global CSR strategies, manage risks and find new opportunities for your business in emerging and developing countries.



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Editorial

Global wealth has almost doubled since 1990. But more than half of the world's population still lives off of less than USD 2 a day. As global poverty continues to be one of the most pressing challenges of the 21st century, the international community heralded the Millennium Development Goals MDGs in 2000 – with the first goal being a commitment to reduce the portion of those living in extreme poverty by half by 2015.

For more than 10 years, ICEP and Codespa have been supporting people in developing countries to surmount poverty by contributing to their integration into economic processes. This commitment is based on the strong belief that economic development is an essential aspect of the global fight against poverty. As corporations are the driving force of economic development, they are central players in achieving the MDGs.

In 2005, the European Commission qualified a project with the objective of enhancing the involvement of the European private sector in the quest to attain the MDGs within the framework of global CSR. The project was jointly implemented by ICEP (Austria) and Codespa (Spain) together with ARS (Czech Republic), Sila Rozvoja (Slovakia) and Híd (Hungary). One of its important outcomes is this case-book, *Business and Poverty: The global CSR case-book*. We proudly present it!

This book is rooted in the experiences we have working in Latin America, Africa and Asia. Business can make profound contributions to social development while developing countries have enormous opportunities for economic value creation. From discussions with decision makers from the private sector, we are familiar with a number of typical questions business leaders have before they enter a developing market: To what extent should companies engage in social problems? How can companies create wealth for the poor? How can the strengths of the private sector thereby be used? How does one start and carry out global CSR measures? And what can be learned from success stories and from those that failed?

The nine cases of European companies operating in the developing world presented in this book suggest that thinking and acting in terms of global CSR – that is to say, thinking and acting in socio-economic categories – has two positive effects for corporations: It can help companies create business opportunities, and it can help corporations manage operational risks in the developing world. On the basis of the corporate experiences captured in this book, *Business and Poverty: The global CSR*

case-book also tries to link the practice of global social responsibility to its theory by presenting 13 essays by experts in the field. They are meant to offer insights into the on-going debate on CSR while increasing the understanding of the problems laid out in the cases. The authors are recognised experts in their respective fields and include Edward Freeman, the inventor of the stakeholder theory, Wilfried Luetkenhorst, chief of cabinet of UNIDO, and Björn Stigson, chairman of WBCSD, to name only a few. We are honoured to have worked with all the experts who contributed the essays in this book and are grateful for their time and effort!

As managing directors of ICEP and Codespa, we want to thank Jordi Canals and Joan Fontrodona of the IESE Business School for their contributions to the making of this book! Dean Canals made it possible to have IESE MBA students conduct the field research that represents the factual underpinning of the cases presented. Prof. Fontrodona, IESE Centre for Business in Society, professionally supervised the students as they implemented their research.

We would also like to express our gratitude toward Carlos Costa of the Boston Consulting Group BCG, Barcelona. He was enormously important for the genesis of this book as his contribution to our discussions helped direct our focus towards questions of relevance to the private sector. In addition, he helped us set up interviews with European company representatives active in the developing world. Thereby, he became an important link between the academic and the professional world.

We also would like to thank the students of IESE Business School who helped to conduct the research of the cases – Alexia Katsouranis, Anil Kathuria, Istvan Fulop, Javier Morales, Ceylan Öney, Nora Oliveró, and Suaye Banigo – as well as Jorge Tomas of BCG and Juliana Mutis and Heinrich Liechtenstein of IESE Business School, who supported the cooperation with the companies and the coordination of the students throughout the project.

In the process of writing the cases and editing the book, our case writing and editing team and ourselves decided not to publish five cases. Still, we want to thank all the representatives of TNT, BCG, the Telefónica Group, the Ringier Group and the Dariu Foundation, all of whom gave their time and effort! Due to company policy, the Holcim case we worked on is not published in this book. Apart from respecting this corporate decision, we want to thank the Holcim representatives who eagerly worked with us until the case was completed in terms of content.

Finally, we want to thank the representatives of those companies which helped us publish the cases presented in this book: Uwe Fölster, Angel Font, Antonio Fuertes, Mads Kjaer, Bjorn Klovstad, Jacques Labre and Alain Mathys, Matti J. Ojanen, Guillermo de Rueda, and José Manuel Sin Cabrero. Thank you for your constructive critiques, time and effort!

Pleasant reading!

Bernhard Weber
Managing Director ICEP
July 2008

José Ignacio González-Aller Gross
General Director Codespa

Preface

The modern company has become one of the major innovations of the 20th century. It has created millions of new jobs around the world, accelerated economic progress and become a major network of knowledge generation and diffusion.

Nevertheless, the modern firm is still a young institution whose shape is not yet fully defined. The essence of the modern corporation used to be defined as sheer business. The entrepreneur or senior manager was supposed to be good at identifying business opportunities and making the most of them. A company means business, but its essence goes beyond mere business.

Today, more and more business leaders think that companies have a purpose that goes beyond making money. Economic performance is indispensable, but it is not the only motivation for a business leader. Companies are made up of people who are the drivers and heroes of business success, including innovation, change and the necessary entrepreneurial drive. Attracting, motivating and developing those people is extremely important, and economic incentives only play a part of it.

But businesses are also part of the wider society in which they grow, develop and innovate. Society at large has expectations regarding firms. These include economic efficiency, but go beyond the goal of simply making money. In this context, the notion of CSR is particularly important because it highlights a way to deal with those societal expectations.

Nevertheless, the notion of CSR also involves a risk: It can be misunderstood as an approach that considers a firm's responsibilities towards society as something superficial, as something that is not anchored in its mission. According to this perception, CSR can help enhance corporate reputation (implying that firms may want to take actions to support it) but it will not be ingrained in the essence of the firm and, thus, eventually become a disposable dimension.

There is, however, a richer perspective on the role of business in society. It considers the firm as an institution that operates in a society, with a primary economic perspective – the generation of economic value – but trying to do so in ways (and with policies and criteria) that help develop the people working for it and the societies in which it operates. It can do so in a variety of ways.

One of these ways that is particularly relevant today is developing new business models around human and social needs that have not been addressed by governments or by

companies in the past. Some innovative firms are tackling these needs while applying the same level of professionalism that they would use in any other business project. Moreover, they try to make these business models work like normal businesses.

We are just at the beginning of a process in which needs-oriented business models are evolving. Some experiences concerning these models from around the world are very encouraging. This book, promoted by the Vienna-based Institut zur Cooperation bei Entwicklungs-Projekten ICEP, is a little treasure as it presents and develops a number of cases on real companies that are developing this business model in a variety of ways.

These companies' important innovations are still young; many more experiences have to be developed to test and improve them. Nevertheless, the enthusiasm and professionalism that many business leaders around the world are showing towards this new business model is especially promising. It shows not just a theoretical approach but a practical way through which companies can help people and society solve some of their most pressing problems.

Jordi Canals

Dean, IESE Business School, Barcelona

June 2008

Preface

Emerging markets pose both a challenge and an opportunity for corporations from the developed world. They are challenged to provide real impacts to less favoured countries or social groups, with the aim of making this world a better place to live. But they also have the opportunity to reap the benefits of serving a large number of new consumers. Within this setting, strategically structured and reinforced CSR measures become an important lever for leading corporate customers.

It is true that these programs need investments and do not provide immediate benefits. Therefore, they require specific lower return hurdles or a short-term “charity” approach. However, in the long run, they will pay off for society and business.

Since governments usually do not provide overall public services to the vast amount of underprivileged, support from corporations unfolds enormous differential value and allows authorities to show real commitment to local communities.

Additionally, if CSR is not taken as only a marginal practice but is integrated within a company’s value chain, it will both solve social problems and provide great business opportunities. Companies implementing thoughtful CSR measures will become relevant societal actors (in the eyes of potential consumers) and, thus, develop tomorrow’s markets.

Currently, about a billion people in the developing world are virtually invisible as potential clients. Our research shows that they represent the largest untapped consumer segment in the world. They are young and have some 40 years of consumption ahead of them. They are also economically active and their incomes are growing faster than the economies of their countries.

Many companies have found that fulfilling the needs of the next billion consumers can be something of a conundrum. But those business actors that start initiating well-structured CSR activities today will have a huge head start when their competitors finally decide to enter the field. Those corporations that are the first to meet the demands of these consumers – and to serve their evolving tastes – are likely to become tomorrow’s global leaders with a sustained competitive advantage. How do these companies operate? How and why do they enter markets in the developing world?

Best practice CSR cases can help to shed light on their motivation, actions and results. *Business and Poverty: The global CSR case-book* is a practical and in-depth answer to the question of how to successfully adapt business operations to the socio-economic context of the developing world. We gladly contributed to its making!

Carlos Costa

Senior Partner and Managing Director, The Boston Consulting Group, Barcelona

June 2008

Preface

CSR is in vogue, yet this is a fact that raises certain questions. There are always people who might think that a company's CSR interest is an issue of image boosting and public relations. But judging intentions is always delicate – and actually should be avoided. It is better to have companies dedicate their efforts towards CSR, even if their motivation is not entirely disinterested, than not have them do anything at all.

CSR is more than just a trend; it is a necessity. It implies a reflection on the meaning of business in society. Some people think that the only social responsibility companies have is to generate profits. In doing so, they say, corporations contribute best to the improvement of society. Other people (such as myself) believe that the role of corporations in society is more complex. Apart from generating economic value, they think that companies also ought to respond to social needs.

Since this wider perception of CSR is often misunderstood, clarifications are necessary. It does not imply that companies should be solely responsible for all the problems harming our society. It also does not demand that the private sector should come up with all the solutions to these problems. Given the impact that companies have on society, corporations should bare some of the responsibility of confronting the challenges of today's world (while not forgetting how much they contribute to our well-being and pleasure). Those sharing this view understand that these problems will not be solved without private sector collaboration.

Today we stand at a crossroads. Society and the private sector are re-inventing their relationship: Society, on the one hand, is beginning to understand that companies are allies – not enemies – which can help solve social problems affecting the development of mankind and the sustainability of the planet. Companies, on the other hand, are starting to recognise that it is truly their responsibility to contribute to the solution of these problems within the framework of their possibilities. As the private sector's role evolves, it is important to enhance how companies live up to their social responsibility – and why.

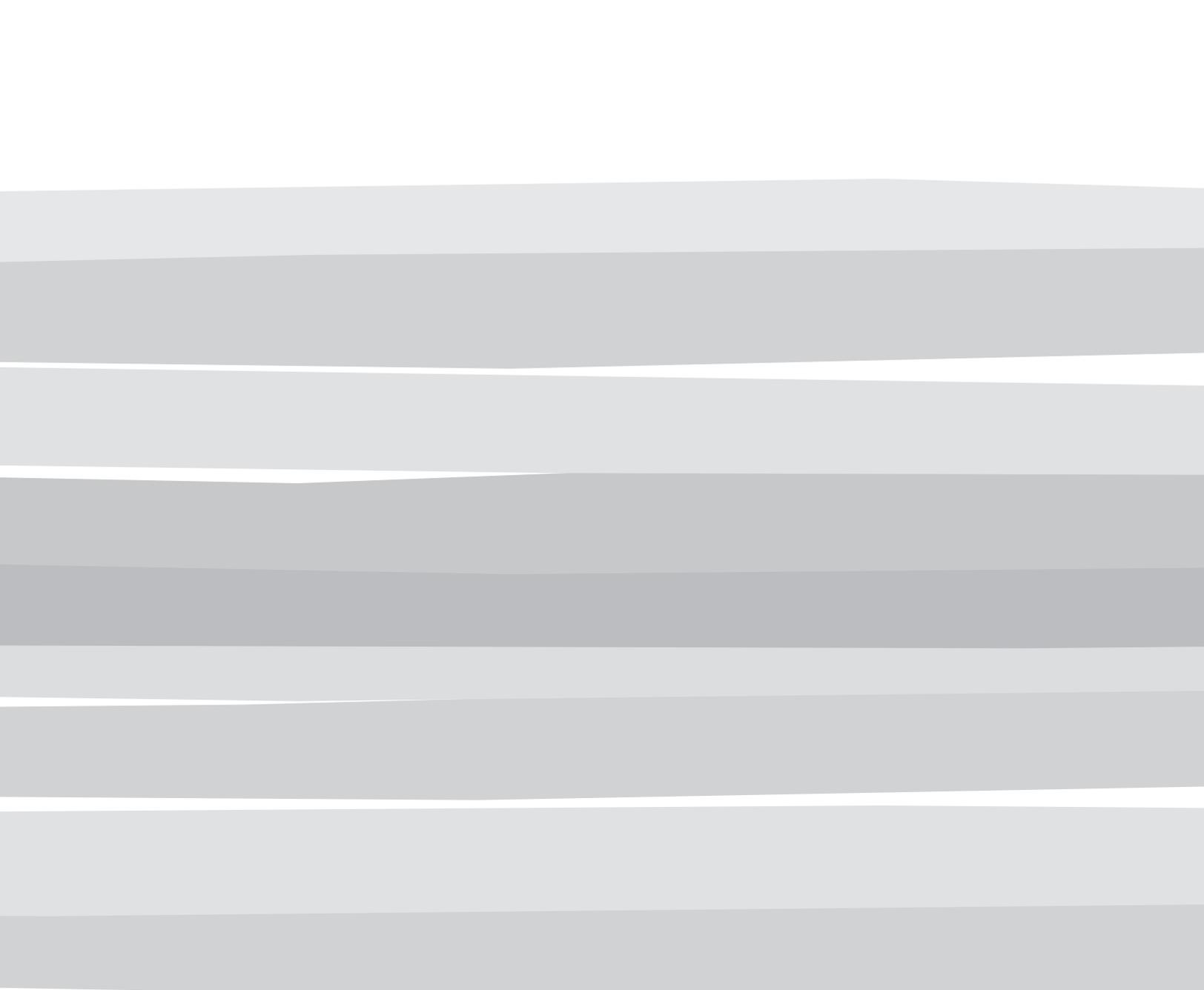
In this sense, it is important to recognise the good activities companies perform. This is primarily important because otherwise companies only surface in relation to negative news – even if we know that companies do more good than harm. Secondly, in this way, they can set an example for other companies. Commendable examples are needed to spread CSR initiatives within the business world.

IESE Business School has a mission. It wants to contribute to the development of society by educating and developing business leaders worldwide, and by generating and communicating new business ideas with impact. Therefore, IESE gladly participated in the making of this book and did so by setting their best assets to the test: a group of MBA students. Supervised by faculty members, they implemented the field research and information gathering that laid the factual basis of the best practice cases that are presented in this book.

MBA students are particularly sensitive with regard to CSR issues. At times it is difficult to channel these interests towards concrete action, which is why initiatives, like this project, are always welcome. MBA students are tomorrow's leaders. Today they are being educated to be able to adequately respond to future challenges. Knowing first-hand what companies can do for society is a initial step towards actually becoming tomorrow's responsible global business leaders our societies are already demanding.

Joan Fontrodona

Associate Professor and Chairman of Business Ethics
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June 2008



Chapter 1

Business and Development

The Business Case for global CSR?

A strategy is a long-term plan of action to cope with a certain perception of the future. CSR – as it is understood in *Business and Poverty: The global CSR case-book* – is a corporate strategy, a concept on how to manage the various interfaces of business and society, today and tomorrow. It thereby expresses the private sector's social and environmental responsibilities and its commitment to respecting ethical principles in the framework of business operations, in order to create mutual value benefiting both society and the private sector. So what is *global CSR*?

European and developing societies differ in many ways. Europeans are well-educated, wealthy and growing old. Societies in developing and emerging countries are characterised by youth, widespread poverty, poor standards of education and large quantities of people. Global CSR takes these societal characteristics into account and accordingly suggests specific ways of managing their effects on business and vice versa.

Typically, companies operating in saturated industrial regions implement CSR activities in order to gain a competitive edge in areas such as human resource management, cost reduction or energy efficiency. From a legal perspective, these efforts are considered to be *beyond compliance*, meaning that they contribute to the solution of socio-economic challenges in ways that surpass judicial obligations. By integrating social and environmental objectives within company goals, corporations aim to sustain long-term company value.

Companies in developing countries face other challenges. Weak public institutions and a lack of legal execution often lead to non-compliance with guidelines and international norms (e.g., in the areas of ecological and social standards). Generally, this does not relate directly to European corporations and their subsidiaries. Rather, it is prevalent in most of their supply chains. For European companies, leading their entire supply chain *towards compliance* of the mentioned standards via strategic global CSR is an important task.

In a second, more pro-active step, corporations operating in developing and emerging regions often implement global CSR in areas such as market development, employee enablement and supply chain management. These efforts are designed

to develop business. Thus, integrating social and environmental objectives within company goals can often be equated to unfolding socio-economic development among the poor. This is not only a social value as such but also transforms societal needs into market-demands – a prerequisite for long-term company value.

Growing importance of global CSR

Given the fact that many developing and emerging countries are currently catching up in economic terms (while their societal risks such as volatility, immature institutions and poverty-caused operational risks remain high), managing the interface of business and developing societies by means of global CSR is a challenge that is growing in terms of relevance. Obviously, companies have always tried to cope with challenges – and have often done so through various means. But today, global CSR is of specific importance as it can give companies a competitive head start in emerging markets while they strive to sustain business operations throughout the process of globalisation.

The areas in which this strategic concept proves to be effective are, among others: product development and marketing, human resource and reputation management, effective know-how transfer or quality control, and supply security. Seen from a systematic perspective, global CSR can positively enable a company's

- core business (e.g., by developing innovative products in order to tap new markets);
- supply chains (e.g., by building social capacity along supply chains in order to secure supply);
- operational context and business environment (e.g., by contributing to community and societal development programmes in order to enhance their social licence to operate).

Case studies suggest the complementarity of economic and societal objectives

The European companies portrayed in the process of developing, implementing and evaluating global CSR strategies show that global CSR is all about thinking and acting in socio-economic categories. This allows companies to manage risks in developing societies (which are often social by nature and economic in their effect) and to benefit from their economic opportunities. The compelling insights conveyed by the cases in *Business and Poverty: The global CSR case-book* refer to the complementarity of economic and societal objectives: Companies that pursue economic goals in developing countries, so the cases suggest, contribute substantially to the attainment of social goals – if global CSR is perceived as a core aspect of overall business strategy. In other words, those corporations that use global CSR as a strategic tool to enable their business, enable social development. In fact, they even support the achievement of objectives of development cooperation – since the goals of the latter are complementary to business objectives in developing and emerging countries. Examples?

- Companies that are able to develop innovative products and sell them to the poor can contribute to poverty alleviation (as the Suez and Unión Fenosa cases show).

- Corporations that cooperate with poor producers in emerging economies in order to react to western market demand help to promote socio-economic value creation through SMEs (as the Coop NKL and Carrefour cases suggest).
- By initiating activities to secure their location or reputation, companies contribute to societal development (even on national levels, as one can see in the Repsol YPF and AstraZeneca cases).
- A company that thoughtfully taps new markets can initiate social capacity building (as seen in the Caixa Catalunya case).
- Corporations' human resource management – if prudently implemented – can lead to the alleviation of skill deficits (so exemplifies the Mondi case) and helps to spark grass-rooted charity initiatives (as the Kjaer case shows).

But the described relationship of business and development is not one-sided. It is reciprocal. Not only do global CSR activities cause social effects, but those companies that use global CSR as a strategic tool in order to enable social development also enable business.

This is of strategic importance for companies as effectively coping with the social risks of developing and emerging economies is a major task. Some of the cases in *Business and Poverty: The global CSR case-book* show how it can be tackled. They suggest that as social problems in developing and emerging countries transform the quality of business, management tools and solutions are needed in these regions, which essentially are social – as well as managers that are willing to transcend an economic mind-set when confronting business challenges in emerging economies. While alliances with NGOs can thereby help to foster effective global CSR strategies aimed at creating social value, corporations ought to make sure that they are integrated within the core realm of their business strategy. This is why Unión Fenosa's social efforts in Colombia are so compelling – because they increased company revenues. In like manner, Suez's quest to bring development to the poor in Manaus, Brazil, was part of a corporate strategy aimed at selling potable water and sewage disposal. Mondi's capacity building programmes in South Africa were similarly a reaction directed at absorbing the costly social side-effects of outsourcing and subcontracting. Repsol YPF's initiative to implement grass-roots social projects throughout Argentina was also an effective way to secure the company's social licence to operate in a country of strategic corporate relevance.

The desired effects of global CSR (both social and economic) overlap with societal objectives with regards to content. Structurally, global CSR initiatives and those of development cooperation also complement one another: While global CSR activities usually unfold their effects at the micro-level (an aspect that is supported by most of the cases), public actors structure settings at the regional and national levels. Strategic alliances between companies and actors of development cooperation, thus, can help to bundle respective tools and resources in order to drive socio-economic development through all levels and create synergistic effects. These kinds of alliances ought to be taken into consideration more actively by private and public actors alike.

The social and the business perspective on the nine cases

The nine business cases published in *Business and Poverty: The global CSR case-book* can be seen in two ways – from a *societal* and from a *business* point of view. When seeing things from a *societal* perspective, the cases show that business can actually contribute to the socio-economic development of the poor – with obvious variations in motivation, action and effect.

In many instances, the companies portrayed in *Business and Poverty: The global CSR case-book* started to implement strategic global CSR measures only after realising that traditional economic tools alone were insufficient to manage business operations in developing countries (see the Unión Fenosa and the Mondi cases). At other times, trying to cope with the volatility of emerging markets or certain legal obligations was the main incitement to corporate social action (as the Repsol YPF and the Suez cases show). Enhancing a company's social licence to operate also offered a reason to think and act in socio-economic terms (see the AstraZeneca and the Coop NKL cases) – as did increasing employee commitment and motivation (as the Kjaer case conveys). Finally, orchestrating social investments of company foundations within the realm of corporate strategy was also a rationale for global CSR measures (as suggested in the Caixa Catalunya and the Carrefour cases).

From a *societal* perspective, the reasons and motivations why companies contribute to the socio-economic development of the poor are not as relevant as the fact that they do – and that they thereby do well when aligning their corporate social efforts to their business strategy. This is a fact which ought to be taken into consideration by companies operating in the developing world and by the public actors of development cooperation who are increasingly considering forms of collaboration with the private sector.

From a *business* perspective, the cases presented in *Business and Poverty: The global CSR case-book* give answers to two important questions:

- How can managers effectively implement global CSR in order to cope with common risks in the developing world (which are often social by nature and economic in their effect)?
- How can they use global CSR as a strategic tool that helps companies benefit from the opportunities of emerging economies?

What is the answer?

By integrating social objectives within their operational strategies – a common course of action throughout the cases, with obvious differences with regard to concrete forms. In the case of Mondi and Repsol YPF, initiating large stakeholder dialogues was an integral component of securing company commodities and company location. Legalising inhabitants of low-income areas and sparking socio-economic development among the poor was necessary for Unión Fenosa and Suez to increase their revenues. The fact that Carrefour and Coop NKL built human capacity along supply chains was

a way of reacting to market demand and unlocking new market segments in Europe. Initiating incentives among employees that sparked grass-roots charity projects increased employee contentment – the latter being a defined business objective for Kjaer. Finally, transferring technical know-how to microfinance institutions in developing countries and conducting R&D on a new tuberculosis drug were parts of Caixa Catalunya’s and AstraZeneca’s respective strategies to establish new markets in developing countries.

Does that mean that there is a business case for global CSR?

In the strict sense of the term, the answer to that question is no, because the actual links between global CSR activities (as a cause) and its effects are not fully comprehensible, as in the case of marketing, innovation, outsourcing and any other complex economic mechanism. That means that there is no business case for global CSR per se. Why? Because global CSR does not refer to a monolithic object with a rigidly defined value, but rather to a certain way of thinking and acting as a corporate manager in order to confront specific social and economic challenges.

Certain fields of action suggest a business case for global CSR

There are, however, certain fields of corporate action in developing and emerging countries that seem to suggest the implementation of global CSR strategies – and, in addition, a business case for global CSR in a broader sense.

According to *Business and Poverty: The global CSR case-book* these fields of action are: product development and marketing in developing countries (Unión Fenosa and Suez) and in Europe (Carrefour and Coop NKL), supply and location security (Carrefour and Mondi), market development (Caixa Catalunya and AstraZeneca), the enhancement of a corporation’s social licence to operate (Repsol YPF and AstraZeneca) and human resource management (Kjaer).

Understood from this perspective – from a point of view that prudently relates certain clusters of challenges to certain types of managerial action – there *is* indeed a business case for global CSR. And it becomes tangible when global CSR measures generate real social and economic value. So, the answer to the million dollar question is yes.

Global CSR can be implemented to confront numerous challenges within companies (within their core businesses, along their supply chains) and in the context of business operations (as community development and enabling environment efforts). It can also help to generate economic value via social action and help establish a company-relevant social value with economic means. It can contribute to risk management and also to market development. And global CSR can pay off.

But, no matter how global CSR is used, the key to its successful application lies in the realistic perception of the likelihood of actual economic and social value creation – both for companies and their stakeholders. ♦

Inclusive Business: Being profitable and serving the needs of low-income communities

Björn Stigson is the president of the World Business Council for Sustainable Development WBCSD, a CEO-led global association of 200 companies dealing exclusively with business and sustainable development. Prior to his appointment in 1995, he served as president and CEO of the Fläkt Group, a company producing environmental control technology. Following the acquisition of Fläkt by the ABB Group in 1991, he became executive vice-president and a member of ABB's executive management group.

Abstract

Poverty and inequity are critical challenges for sustainable development and global stability. Although global wealth has almost doubled since 1990 to an average GDP per capita of USD 6,000, almost 90 percent of the world's wealth is held in the OECD countries. Since the world's population is projected to reach nine billion by 2050, and with the developing world being home to over 85 percent of people, the scale of the growing inequity is a challenge.

But where there is challenge there is also opportunity. Companies can succeed in doing business in the developing world in a commercially viable way. After all, these are often considered the growth markets of tomorrow. This essay sketches an example of an inclusive business approach and how to finance it. Further, it describes the activities of the WBCSD with regards to taking a business global. Finally, it provides several examples of businesses which have attempted inclusive business practice and have succeeded, as well as how to build an environment in which to do so.

**Businesses can help
alleviate poverty**

The business contribution to development

The private sector is a key provider of economic opportunities, training and education, and it can offer many people a route out of poverty. Business investments and operations in developing countries generate both economic growth and social development. Deregulation and privatisation have led to companies assuming roles that were once the exclusive domain of governments: Worldwide, more than 100,000 state-owned enterprises have been privatised in the last two decades.

There is also increasing recognition by governments, development actors and NGOs that broad-based private sector development is critical to economic advancement and sustainable poverty alleviation. The private sector already dominates global financial flows to developing countries: Net inflows of private capital reached a record level of USD 650 billion in 2006. This represents a quadrupling of investment levels from USD 170 billion in 2002. According to an article in May 2007 in *The Economist*, developing countries repaid loans totalling some USD 185 billion to official lenders, including governments and the IMF, from 2003 to 2006. Money is flowing and, on balance, country risks are falling.

So, what can businesses tangibly contribute to development? First, companies can take the lead in developing suppliers from low-income communities in the countries where they operate, thereby building capacity, generating employment and bringing small businesses into the formal economy. Second, businesses can lead in developing innovative and affordable products and services that improve the overall quality of life. Third, businesses can take a leading operational role in the provision of basic needs such as water, sanitation, energy, housing, health care and communication services. Last, businesses can work with others to improve the investment climate, root out corruption and improve overall health and education levels in the developing world.

Keys to successful inclusive business models

With trust and an inclusive business approach, the developing world becomes not only the market for the future, but also the supplier and the workforce. But if the poor are the market for the future, it is vital to ensure that the products offered meet their needs. Inclusive business models aim to use commercial means to better people's lives, but there are no formal checks and balances that guarantee this outcome. Developing appropriate products that truly meet people's needs and contribute to local development is a delicate balancing act, with the risk that companies market products that are inappropriate for low-income communities.

**The developing world
needs products
targeted to their markets**

The experience of WBCSD member companies suggests that successful inclusive business reflect a combination of three factors: focus, partner, and localise. In essence, companies will need to:

Focus on core competencies

Companies that concentrate on their key strengths are better able to innovate around those strengths. This helps guarantee consistency between the company's portfolio of activities and the inclusive business model, and will make it easier to take successful pro-poor business mainstream in the future.

Partner across sectors

Governments and NGOs are increasingly interested in working with businesses. By

involving development organisations that share complementary goals, companies can benefit from on-the-ground expertise and additional resources. Ensuring that companies have the trust of the communities they work with is also essential. Likewise, thinking across sectors might lead to innovative partnerships involving companies from different industries, addressing a bundle of needs holistically.

Localise the value creation

Companies operating in developing countries often lack the usual infrastructure and support systems: market intelligence, manufacturing capabilities or distribution channels. They have much to gain from tapping into local networks and local knowledge.

WBCSD suggests to focus, partner and localise in order to succeed

Financing inclusive business opportunities

One of the greatest challenges that surrounds inclusive business is attracting sufficient and appropriate capital to finance such activities, especially in countries with considerable business risk. To overcome this barrier, a shift in mindset is required whereby companies embrace new ways of thinking about how business could be done. To make the most of available resources, companies need to redefine how, from whom and for whom they raise capital.

Financing inclusive business does not involve abandoning the traditional modelling process of gauging risk after estimating the capital needs and expected future cash flows. However, it does entail adjustments to factor in indirect and less tangible benefits for the company. The considerable social benefits these projects bring mean that many non-traditional sources of capital may be interested in helping such a business succeed. These sources of *patient capital* can help remove obstacles to profitability and shorten the lead-time until a business is fully commercially viable. Both direct funding (project capital), and funding that improves the business environment and supports partner organisations (partner capital) can help to achieve this.

Patient capital can help remove obstacles

Some companies have begun to shift their thinking from a centralised capital strategy mentality, whereby companies alone raise funds for their business to a distributed capital strategy, in which companies also become capital conduits to already existing local expertise and capacities. Development agencies are becoming increasingly interested in working with companies, and some private foundations are beginning to support for-profits whose goals mesh with their own programme objectives. Many of these organisations have billions of dollars at their disposal.

However, to benefit from this public money, inclusive businesses need to demonstrate tangible social benefits. In addition, managers might need to learn the language and goals of non-business organisations.

A considerable amount of money, earmarked for development, is available from a number of sources to support business activities in poor communities. Increasingly, these external capital providers are keen to help start up inclusive businesses and finance those with limited access to conventional borrowing.

The WBCSD's work toward doing business with the world

The WBCSD brings together some 200 international companies in a shared commitment to sustainable development through economic growth, ecological balance and social progress. Members are drawn from more than 30 countries and 20 major industrial

**Raising awareness
of business and
development**

sectors and greatly benefit from an association called the *Regional Network* of 60 national and regional business councils and partner organisations. Via its development focus area, the WBCSD is seeking to raise awareness of the business contribution to development, helping business and non-business stakeholders understand what is possible by providing case studies, guides and tools that advance our understanding of development challenges and opportunities.

Several WBCSD member companies and Regional Network partner organisations are committed to playing their part in building capacity and empowering people so that they have the opportunity to move out of poverty and into the formal economy. They intend to help create new businesses, new markets, new employees and new customers among low-income communities. If these efforts are to be substantial and sustainable, they must also be profitable.

Such business activities require a delicate blend of innovation and business-as-usual. The most radical innovation is thinking of low-income communities as business partners and customers. To be successful, companies have to develop new ways of buying, manufacturing, packaging, marketing, distributing, advertising and charging.

They are therefore looking beyond corporate philanthropy to build inclusive business models that are both profitable and serve the needs of the low-income segment. In other words, they are *doing business with the world* by promoting responsible, sustainable and inclusive business activities. So far, some 60 WBCSD member companies and Regional Network partners have embarked on this journey.

In essence, inclusive business models try to find synergies between development goals and the company's core business operations. Sound inclusive models will therefore deliver higher socio-economic value for communities while opening new avenues for growth for the company.

The notion of inclusive business calls for additional focus and significant innovation in the way that companies do business. It is about creating new forms of employment, new markets, and affordable products and services aimed at making business benefit many more people in a way that spurs economic growth and encourages entrepreneurship.

As employees and suppliers, the low-income segment gains access to the formal economy, including provision of training, access to finance and, of course, income. As consumers, the low-income segment can benefit from products and services that meet their needs in an affordable way. If business does both, it opens up the virtuous cycle of business in development.

**Low-income segments
are gaining access to the
formal economy**

Inclusive business opportunities in practice

As a group of leading companies, WBCSD members are promoting responsible, sustainable and inclusive business activities. They feature prominently among the pioneering companies portrayed in this publication.

Another link between WBCSD and the publishers of this book surely is their desire to have people look at – and learn from – what is already happening. Having chosen case studies as their means to this end, the publishers opted for a strategy that the WBCSD has long employed. The WBCSD's online case study library² holds available detailed information on what companies are doing to implement the inclusive

business concept on the ground. The following examples are taken from the case study collection:

ABN AMRO

The Netherlands-based multinational bank is contributing to the improvement of living conditions for Brazil's poor through self-sustaining micro-finance programmes. An estimated 15.7 million people in Brazil work in the informal economy as micro-entrepreneurs, outnumbering formal sector entrepreneurs by more than three to one. Of these informal micro-entrepreneurs, 93 percent run profitable businesses, 84 percent of whom do not have access to credit. It is estimated that 50 percent of these micro-entrepreneurs would apply for a micro-credit loan if they had access to banking services. This figure represents a potential of USD 3.7 billion per year in loans. Recognising a potential market and seeing a service that could both help the community and be self-sustaining, ABN AMRO's Brazilian subsidiary Banco ABN AMRO Real launched Real Microcredito in July 2002, in partnership with ACCION, an NGO specialising in micro-credit worldwide. ACCION provides the technical expertise in micro-lending while ABN AMRO provides its strong financial background, infrastructure and banking network in Brazil.

BP

The London-based multinational energy company currently leads several consortia of petroleum companies developing oil and gas fields in Azerbaijan, Georgia and Turkey. Developing an effective local supplier base is core to the success of BP's business and to strengthening the Azerbaijani economy. In 2002, BP opened an enterprise centre in the Azerbaijani capital Baku for its international oil and gas partners in the Caspian region. The enterprise centre helps local companies develop their business in support of oil and gas projects, particularly those involving international companies. The centre offers training in management, finance, IT, quality control and marketing. Experts also provide technological assistance to improve engineering and manufacturing know-how. Azerbaijani SMEs receive free training in health, safety and environmental policies and are helped to participate in tender processes, access technical requirements of oil and gas operators and identify foreign partners for local projects. The enterprise centre also supports firms by identifying sources of credit, training and certification. In addition, it maintains a supplier database tracking more than 150 local SMEs.

The BP enterprise centre offers training to improve engineering know-how

Eskom

The South African utility provider is working to bring electricity to all of South Africa through the installation of pre-payment metres in poor communities. Eskom's newly electrified customers reside in predominantly low-income communities where electricity consumption averages less than 100 kWh per household per month. Pre-payment systems keep a customer from falling into debt as it provides automatic credit control (as opposed to the billing system where the utility company manually has to do this itself). Eskom intends to make electricity supply affordable as well as remove the issue of deposit management. The Eskom pre-payment system uses a single rate energy-based tariff, allowing customers to easily relate usage and money as well as supporting the marketing of Eskom's product: electricity. The customer can compare

Eskom brings electricity to all of South Africa with pre-pay metres

the cost of a unit of electricity directly with another energy carrying item such as a bottle of paraffin.

SC Johnson

Kenya currently accounts for 60 percent of global pyrethrum production, a type of daisy. For more than 200,000 subsistence and low-income farmers supporting families – nearly a million people – pyrethrum provides the entry point into the monetised economy. Pyrethrum’s primary use is as the active ingredient in household insecticides. US-based global consumer products manufacturer SC Johnson prefers natural, biodegradable pyrethrins to synthetic ones for production of one of its household insecticides. However, SC Johnson must ensure this supply can be reliably sourced. To achieve this, SC Johnson works in partnership with an NGO and the Pyrethrum Board of Kenya to improve local farmers’ productivity and streamline their supply chain.

Unilever

Unilever is a world leader in hygiene, personal care, food and cleaning products. Its Indian subsidiary, Hindustan Lever, already enjoys a sophisticated and extensive distribution network encompassing both urban and agricultural areas. Yet a core challenge is to develop locally appropriate distribution channels for customers in undeveloped, and often very remote, regions. The goal is to work from within these communities, promoting health while generating sustainable income for the poor. Through its Project *Shakti* meaning *strength* in Hindi, Hindustan Lever now works with 15,000 underprivileged women to bring its products to 70 million rural consumers. This innovative business model provides significant opportunities for local women to participate in the economy; it empowers local communities and promotes health and hygiene.

**Unilever:
Promoting health
while generating
sustainable income**

Vodafone

Following a successful pilot programme in Kenya, Vodafone is rolling out a service that allows customers to access cash via their mobile phones. Called *M-PESA*, the service allows customers to borrow, transfer and make payments using a mobile phone, transforming financial services by making transactions cheaper, faster and more secure. In its first three months of commercial operations following its launch in April 2007, M-PESA has attracted 95,000 customers.

Building an enabling environment for inclusive business

The contribution of the private sector to development can be accelerated, but only if there is a sound enabling environment in place. This is as true for SMEs as it is for large multinational corporations. Through endeavours such as those outlined above, companies are discovering that there is no one-size-fits-all approach. To be successful in these markets, companies must focus on meeting real needs, using approaches adapted to the markets they target and that integrate well with their core business competences. This is not always easy and can carry with it considerable business risk.

A key prerequisite for the success of the business model is a favourable investment climate that is both stable and predictable. The WBCSD advocates change by working collaboratively with multiple stakeholders to create a more enabling

**Companies are
discovering that
one-size-fits-all
approaches do not work**

business environment and seeking synergies between official development assistance and foreign direct investment. In this context, the WBCSD has called upon political leaders to focus their attention and work toward on the following priorities:

- A fair and competitive global market that is non-discriminatory;
- Regulatory frameworks that uphold property rights, promote greater movement of entrepreneurs to the formal economy, and root out corruption;
- Capacity-building and access to finance for local enterprises and entrepreneurs;
- Investment in the necessary infrastructure such as roads, energy, telecommunications and ports.

While governments create the frameworks that encourage – or hinder – development, the private sector generates entrepreneurship, creates employment and builds wealth. Companies that move beyond conventional wisdom and work with new partners have an unprecedented opportunity to help people lift themselves out of poverty and into market economies. At the same time these companies will be developing new markets for their businesses. Unfortunately, it is precisely low-income communities, which are far too often excluded from functioning markets and untouched by the benefits markets can bring. Business, governments and civil society therefore have a collective responsibility to ensure that markets really exist for all, thereby making globalisation truly inclusive. ♦

Assuming collective responsibility to ensure that markets exist for all

Notes

¹ See *Statement of Intent for Doing Business with the World* signed by the leaders of 12 WBCSD Member companies, posted on the WBCSD's website at <http://www.wbcds.org>.

² See <http://www.wbcds.org/web/dev/cases.htm>.

Stakeholder Capitalism

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Abstract

The industrial revolution, the rise of consumerism and the dawn of the global marketplace, each in their own way have made life better for millions of people. Many of us now know comforts, skills and technologies of which our ancestors could only dream. Capitalism and markets have also notoriously increased the division between the rich and the poor, both within and across nations. While there are many understandings of capitalism, we wish to focus on a recent version that integrates many concerns with markets into a view called stakeholder capitalism. Stakeholder capitalism describes a view of value creation and trade that makes sense in the modern business world of the 21st century.

Beginning with a description of stakeholder capitalism, thereafter detailing its six principles, this essay provides a revised approach to capitalism, one in which stakeholders play a significant role in value creation. Furthermore, this contribution lays the theoretical foundation of a capitalistic society which is not, contrary to popular belief, comprised merely of self-interested individuals solely seeking profit.

Introduction

We live in the age of markets. Although markets have been around for thousands of years, we are just beginning to understand their power of organising society and creating value. In the last 200 years markets have unleashed a tremendous amount of innovation and progress in the Western World.

In the pursuit of innovation, we have become blind to some of the harmful consequences of our actions on others, such as environmental degradation, dominance of less privileged groups and the inequitable distribution of opportunities. Global warming, global financial crises and global terrorism threaten to destabilise our world. More than ever, it is imperative to carefully study and understand the power of markets and capitalism. We need to be more sensitive to understanding those groups and individuals who can affect or be affected by the value creation and trading processes of markets and capitalism. We call these groups and individuals the *stakeholders*.

In the age of markets we are fast moving toward a more global stakeholder society. The fact that we have access to people around the globe interested in stakeholder theory means that our way of working instantaneously becomes quite different. Indeed, in such a society, our very way of living together is filled with possibility that we do not yet fully understand.

As we move toward a more global stakeholder society, we need a theory of capitalism that allows us to flourish, and allows us to continue cooperating voluntarily to create and trade value with each other.

Stakeholder capitalism

Stakeholder capitalism is founded on libertarian and pragmatist ideas, but it is not based solely on private property, self-interest, competition and free markets. Rather stakeholder capitalism is based on freedom, rights and the creation of positive obligations by consent.

First, adults have *freedom* to do what they want, including making voluntary agreements that are sustainable over time. Rather than focusing on individuals in competition over limited resources as in traditional narratives of capitalism, stakeholder capitalism focuses on individuals voluntarily working together to create sustainable relationships in the pursuit of value creation.

Second, individuals have rights protecting them in those agreements. One group's rights do not ostensibly dominate the narrative of capitalism. Rather, each stakeholder should be protected within their voluntary agreements. Finally, those individuals can decide to cooperate and *obligate themselves* to others through those voluntary agreements. These obligations can take the form of written or social contracts with assumed responsibilities. The relationships are sustainable when these obligations and responsibilities are upheld.

We offer six principles that together build a framework for our value creation and trade that infuses ethics at the foundations, respects the complexity of human beings, fosters innovation and helps us move beyond the problems outlined above.

1. The principle of stakeholder cooperation

Value can be created, traded and sustained because stakeholders can jointly satisfy their needs and desires by making voluntary agreements with each other that, for the most part, are kept.

A more global stakeholder society calls for capitalism redefined

Stakeholders voluntarily working together are protected in their agreements

Rather than assume that we are all first and foremost self-interested and out to maximise our own benefit, this principle highlights the social nature of value creation. Value, any value, is a social phenomenon. We must create value in a context, with the help of others and with others who value what we create. This principle acknowledges the fact that business activity is explicitly social and uses that to enhance the process of value creation.

**Six principles
build a framework
for value creation**

2. The principle of stakeholder engagement

To successfully create, trade and sustain value, a business must engage its stakeholders. Almost every business transaction involves customers, suppliers, communities, employees and financiers. Other stakeholders such as media, additional civil society representatives, NGOs and others are often affected or can affect value creation.

Rather than argue over whose rights trump whose, this principle acknowledges that a large cast of stakeholders are necessary to sustain value creation. As often as possible, the needs of multiple stakeholders must be met. There may be specific situations in which privileging the rights of one group can benefit others in the long-term, but this is not clear *prima facie* and must be decided by the effected parties.

3. The principle of stakeholder responsibility

Value can be created, traded and sustained because parties in agreement are willing to accept responsibility for the consequences of their actions. When third parties are harmed, they must be compensated, or a new agreement must be negotiated with all of those parties who are affected.

**Business is
a social process
and morality is
at its center**

This principle rejects the view that business is amoral or even immoral. If business is a social process, then morality is at its centre. Scandals and selfish behaviour are a breach of the trust and transparency, both of which are necessary for a business to flourish. Being proactive about repercussions on others, rather than waiting for government recourse, will help managers build stakeholder trust and loyalty which, in turn, will help create more sustainable business.

4. The principle of complexity

Value can be created, traded and sustained because human beings are complex psychological creatures capable of acting according to different values and points of view. Individuals are socially situated and their values are connected to their social context.

This principle rejects the cardboard view of human nature at the heart of the current narratives of capitalism. People are complex; they act for a variety of reasons. Their actions benefit themselves and others, and people usually take that into account. It is also important to note that since humans are complex, we are able to differentiate consequences based on who is being affected. It is part of human nature to care more about the consequences that affect those we are close to, than those that affect others. This also supports the Principle of Stakeholder Responsibility. It helps to balance our natural tendency to discriminate and reminds us that despite our differences and separation, we can still have profound effects on each other.

5. The principle of continuous creation

Business as an institution is a source of value creation. Cooperating with stakeholders, and motivated by values, business-people continuously create new sources of value.

Motivation from collaborative work versus self-interest

Self-interest is not the only source of innovation or progress. Working with others – and for others – can be a stronger motivation to enhance the pace of progress.

6. The principle of emergent competition

Competition emerges from a relatively free society so that stakeholders have options. Competition is an emergent property rather than a necessary assumption to capitalism.

This principle also highlights the ways in which our assumption of competition can affect our behaviour. Not every interaction is a zero-sum game and not every interaction has a win-win solution. We should do our best to look for the win-win before jumping to other sub-optimal solutions.

Rethinking the foundational assumptions of capitalism

Based on these principles, capitalism becomes *the voluntary associations between fair, responsible, cooperating, consenting and complex adults* and does not include competition or self-interest as foundational assumptions.

Finally, these principles and the stakeholder capitalism view do not claim to be a panacea. There will always be a small minority focused on their own self-interest at the expense of others. Our claim is that we should set the bar high for capitalism, at the best we can achieve, and not limit it by only trying to avoid the worst. Talking about capitalism in this way can foster behaviour along these lines. Those that choose to exploit the trust of their stakeholders for their own gain are doing so at their own peril.

We are not claiming that by adopting these principles we will remove conflict from capitalism and that from then on things will be easy. In some ways explicitly dealing with stakeholders is harder than ignoring them. Participants in the value creation process will have to have a thick skin, patience and be comfortable with conflict and change. These things are not easy. But creating value makes them necessary. They provide the opportunity for real leadership.

Conclusion

Those of us involved in business should focus on the best that we can create together, rather than trying to avoid the worst. By critically embracing a new set of assumptions about how value is created, the practice of business will soon follow. We do not have to sacrifice taking great strides forward to solve some of the deeply troubling issues with capitalism. As we move toward a more global stakeholder society, we need to think critically, acknowledge the social nature of value creation and work with persistence to create value for stakeholders. ♦

Portions of this paper originally appear in Freeman, Martin, and Parmar, *Stakeholder Capitalism*, Journal of Business Ethics, Vol. 74, No. 4, 2007. Some of the ideas in this paper appear earlier in Freeman, *Business Ethics at the Millennium*, Business Ethics Quarterly, Vol. 10, No. 1, 2000. Also in: Freeman and Philips, *Stakeholder Theory: A libertarian defense*, Business Ethics Quarterly, Vol. 12, No. 3, 2002; Freeman, Martin, and Parmar, *Ethics and Capitalism*, in: Epstein, and Hanson, (eds.), *The Accountable Corporation*, Vol. 2, Praeger, Westport, 2006. We are grateful to all of the editors and publishers for their permission to recast some of the ideas in these papers here.

Value creation in stakeholder capitalism requires patience and acceptance of change

On Corporate Responsibility for Human Rights

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Abstract

The debate on business and human rights has become a central theme on the international corporate responsibility agenda. Eight out of ten people in an opinion poll conducted in industrial countries and emerging markets assign large companies at least part of the duty to reduce the number of human rights abuses in the world. While this public opinion – at least in the short-run – will not have legal consequences for companies, it is a strong indicator of the perceived legitimacy of corporate activities. This essay illustrates how corporations can change this public perception by developing a clear view on what corporate responsibility of human rights encompasses and what activities reflect this position in particular. It might be helpful to distinguish different generations of human rights before shaping effective ways of external dialogue and internal values management. Finally, this essay focuses on the expectations of corporate deliverables and how to successfully reach them.

“The recognition of the inherent dignity and of the equal and inalienable rights of all members of the human family is the foundation of freedom, justice and peace in the world.”
Preamble Universal Declaration of Human Rights

**Central theme:
business and
human rights**

Since all human beings are born free and equal in dignity and rights, everyone – simply by virtue of being human – is entitled to all the rights and freedoms enshrined in the Universal Declaration of Human Rights. Without a doubt, the state and its institutions bear primary responsibility for ensuring that human rights are respected, protected and fulfilled.

The reference to the state and its institutions, however, does not mean that other actors have no obligations. The preamble to the Universal Declaration of Human Rights states that “every individual and every organ of society shall strive by teaching and education to promote respect for these rights and freedoms and by progressive measures to secure their universal and effective recognition and observance.”

Increasingly, human rights groups draw on this statement as a basis for far-reaching demands on companies – in particular, large ones and MNCs. Such demands are often brought forward with a world-view in which globalisation is the source of all evil and multinational companies MNCs and their managers are generally driven by pure greed for profits and show nothing but contempt for humanity.

The intellectual challenge does not lie in pointing to the selective nature of the generalisations on which these accusations are based. The challenge – both intellectually and politically – lies in working out a meaningful and broadly accepted package of corporate human rights responsibilities and implementing them in the day-to-day business through appropriate management processes.

Different generations of human rights

To cope realistically with the task of assigning human rights obligations to companies, it is important to distinguish between different generations of human rights. Civil rights (such as the protection of life and freedom from bodily harm), non-discrimination as well as legal and political rights form the first generation rights. They are defensive rights that are intended to protect individuals from infringements by the state and typically require few financial resources. The overriding obligation for companies with regard to these rights is to respect and support them in their sphere of influence and make sure that the company is not benefiting from violations of third parties.

Economic, social and cultural rights (such as the right to an appropriate standard of living that guarantees health and well-being) form the second generation rights. These are positive rights that usually require resources (for example, to ensure non-discriminatory access to basic medical care). The state and the international community have a legal duty to promote human development; but other members of society have a moral obligation to support such endeavours as well. Corporate contributions to respect, promote and protect human rights of this generation become reality mainly through doing business with good management principles.

The third generation of human rights encompasses collective rights – such as

**Do human rights
include access to
economic and social
development?**

the right to peace, to economic and social development, to a healthy environment and natural resources, and to a social and international order in which the rights and freedoms proclaimed in the Universal Declaration can be fully realised. This generation of rights remains the most debated but is the one least covered by legal means.

Corporate human rights commitment as value management

For their company to attain the highest possible social and ecological quality in the pursuit of its economic interests, managers have to engage in *value management*, defined as the use of “company-specific instruments designed to define the moral constitution of a team or organisation and its guiding values and to live them in all day-to-day practices.”¹

A value management system embraces all the variables that a company has at its disposal in this respect. This necessitates defining what the company considers to be appropriate in keeping with its values and with regard to human rights. For practical relevance on normative requirements, a distinction should be made among:

- non-negotiable *must norms*: These demand compliance with national laws and regulations in all cases as an ethical minimum;
- *ought-to norms*: These are not stipulated by law but are morally expected of a company competing with integrity (for instance, living up to reasonable social or environmental standards even if local law would allow unfavourable practices); and
- *can norms*: These allow the assumption of additional responsibilities (for example, through philanthropy programmes, pro bono research and other not-for-profit endeavours).

**Must norms,
ought-to norms
and can norms**

According to these distinctions, corporate instructions are formulated on what to do and what not to do (codes of conduct and corporate guidelines) to put the basic value-specific decisions into practice. With numerous methods and instruments – corporate communication programmes, agreements on individual business objectives and performance targets, performance dialogues and appraisals of results, compliance monitoring, ombuds institutions and auditing – the implementation phase encompasses all components of the management processes used in the company for the achievement of financial, technical or other objectives.

By acting in this informed and structured way and by being able to justify the portfolio of corporate responsibility-related activities, a company avoids the pitfalls of making opportunistic concessions to the most vociferous demands and of finding itself at the mercy of variable external interests.

The human rights principles of the UN Global Compact

The UN Global Compact is a voluntary global initiative to support universal environmental and social principles and to integrate these principles into business activities. Participating companies commit themselves to comply in their sphere of influence with two important principles:

**UN Global Compact:
Companies declare
commitment to human
rights**

- to support and respect the protection of international human rights and
- to ensure that they do not become complicit in the human rights abuses of others.

What sounds unproblematic on the surface acquires a certain complexity on closer inspection. Ambiguous terms are used that are given a variety of meanings by society's different stakeholders (such as the *sphere of influence* or *complicity*), resulting in huge scope for interpretation, especially with regard to companies' statutory obligations. A company therefore has to engage in a value management process specific to human rights to decide which of these rights and obligations are relevant and the extent to which it is responsible for them.

The decision-making process on corporate human rights commitment

**Corporate homework:
Fact- and value-based
knowledge**

In the case of issues dealing with human rights, as with all other corporate issues, it is necessary to do *corporate homework* in terms of both fact-based and value-based knowledge. For this purpose, it is useful to enter into dialogue with human rights institutions and to take part in *learning forums* such as those offered by the Global Compact and the Novartis Foundation for Sustainable Development.

It is on the basis of the collective wisdom that exists within a company and in civil society that the internal corporate decision with regard to the nature and scope of human rights obligations accepted by the company ought to be made. A landmark decision of this kind should, for example, be that the company is not only committed to the principle of legality but that it goes beyond this and, through a voluntary commitment to higher standards, ensures that as far as possible it does not profit from any gaps in the law or from *freedom of interpretation*.

Internal and external dialogue

The points of intersection between human rights and corporate responsibilities are regarded as *chaotic and contested*: On the one hand, there are those who regard companies as the *source of all evil*; on the other hand, there are those who have a touching faith in the ability of companies, economic growth and the laws of the market to eventually also solve human rights problems. Yet, reality is more complex than these extreme views. The expectations directed at companies remain highly pluralistic.

Some clues are provided by the self-critical study of materials produced by competent institutions, such as Amnesty International, the Business & Human Rights Resource Centre or the Business Leaders Initiative on Human Rights. Although not all demands put forward in such publications are to be understood as *corporate obligations*, any company who wants to be successful has to be familiar with the most important *opinion markets*.

**Deeper insights through
an informed discussion on
critical questions**

A catalyst function for deeper insights is thus served by management engaged in an informed discussion of critical questions such as:

What are the human rights-related risks of our business operations? If there are any, in what order should we approach them? Are there human rights-related opportunities?

In what areas of activity do those things we consider reasonable differ from what human rights groups demand of companies? Are there any reasons to change our business practices?

Where – and on the basis of what special circumstances (such as market failures or failing states) – do we recognise particular demands for the fulfilment of human rights (such as the offer of life-saving medicines at special prices), and what concrete deliverables result from this?

Which civil society actors do we want to include in our analysis to ensure that the information on which we base our decision is appropriate to the complexity of the issue?

Where do we draw the limits of our responsibility? In other words: How do we define our sphere of influence?

Such questions need to be discussed to allow for informed decisions on the nature, scope and depth of the sustainable corporate contributions. The distinction between *must*, *ought-to* and *can norms* helps to distinguish good management practice from corporate responsibility excellence.

Companies need to decide on the nature, scope and extent of corporate action

All responsibilities in the context of first generation human rights are an integral part of the *must* dimension. As far as these rights are concerned, a company must do all in its power to ensure that there are no violations within its own sphere of influence and that it also does not benefit from human rights abuses by other parties.

As far as second generation human rights are concerned, the normal business operations of a company form the main contribution to the preservation of these rights: It is the social function of companies to produce products and services in a legal way and to sell them on the market. To this end, they purchase goods and services for market prices and hire employees of an adult age who work of their own volition in exchange for pay as defined in binding contracts. In addition, companies pay contributions into the social security system. In this way, they enable their employees to secure their own economic human rights. Through taxes and duty, companies make a financial contribution toward the community. This enables the state to fulfill its tasks.

Activities that go beyond what is legally required fall under the *ought-to* dimension. Most of them are moral obligations but nevertheless constitute good management practice. This includes a remuneration system that ensures that basic needs can be met (a *living wage*), affirmative efforts for greater gender justice, training beyond a person's immediate needs and more.

Delivering corporate responsibility excellence means accepting challenges that are mainly located in the *can* dimension. Companies seeing themselves as good corporate citizens may provide additional services of their own volition. They may, for example, offer products at special conditions such as differential prices of medicines for poverty-related and tropical diseases, finance philanthropic foundations, conduct pro bono research and make donations. With regard to third generation human rights, it is too early to apply the *must*, *ought-to* and *can* grid.

The rational justification of normative maxims of behaviour is an essential step in value management but does not inevitably lead to implementation. For this reason, appropriate management processes and standard operating procedures must be put in place.

Implementation through management processes

Principles of action and behaviour resulting from value-based management decisions, as well as corporate guidelines for dealing with human rights, have to be formulated and communicated. The first important steps are personal model behaviour and visible

Principles of action and corporate guidelines have to be formulated and communicated

commitment at the management level, as well as a launch campaign addressing imperative and prohibited modes of behaviour.

Further management steps are the appointment of someone at top management level with responsibility for human rights issues, the development of measurable benchmarks and the setting of concrete, bonus-relevant goals. Finally, compliance with self-declared commitments must be monitored in a manner similar to the way in which compliance with legal requirements is checked.

When designing appropriate management processes and standard operating procedures, it is important not to mistake corporate human rights engagement as a *project*. It is more of an open-ended process that may provoke changes in basic corporate practices. However, not all challenges can be satisfactorily met by means of *standard operating procedures*. Sensitivity and keen intuition are needed to recognise ambivalent situations and to assess them in the light of the existing guidelines.

It will be one of the great tasks of value management in the future to adopt a credible approach in finding the right balance between the extremes of a basic refusal to accede to public demands and a general acceptance of obligations attributed by pressure groups. Both *fundamentalisms* would lead to competitive disadvantages that would be detrimental to business as well as society.

Finding the right balance between basic refusal and general acceptance of obligations will be important

Emerging core concepts and remaining problems

As outlined above, remarkable steps have been taken to clarify concepts that help companies deal with practical issues that arise in the context of a corporate human rights commitment. But dealing with the issues debated here requires a commitment to a political and ongoing process. Three of the most important recurring questions are discussed here briefly: What is a fair definition of a company's *sphere of influence*? How should a company competing with integrity define *complicity*? And what corporate deliverables can be reasonably expected in the context of the economic, social and cultural human rights?

What is a company's sphere of influence?

Where exactly a company's *sphere of influence* begins and where it ends remains a subject of controversy. Does it refer *only* to the areas behind the factory fence, where a company is fully able to apply its rules and regulations? Do business partners and suppliers also fall within the sphere? And what about the communities in which the company operates or from which it recruits its employees? Mapping the sphere of influence is a crucial prerequisite to determine where companies can exert direct influence to advance the fulfilment of economic, social and cultural human rights.

As a rough guide, political, contractual, economic or geographic proximity to human rights abuses is an important criterion for determining the sphere of influence. The International Commission of Jurists recommends that companies "look for the warning signs. The closer you are to victims, the more you have a responsibility to watch out for the impact of your actions."

Ultimately such questions have to be answered by the company itself. There is an emerging consensus view that the sphere of influence extends beyond the factory site. Direct corporate responsibility is seen as gradually declining outward from employees to suppliers, contractors, distributors and others in their value chain, including

Decision to include third parties in its own area of responsibility should be a feasible one

communities but not necessarily government and the wider society.

Such a definition might be criticised as too restrictive, but a company has to be able to live with such dissent. Not all stakeholder demands constitute a moral corporate obligation. A company's decision to include immediate *third parties* in its own area of responsibility should be a feasible one to take because no respectable company today can hide behind a supplier with low standards. Companies of integrity will, in their own interest, seek and provide transparency and exert direct influence wherever they can.

What is complicity?

What kind of proximity to abuses by the state, by terrorists, by individuals or by other companies would justify the negative judgment of being complicit in human rights violations? Again, the basic set of corporate values will determine the kind of definition used by a company. The UN High Commission for Human Rights points out that a company is guilty of complicity if it “authorises, tolerates or knowingly ignores human rights abuses committed by an entity associated with it, or if the company knowingly provides practical assistance or encouragement that has a substantial effect on the perpetration of human rights abuse.”

The Global Compact adds that “the company's assistance or encouragement has to be to a degree that, without such participation, the abuse most probably would not have occurred to the same extent or in the same way.”

The judgment that is ultimately passed regarding the legitimacy of corporate acts committed or omitted in this respect is reached less in courtrooms than in the domain of public opinion. Corporations are better off if they put managers in charge of the complicity issue that approach their job in a holistic rather than legalistic way, using both due diligence and intuition to identify risks and eliminate them.

What corporate activities can be expected to address human rights issues?

Companies mainly contribute to the fulfilment of second generation human rights in the course of their usual business activities. But in some cases, the expectations of society go far beyond what managers regard as business duty. A survey carried out in Germany shows that a large majority of people expect pharmaceutical companies to distribute medicines free of charge or at massively reduced prices if patients cannot afford them.² An UN Report mentions that major pharmaceutical companies are “widely perceived to abuse their power.”

Most managers of pharmaceutical companies would be astonished to hear that patent rights are equated with abused power. They would probably quote the Universal Declaration of Human Rights, which states that “everybody has the right to own property” and “no one shall be arbitrarily deprived of his property.” Some of them would also put forward the argument that governments are the primary bearers of responsibility. And yet, even business schools debate answers to such questions as whether there is a *morally-right price* for drugs in the developing world.

Issues like this necessitate a differentiation between what is a *legal* entitlement and what is perceived to be a legitimate handling of an extraordinary social catastrophe. In view of persistent mass poverty, and as a reaction to evident shortcomings of the primary bearers of responsibility, many concerned people turn to the private sector for help. The right way for companies to cope with the fact that the expectations of

Companies can become guilty of complicity with regard to human rights

Growing societal expectations are a significant challenge for corporate management

society are growing on a scale that is incompatible with a reasonable definition of a fair societal distribution of responsibility poses a significant challenge to be met by corporate management.

The only possibility for establishing a credible corporate standpoint on this issue is through informed decisions based on the *homework* and dialogue with stakeholders. The uncompromising rejection or opportunistic acceptance of demands is always a worse solution than the self-confident, positive and constructive presentation of the scale and limits of human rights engagements that corporate management sees as reasonable.

The business case for corporate human rights engagement

Companies that have made exemplary commitments to human rights are often tossed into the same basket with those exhibiting the worst kind of aberrant behaviour. A more balanced appraisal by civil society actors would confer moral reputation capital upon a company and thus reward additional efforts. Through this, the discretionary freedom of management could be guided into the acceptance of doing more. In the best of all cases, a new level of corporate competition could be established.

Enlightened companies will take a *rights-aware* approach – that is, be willing to accept that their stakeholders have universally accepted human rights and take appropriate action to respect these. There are a number of good reasons for assuming this corporate responsibility:

- Companies that critically reflect on the quality of standards relating to human rights, engage in stakeholder dialogue and are prepared to be measured by criteria of legitimacy and not just of legality, reduce legal and financial risks, and damage to their reputation. Any increased costs that result from their commitment must be seen as an *insurance premium* against such risks becoming reality.
- Companies that take a proactive approach tend to be seen as *part of the solution* rather than as *part of the problem*. This provides a company with a *social licence to operate* and safeguards it from boycott calls or *shameful* campaigns.
- Companies with a reputation for integrity tend to have better motivated employees because they look at their company with pride and identify themselves with its objectives; this kind of company is also more attractive to highly qualified, talented individuals.
- Companies whose performance is regarded as exemplary in terms of human rights tend to be preferred by ethical investment funds and socially-conscious customers. This ethical distinction can lead to advantages in the valuation of the company and in the competitive environment.
- Finally, the acceptance of responsibility that is credible by virtue of the fact that it is verifiable is the best argument against political demands for additional regulation.

Enlightened companies
will take a rights-aware
approach

Corporate human rights engagement: The next generation

Through compliance with laws and regulations, through good management principles and through their implementation, companies help to advance human rights in their sphere of influence. Good companies respect the Universal Declaration of Human Rights and thus acknowledge that “recognition of the inherent dignity and of the equal and unalienable rights of all members of the human family is the foundation of freedom, justice and peace in the world.”

Companies can advance human rights in their sphere of influence

It is only on this foundation that human rights of the third generation – such as the right to sustainable economic and social development – can be achieved. Essential questions such as who exactly is entitled, who is under obligation and on the basis of what criteria and to what extent remain a matter of debate. For the time being, third generation human rights are treated by companies as aspirations, albeit aspirations whose fulfilment is in the interest both of the international community and of the companies themselves.

Alleviating poverty clearly counts among these aspirations. No social phenomenon is as comprehensive in its assault on human rights as poverty. The private sector contributes to poverty alleviation by contributing to economic growth, and by creating jobs and income. Thus, encouraging corporate activities and unleashing entrepreneurship is critical. As UN Secretary General Annan expressed it: “Wherever we lift one soul from a life of poverty, we are defending human rights.”

Sustainable responses to poverty alleviation involve securing and enlarging freedom, increasing choices and enabling empowerment. The promotion of human development and the fulfilment of human rights share, in many ways, a common motivation and reflect a fundamental commitment to promoting the freedom, well-being and dignity of individuals in all societies. Good companies are part of the solution of fulfilling these aspirations. ♦

Companies can help promote the dignity of individuals

Notes

¹ Wieland (ed.), *Handbuch Wertemanagement*, Murmann, Hamburg, 2004.

² See Lunau & Wettstein, *Die Soziale Verantwortung der Wirtschaft: Was Bürger von Unternehmen erwarten*, Haupt, Bern, 2004.

Fighting Corruption in the Global Economy

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Abstract

Corruption is everywhere. It permeates politics, business and private life throughout rich and poor countries. The scourge of corruption is a barrier to positive change. It deflects the flow of funds to worthwhile housing, health and educational projects. Its devastating effect is increasingly recognised and civil society is reacting by forming powerful tools, frameworks and coalitions.

In this essay, I will discuss the impact of corruption and factors that have led to its growth. After a brief introduction of some definitions, I will lay out the principles of corporate governance, an anti-corruption convention, a set of business principles and the legal framework for corporations to act responsibly. I will then examine how the active participation of civil society organisations such as Transparency International in global governance is essential to battling corruption.

Introduction

The beginning of the 21st century was marked by the largest gathering of world leaders at the United Nations in New York who expressed a global determination to address the enormous challenges faced by humanity. The message that the leaders sent out to the entire world was a message of hope. Extreme poverty, disease and environmental degradation, the message ran, could be alleviated with wealth, new technologies and global awareness with which we entered the new millennium. Similar hope was expressed for other burning problems of global governance, such as the violation of human rights and the breach of basic labour standards, all of which are inextricably linked and are the main elements of sustainable development.

**Corruption
as a hindrance
to development**

Corruption is a major hindrance to sustainable development. It has a devastating effect on the developing world, but it is corrosive to the societies of wealthier countries as well. Corruption diverts resources to improper uses and compromises the quality of economic policies and decision-making for development. This is particularly true in countries rich in oil and gas, but also in those blessed with other natural resources. The term *resource curse* is often used in connection with such countries to connote the mismanagement and corruption involved with exploiting of resources. The responsibility for this *curse* lies with all sides: the host countries, the extractive industry companies and their home countries.

Transparency International is an example of an organisation effectively fighting corruption. Since it started work in 1993, it has been a dramatic and sometimes painful struggle toward the present consensus that corruption is perhaps the most important impediment to economic and social development, to peace and security and to a globalisation that is beneficial to all people.

The impact of corruption

I use the term *corruption* in a broad, non-legalistic way, covering the *abuse of entrusted power for private gain*. Misbehaviour such as theft, fraud, organised crime, drug trafficking and money laundering are not included in this definition, even though they are the so-called *ugly sisters* of corruption. In the public sector, the term covers the misuse of public power for private gain; outside the public sector it encompasses private-to-private corruption and other forms of abuse that have severe political, economic and social costs. Left unchecked, corruption undermines compliance with environmental and employment regulations, distorts competitive markets and leads to a wasteful misallocation of resources. The most damaging effects of corruption are felt by victims in the developing world, ordinary people who lack the political or economic leverage to bring about change.

**Most victims of corruption
live in the developing
world**

In the private sector there are many reasons for why it is in a company's interest to ensure that it does not engage in corrupt practices. Corruption impedes economic growth, distorts competition and entails serious legal and reputational risks.

Why does corruption exist?

The main reasons are greed and selfishness. Weaknesses in the system of values, institutions and rules in society invite corrupt practices. The question why corruption has flourished in the globalised economy is particularly important to address. Globalisation has reduced the reach and influence of state governments and concomitantly made them more vulnerable to events happening far outside their

traditional sphere of influence. Inversely, it has unleashed business from national regulation. Rapid globalisation has not only opened up new frontiers, it has allowed global corporations to establish their own ground rules and has made it easier to avoid governmental oversight.

Furthermore, privatisation and deregulation mean that companies take over activities that once used to be public. Some corporations exploit the new opportunities to conceal proceeds from overseas operations for money laundering, manipulating the international financial system, rigging stock exchanges across international borders and reaping profits from conflicts in regions rich with minerals and other natural resources. Often, the result is a failure of governance to respond to the legitimate needs of the people.

Major responsibility must be borne by industrialised countries and their multinational corporations, who for too long were unwilling to confront the emergence and spread of corruption. The political and business elites of rich countries were convinced that bribery by their citizens and enterprises outside their borders was necessary for successful business; hence, until 1999 it was permissible under many official legal systems to deduct expenditures relating to corruption from taxable income.

Corporate Social Responsibility

CSR is generally seen as businesses' contribution to sustainable development. CSR is defined by the World Commission on Environment and Development WCED, under its chairwoman Gro Harlem Brundtland, as "development that meets the needs of the present without compromising the ability of future generations to meet their own needs."

It is generally understood as focusing on how to achieve the integration of economic, environmental and social imperatives. As people become more aware of the importance and impact of corporate decisions upon society and the environment, corporations increasingly come under pressure to involve all stakeholders in their decision-making and to address societal changes.

An example of such a successful multi-stakeholder initiative is the Extractive Industries Transparency Initiative EITI which engages governments, businesses, NGOs and civil society organisations in their efforts to increase transparency and accountability in the natural resources sector.

Corporate governance: OECD principles

Good corporate governance is of crucial importance to countering corruption in both developed and developing countries. In 2004, the OECD set up its *Principles of Corporate Governance*: "Corporate Governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined."

Where levels of corruption in the public sector are high, it is not the most competitive companies that succeed but, rather, those that can afford to sway the market and regulatory system in their favour. Without fair competition, international investors prefer to direct their investments elsewhere or demand higher returns to

Globalisation made governments vulnerable to corruption

Integrating economic, environmental and social imperatives

**Corporate governance
increases trust and
improves competition**

mitigate the increased risk of doing business. Higher national standards of corporate governance can significantly increase trust among international investors and lenders, thus improving the international competitiveness of national economies. Good corporate governance at home and abroad can also help improve conditions for small or local companies in developing countries who cannot afford to compete with foreign businesses that choose to engage in unethical practices.

Corporate governance covers many areas, including ground rules governing the relationship between investors and creditors on one side, and managers on the other. They ensure, for instance, the disclosure of core financial and business information to shareholders and, often indirectly, to the public. Such transparency provides fair and responsible competition. The OECD's Principles of Corporate Governance illustrate the current consensus on good practices. Transparency International will continue to encourage the OECD principles with its work on issues of transparency, especially by identifying the best practices and by further developing general principles for market-driven cross border investment of both private and state-owned enterprises.

Civil society and CSR: Business principles for countering bribery

Battling against corruption is the priority for Transparency International and other CSR practitioners. Since its inception in 1993, Transparency International has been actively involved in the monitoring and formulation process of anti-bribery conventions. The Business Principles for Countering Bribery, for example, were developed by Transparency International in conjunction with Social Accountability International.

The two groups provide a practical framework for implementing a "no-bribes" policy to deal with the many challenges businesses face domestically and abroad. The policy has become recognised as the standard for industry since its inception in 2002. An increasing number of companies worldwide are using these principles to develop or to benchmark their own policies. Over the coming years, the legitimacy and credibility of such codes will be severely tested. Companies must be aware that the adoption of no-bribes policies is crucial for achieving effective risk and reputation management.

The OECD anti-corruption convention

Historically, a major obstacle for international companies to stop bribing was the fear that unilateral attempts to adopt a higher level of CSR than their competitors would lead to a competitive disadvantage. The challenge was to introduce anti-bribery rules for all competitors simultaneously. This was achieved by the OECD with the support of civil society, particularly Transparency International. An OECD Anti-Bribery Convention was developed in 1997 under the OECD forum and entered into force in February 1999 to convince businesses to support the convention. Transparency International offered a solution to the *prisoner's dilemma*. Many companies did not want to bribe but felt obliged to, in order to keep up with their competitors. Transparency International arranged no-bribes integrity pacts to be signed by all competitors in markets where all competitors were known. This vision was welcomed by many large companies and played an important role in securing their support for the convention, which, in turn, was the key for its subsequent ratification.

**Simultaneously
introducing anti-bribery
rules for everyone**

Conclusion and outlook

Good governance is an essential precondition to any sustainable action against poverty, both for the domestic development of poor countries and for investment and development assistance from wealthier ones. Civil society is crucial to promoting good governance at every step of the development chain – from assessing the need for development assistance to monitoring its implementation and evaluating its effectiveness. In many different contexts, effective policy formulation and implementation has to involve diverse stakeholders and complex engagements across national and sectoral boundaries, since solutions – at local, national, and global levels – depend on information, perspectives and resources beyond those available to any one sector or agency alone.

The biggest challenge for civil society will be to improve the lives of the most vulnerable and to create a level playing field for national and international actors who want to work with integrity. The private sector has increasingly demonstrated its willingness to engage civil society, evidenced by the rapid growth of the CSR movement, including the adoption of social reporting. The fight against corruption is a challenge not only for states but for all actors in the international community. ♦

**Good governance
as precondition
to combat poverty**

CSR and the Development Agenda: The role of small and medium enterprises

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Abstract

Increasing attention is being given to CSR. But the CSR movement will only be sustainable if a critical mass of SMEs buys into the concept. This essay briefly refers to the central importance of SMEs as great contributors to the economy and employment, offers insight into the economic and social cohesion powers of SMEs in the developing world, and suggests the need for intermediaries to help bridge the gap between producers of the developing world and trans-national companies TNCs. While producers are confronted with quality demands as well as productivity and CSR requirements, which do not yet apply to their markets, TNCs tend to have insufficient information about the existence and capabilities of potential business partners and their technical needs.

The rise of CSR

Throughout the past decade, increasing attention has been given to the concept of CSR as a postulate for the ethical behaviour of business and as a basis for good corporate citizenship. Amidst shocking evidence of large-scale corporate irresponsibility and fraud, there is insistence that business can and should act in a manner that respects the legitimate goals and demands of all stakeholders. A wide array of initiatives abound in terms of public-private partnerships, both at the country level and within the UN system. These include cross-border corporate coalitions; global conferences, studies and workshops; social standards, labels and related monitoring mechanisms; fair trade groups and socially responsible investment funds.¹

Increasing attention is being given to the concept of CSR

While the social dimension has been an inherent feature of the European post-war market economies, we are now witnessing attempts to anchor responsible business practices in the corporate world itself to voluntary actions and direct contributions to social and environmental public policy objectives. The European Commission, for instance, sees CSR as part of the contribution of businesses to sustainable development and to the European Growth and Jobs Strategy, and believe that CSR has the potential to contribute to various common goals, such as social cohesion, economic competitiveness and a more rational use of natural resources.²

However, at the margin of this substantial attention to CSR, it was also observed that the rapidly accelerating globalization process has gradually disconnected fast-moving international networks of production and finance from a lagging system of global policies and institutions. In a closely connected development, as pointed out by Harvard economist Dani Rodrik as early as 2001, “international economic integration is taking place against the background of receding governments and diminished social obligations.”³ Does this imply that we are witnessing the emergence of increasingly hybrid governance structures in which social needs are no longer the exclusive realm of the state?

CSR and SMEs

Over the years, CSR has been defined in many different ways. Generally, it refers to companies integrating “social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis [...] not only fulfilling legal expectations, but also going beyond compliance.”⁴ Importantly, this definition links CSR practice intrinsically to *business operations* thus excluding corporate philanthropy and connecting CSR with the core of a company’s operations. This emphasis on economic benefits derived from environmental and social considerations is generally referred to as the *CSR business case*.

The business case for CSR can be traced to various different motives

This business case for CSR can be traced to a number of different motives and mechanisms. These range from defensive attempts at avoiding financial losses and protecting image and reputation, to a pro-active, cost-benefit-calculus that factors in financial gains from productivity improvements (e.g., resulting from enlightened human resource management or from higher energy or material efficiency). In the ultimate scenario, CSR forms the core of a company’s corporate strategy and becomes the basis for brand equity and the driver of organizational learning, innovation and technology management.⁵

Given the central importance of SMEs as the greatest contributors to the economy and employment in most countries, UNIDO has long advocated a wider application

of CSR practice in SMEs.⁶ Also, the European Commission stated in its 2006 communication that “the collective impact of CSR as practiced by SMEs is critical if the potential of CSR to contribute to growth and jobs and sustainable development [...] is to be fully harnessed [and that] a specific approach is needed to foster CSR amongst SMEs.”⁷

Wider application of CSR practice in SMEs is of central importance

Importance of SMEs in national economies

Indeed, in economic and industrial development, a critically important role is played by micro-, small- and medium-sized enterprises which, on average, make up over 90 percent of enterprises and account for 50 to 60 percent of employment – especially in the developing world. While important at all levels of development, empirical studies have clearly shown that at the lower income levels typical in developing countries, the prevalence of SMEs is particularly pronounced. Also, as average income increases, the size distribution of firms typically moves upwards, with the share of micro-enterprises going down and that of more sophisticated medium enterprises rising.⁸

While not entirely without some controversial areas, there is widespread consensus that SMEs tend to employ more labour-intensive production processes than large enterprises (partly because of the industrial sub-sectors and product groups covered by them) and thus contribute significantly to the provision of productive employment opportunities, the generation of income and, ultimately, the reduction of poverty. There is also ample empirical evidence that countries with a high share of small industrial enterprises have succeeded in making the income distribution more equitable.

SMEs are essential for income generation due to their labour intensive production processes

Furthermore, SMEs often produce goods in niche markets in a highly flexible and customized manner, and are a seedbed for entrepreneurship, innovation and risk-taking. As such, they are key to the transition from agriculture-led to industrial economies as they provide opportunities for value-adding processing activities. This can generate sustainable livelihoods, provide the foundation for long-term growth and the transition towards larger enterprises, and contribute to the creation of resilient economic systems in which small and large firms are widely interlinked. With TNCs seeking reliable domestic partners for their supply chains, such linkages are of particular importance in the growing global competition for foreign investment.

The development contributions of SMEs can thus be found at the intersection of economic and social dimensions: SMEs foster *economic cohesion* by linking up with – and supporting – larger enterprises, by serving niche markets and, in general, by contributing to the build-up of systemic productive capacities. At the same time, SMEs foster *social cohesion* by reducing development gaps and disparities, thus spreading the gains of economic growth to broader population segments and deprived regions.

Business linkages and CSR

When reviewing the landscape of SMEs in developing countries, there are at least three types of roles they play in the different business environments in which they operate: (i) as subcontractors in international value chains, usually as suppliers to TNCs; (ii) as independent international players; and (iii) as domestic entities, often in national value chains. In particular, the first group epitomizes the general significance of business linkages between TNCs and SMEs and the role that global value chains play in providing access to export markets for SMEs. Specifically with regard to CSR

practices, such business linkages assume great importance with TNCs sourcing parts, components and services from domestic SME suppliers, thus enhancing the local content of production within global value chains.

At least three different types of SMEs in developing countries

In reality, however, the development of business linkages between TNCs and SMEs is impeded by market failures in the supply of information, skills and infrastructure.⁹ While producers in developing countries are often quite abruptly faced with quality, productivity and CSR requirements that do not yet apply to their domestic markets, TNCs tend to have insufficient information about the existence and capabilities of potential business partners and their technical needs. The effect of this information gap is even more evident when looking at second and third tier small suppliers that negatively affect the performance of the entire supply chain due to inadequate technical support, including technical infrastructure for compliance (e.g., testing laboratories). In addition, an effective investment into enterprise upgrading is often restrained through policy incentives that are biased against SMEs and intricate barriers to suitable financial instruments and, thus, access to capital.

Hence, there is a case for an intermediary to intervene and complement market mechanisms in creating sustainable business linkages and inserting CSR further into the mainstream. In response to this need, many governments, SME support institutions and also some TNCs themselves, have initiated programmes aimed at enhancing the capabilities and performance of SMEs as partners for local sourcing. While such programmes often tend to focus on company-level measures of quality upgrading and productivity enhancement, there are further initiatives that adopt a broader developmental perspective and explicitly take on board principles of CSR.

The necessity for an intermediary to bridge the gap between TNCs and SMEs is given

One such example is UNIDO's Business Partnership Programme¹⁰ that works with TNCs, business organizations, research institutions and NGOs to help SMEs in developing countries meet the rising demands of quality, productivity and social responsibility. While only a limited number of projects have so far been implemented, tangible results have been achieved in terms of SME performance improvements and improved business linkages. The rationale of this programme has been to move beyond the partial support that individual TNCs may provide to their preferred suppliers, and initiate an upgrading process at the level of entire industrial sub-sectors – leading to better quality, higher productivity, environmentally sound production and improved working conditions.

One of the lessons learnt is that the demonstration of business benefits from a partnership approach widens the horizon of SME managers and makes them responsive to a broader CSR agenda. In essence, a commitment to improving the impact of business on workers and the environment is a result of instilling a longer-term perspective and of developing a clear CSR business case. Thus, while a CSR agenda was clearly not the initial trigger of SME participation in the partnership programme, many SMEs now see clear merits in positioning themselves as responsible companies.

Responsible competitiveness: Macro-level evidence?

This practical example brings us closer to the question (on top of casuistic micro-evidence at the firm level) whether there is a *macro-case* in favour of socially responsible development strategies. In other words: Assuming that a critical mass of companies act in a socially and environmentally responsible manner and that economic governance structures and incentives are designed to encourage such a strategy, would the result

be enhanced overall competitiveness? This is the question addressed in research on *Responsible Competitiveness* undertaken since 2003 by the Copenhagen Centre and AccountAbility. Although it is too early for clear-cut long-term conclusions on cause-effect relations between national wealth and social and environmental considerations on national level, latest findings show “a close correlation between countries’ responsible competitiveness and their economic strengths.”¹¹

The question remains, however, whether this positive correlation is a result of responsible business action or of stringent industrial policy and social and environmental legislation in industrialized countries. Nevertheless, these preliminary findings can complement empirical firm-level evidence with macro data and push the CSR agenda to a new level of aggregation, providing a basis for further investigation and research.

Conclusions and Outlook

It can be claimed, not without a certain dose of irony, that the economic dimension remains the least explored aspect of CSR, compared to the environmental and social dimensions. The way in which large TNCs interact with their SME suppliers is, in itself, key to CSR strategies and results. The build-up of stable, long-term and trust-based relationships contributes to nurturing local entrepreneurship and employment and can be among the most powerful social contributions large enterprises can make. Therefore, enlightened strategies of supply chain management should be considered part of the CSR agenda.

Responsible enterprises are those moving from mere compliance mode to engagement mode, from harm minimization to value creation. SMEs, particularly those in developing countries and those active in manufacturing for export markets, need adequate tools to monitor, report and continuously improve their own CSR performance. Responding to this need, UNIDO has recently launched the Responsible Entrepreneurs Achievement Programme REAP, a CSR-based management and reporting tool, which assists SMEs in grasping CSR-based management approaches in accordance with the forthcoming ISO 26000 Guidance on Social Responsibility.

It is clear that the currently observed results of the CSR movement will only be sustainable if a critical mass of SMEs buys into the CSR concept – if they can reap economic benefits from CSR practice also in the short-term. There is, therefore, a need for up-scaling individual CSR initiatives taken at the level of companies. This, in turn, calls for: (i) a stronger involvement of business organizations in CSR advocacy and awareness raising, and in providing CSR implementation support to their SME members; and (ii) deliberate public action seeking to reshape markets and strengthen drivers for the adoption of CSR practices both in production and consumption. As SMEs are one of the primary beneficiaries of transparent rules and the absence of corruption, good public governance should also be regarded as an essential factor in mainstreaming CSR.

In developing countries, the debate on CSR is subject to two major suspicions: Environmental standards are often seen as restraining growth while social standards are regarded as constraining trade. Both are sometimes conceived as attempts to deny developing countries access to a fast growth track. Furthermore, there is a critique claiming that CSR is based on a misunderstood market paradigm seeking to confer social functions upon profit-driven companies. At the same time, there is also a critique

Link between responsible competitiveness and economic strength of a country assumed

In developing countries the CSR concept is subject to two major suspicions

**Increasing evidence
that being a responsible
producer has lasting
economic benefits**

alleging that CSR is based on voluntarism and, ultimately, is seen as an initiative that weakens the regulatory power of the state.

The jury is still out on the future direction of CSR strategies and the final verdict will partly depend on the forthcoming ISO 26000 guidance. However, there is increasing evidence that being a responsible producer has lasting economic benefits in many highly competitive markets. This has created increasingly powerful incentives for sound CSR practice. At a time when globalization exposes industrialized countries to low-wage competition from developing countries, the developing world faces the challenges of rising environmental and social standards to exporting companies, including SMEs. Can these challenges and threats be turned into opportunities and strengths – by using CSR strategies as a source of a company’s competitive advantage? ♦

Notes

- ¹ See Nelson, *Building Linkages for Competitive and Responsible Entrepreneurship*, UNIDO and Kennedy School of Government, Harvard University, 2007.
- ² See *Implementing the Partnership for Growth and Jobs: Making Europe a pole of excellence on corporate social responsibility*, COM (2006) 136, European Commission, Brussels, March 2006.
- ³ Rodrik, *Survey on Globalization: Is government disappearing?*, The Economist, September 29, 2001.
- ⁴ See *Promoting a European Framework for Corporate Social Responsibility. Green Paper*, COM (2001) 366, European Commission, Brussels, July 2001.
- ⁵ See *Corporate Social Responsibility: Implications for small and medium enterprises in developing countries*, UNIDO, Vienna, October 2002.
- ⁶ See *Corporate Social Responsibility. Implications for small and medium enterprises in developing countries*.
- ⁷ *Implementing the Partnership for Growth and Jobs: Making Europe a pole of excellence on corporate social responsibility*.
- ⁸ See Snodgrass & Biggs, *Industrialization and the Small Firm: Patterns and policies*, International Centre for Economic Growth and Harvard Institute for International Development, 1996.
- ⁹ See Stanton & Polatajko, *Business Linkages: Their value and donor approaches towards them*, UK Department for International Development, London, 2001.
- ¹⁰ See *Business Partnerships for Industrial Development*, Unido, Vienna, 2002.
- ¹¹ *The State of Responsible Competitiveness 2007: Making sustainable development count in global markets*, AccountAbility, 2007.



Chapter 2

Customers and Development

Product Innovation for Low-Income Markets: Beyond making cheap goods

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Abstract

Low-income communities with annual per capita income of less than USD 1,500 account for about two-thirds of the world population. Despite the vast size of this low-income market, often referred to as the bottom of the pyramid BOP, there are not many products and services specifically made to satisfy the particular needs of low-income communities. Recently, however, some corporations have come to realise the untapped potential of this market so that both companies and communities can potentially benefit. Corporations can sustain their long-term success while fulfilling part of their corporate social responsibility by satisfying the underserved needs of low-income communities. By emphasising the importance of specific value proposition and the focus on functionality, this article describes some key factors in innovation and product development for low-income markets.

Introduction

In a global marketplace which is subject to increasing market pressures, new product strategies are often driven by the imperatives of innovation and of meeting unsatisfied needs. The success or failure of an enterprise ultimately depends on its ability to do this well. Teamwork is needed for an effective integration of engineering and management for the successful launch of breakthrough products. Recently, a new dimension has been added by the emerging necessity to look at the hitherto untapped market potential of low-income markets. Corporate leaders are talking about CSR and greater empowerment of the underserved masses.

BOP is a socio-economic designation for the estimated four billion people who live primarily in developing countries and whose annual per capita income is below USD 1,500 (in purchasing power parity). The term is used in particular by those who are developing new models for business that deliberately target that market.

For decades, the majority of the corporations marketing in developing countries have focused on the affluent minority – those who tend to live in urban areas and have shopping habits and product needs that are similar to advanced markets. But by focusing only on the upper-income urbanites, marketers are missing a vast opportunity at the bottom of the economic pyramid.

Some might doubt whether the poor – whose available income is less than USD 4 per day – are a viable market for new products and services. But to remove any doubt we should consider that about four billion people fit into this low-income profile. Product innovation and new ways of thinking make it possible to meet these people's needs ethically, fairly and profitably.

Many successful companies acknowledge that addressing global problems such as poverty and trade imbalances through a CSR programme is an investment opportunity. Fewer corporations have realised that their long-term success may depend on their response to these problems.

In order to thrive in global competition today, corporations should broaden their range of prospective consumers. Playing a more active role in narrowing the gap between rich and poor will ensure their long-term success. This cannot be achieved if companies offer only products for higher-income consumers. Success will depend on their ability to “nurture local markets and cultures, leverage local solutions, and generate wealth at the lowest levels of the pyramid. [...] To do this [multinational companies] must combine their advanced technology with deep local insight. [...] New business models must not disrupt local cultures and lifestyles. An effective combination of local and global knowledge is needed, not a Western system.”¹

Seeing BOP challenges as innovation opportunities

Low-income markets challenge corporate business strategies that are based on mainstream markets in developed countries. Some infrastructures and services that are taken for granted when serving an advanced market are not available in BOP markets. Limitations such as fluctuating electricity or blackouts, inadequate transportation services on the supply side and lack of literacy, skill and credit on the demand side make the conditions in BOP markets hardly comparable to those of advanced markets. For such reasons, some factors which are considered attractive when producing goods for advanced markets will not be valued by BOP customers. Take ordinary household appliances: Adding digital controllers increases their operational sensitivity and makes

**Targeting BOP markets
in the developing world
opens new opportunities**

**Businesses broadening
consumer range and
nurturing local markets**

items more attractive for the Western consumer, but usually such controllers tend to break down sooner in tough conditions that dominate BOP markets. Manual controllers, which are more reliable and easier to use, are more appreciated by BOP consumers.

One might see the different characteristics of BOP markets as a negative restriction for product development. But the history of innovation shows that some limitations of the past led to many inventions of today. Some bold changes in production and marketing that are required for addressing BOP markets can bring solutions for corporations to change the rules of the game in other markets by offering what is called *Disruptive Innovation*. As management experts Hart and Christensen point out, there can be a match between this type of innovation and the opportunities in BOP markets.²

History shows that restrictions of the past led to many inventions

Addressing low-income markets

Serving BOP markets is not the same as serving existing markets better or more efficiently. In BOP markets businesses need to develop an infrastructure that is adapted to the needs and challenges of the low-income communities. The challenge is that a firm does not possess all the required means to build such a tailored infrastructure. Multiple players must be involved, including local governmental authorities, NGOs, communities, financial institutions and other actors.

In addition, businesses that want to serve the BOP market must look beyond just marketing and selling products; they must find innovative ways to create social and economic value through their product offering. Creating such value requires understanding what constitutes value in the BOP, what the specific needs are and how those needs can be satisfied in the form of appropriate products and services.

Most studies on business and management are based on conditions in Western markets. Just a handful of studies have focused their attention on the specifics of low-income markets. Despite this limited knowledge, some corporations have tried to tap this market. One can learn from their success stories. In his groundbreaking book, *Fortune at the Bottom of the Pyramid*, C.K. Prahalad has established a set of principles for addressing BOP markets.³ In the next section we utilise such a BOP philosophy to describe certain principles in product innovation for the poor.

Product innovation for the poor: How?

Product development for BOP markets requires specific innovation principles that take into account the realities of low-income communities. They might challenge the assumptions of managers that have been primarily involved with innovation for advanced markets. But as mentioned earlier, addressing BOP markets can offer a firm growth, provide relief for underserved communities and create an opportunity for introducing innovations to other markets.

The required adjustments for a BOP product might seem taxing. However, not every product requires multiple changes. Moreover, once a company overcomes the mental barriers about low-income markets and begins pro-poor innovations, the process will be easier to handle.

Important for companies to overcome mental barriers about low-income markets

Increasing the perceived value

Because of their limited budget, the poor pay special attention to the choices they make for purchasing a required good. The problem is that often they do not have a variety to choose from. Their choices are limited to the often low-quality or cheaper

A BOP product needs to bring specific economic and social value

versions of products and technologies from the advanced markets.

Considering the specific context of low-income markets, a BOP product needs to bring economic and social value in order to be accepted. The goal is not to sell cheap products to poor communities; this is already being done. Instead, an offer that provides a better value for money will be more widely accepted among these communities. BOP consumers are not wealthy enough to buy low-quality, non-durable goods.

However, what is perceived valuable in an advanced market might not always be appreciated in a BOP context. A microwave oven for instance might be a valuable product for a busy urban customer but a BOP consumer does not find it valuable given his or her different levels of need, skills and accessible infrastructure. Therefore, businesses should understand the value perception mechanism of BOP consumers and justify their offering to that context. This can be achieved in two ways: providing a high level of price-performance and improving functionality.

Providing a high level of price-performance, or increasing a product's monetary value, to a consumer population that exists on less than USD 4 a day requires a dramatic upgrade well beyond the usual 5 to 10 percent which takes place in advanced markets. The margin per unit in such an approach might be low but the large scale of the market and sales volume can compensate for that. For this reason, a significant increase in price-performance needs to be accompanied with high sales in order to be profitable for the company. *Scalability* of a BOP initiative should be planned from the beginning phases of product design. In reality, many pro-poor innovations were unsuccessful because the sales were scattered. As Prahalad suggests, scale of operations is a preeminent point for the business case for BOP, and requires corporations to engage with NGOs and local community-based actors to co-create new products and services.

Modular design is a way to adapt to differences in various BOP markets

Because of the geographical range of the BOP markets, businesses must also consider the differences of each market when scaling a product (e.g., its environment, infrastructure, culture, etc.). The challenge is how to adapt while keeping the unit cost affordable. Modular design is one solution. Modular design subdivides an assembly into smaller parts (or modules) that are easily and interchangeably used. Hence, it allows the product to have a variety of uses. This way, several changes can be made to the product without redesigning the whole product or changing the production line and which will keep the production costs low.

Take a multiple-fuel stove for India's rural poor, for example, which was developed by a large multinational corporation. The stove, called *Combination Chula* (*chula* is Hindi for stove), can burn both biomass and natural gas. It is thus a good product in surroundings where user budgets fluctuate and the availability of energy sources varies. The cost of the Combination Chula is less than USD 20. If the pilot programme succeeds, the device will be sold widely and could potentially and significantly improve the quality of life for people in the developing world.⁴

Focusing on functionality not product

Focusing on functionality to increase product value, is another approach to recognising the specific needs of BOP consumers. The needs of consumers in BOP markets might not be obvious to firms or to consumers. Here, the main task is not to find the best product to sell but rather to find out what problems can a new product solve. When considering functionality, specific conditions of the BOP should arise: issues such as

poor infrastructure, lack of skills to operate complicated technologies illiteracy, and higher levels of heat, dust or humidity.

Dedicated research and development teams can provide answers to functionality questions such as: How are the needs currently being satisfied? Can the product operate in the environment given (e.g., fluctuating electricity, high moisture, dust)? How can the current infrastructure be utilised (e.g., operability with solar energy in remote but sunny areas)? Can it easily be maintained? Can it be operated by an illiterate or unskilled person?

The best option would be to make robust products that need minimum repair and maintenance. If well informed and educated about the product, low-income consumers tend to be more careful about the proper use and maintenance of their goods compared to the affluent consumers who might consider replacing their materials when newer ones are marketed.

As emphasised in E. von Hippel's user-innovation concept, getting feedback from users provides valuable information that assist the research and development – even more so than in developed markets.⁵ Some of the fix-it shops in developing countries have hands-on knowledge about the way that a product can be adapted to the local conditions. For example, they know how to install affordable protection on different home appliances to protect them from local hazards like high temperature, humidity or dust. Sometimes it is interesting to see how they find solutions to repair broken appliances when the original components are expensive or out of reach.

Corporations can learn a valuable lesson from operating in BOP markets: Resource constraints in such markets can actually make people more innovative. Close collaboration with the users in these markets provides opportunities for learning about user innovations that satisfy their needs.

Putting it all together

Entering into BOP markets can improve competition, stimulate innovation, lower prices and increase consumer choice, thereby creating an environment where more attention is paid to satisfying the specific needs of the BOP markets. This results in a better quality of life for underserved communities.

It should be clear from the argument of this article that making successful BOP products is neither about making cheap products nor about radically changing the manufacturer. The offered product has to have a mixture of certain functionalities, to make it *worth* buying for people with very limited resources. In the end, success in BOP innovation is about creating value, both economic and social. Companies that understand what it takes to offer such innovations will ultimately find themselves in a win-win situation: They sustain their long-term success, while fulfilling part of their corporate social responsibility, by satisfying the underserved needs of low-income communities. ♦

Notes

¹ Prahalad & Hart, *The Fortune at the Bottom of the Pyramid*, Strategy+Business, 26, 2002, pp. 54-67.

² Hart & Christensen, *The Great Leap: Driving innovation from the base of the pyramid*, Sloan Management Review, 44, 1, 2002, pp. 51-56.

³ Prahalad, *The Fortune at the Bottom of the Pyramid*, Upper Saddle River, NJ, 2004.

⁴ Prahalad, *The Innovation Sandbox*, Strategy+Business, 44, 2006, pp. 62-71.

⁵ von Hippel, *Lead Users: A source of novel product concepts*, Management Science, 32, 7, 1986, pp. 791-805.

BOP markets in need of robust, easy-to-maintain products

Entering a BOP market can improve competition and stimulate innovation

The Social Responsibility of Corporations is Innovation

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Abstract

The socio-economic well-being that many of us in the developed world enjoy has its roots in the recent economic progress sparked by the success of the market system. Aligning this economic model with the complex realities of the world's poor countries whilst absorbing its potentially negative social and environmental impacts is one of today's major challenges. This can only be achieved through entrepreneurial innovations that have the capacity to transform systems. It is therefore proposed that innovation is the key social responsibility of organisations and corporations. Social entrepreneurs provide us with new business models that demonstrate how innovation and progress can be enacted even in the least-developed countries. For companies, social entrepreneurs can be valuable partners to enter or even build new markets that generate significant social benefits and the economic returns required by corporate investors.

Today's challenge is to replicate economic development for poor countries

Introduction

Economic progress, as we know it, emerged progressively in the last 150 years and created widespread socio-economic well-being in today's industrial nations at unprecedented levels. If we compare our lives to those of our parents and grandparents, we will notice enormous differences, not only economically, but also regarding social factors, such as healthcare, education and civil and political rights. Economic progress is thus a young but powerful phenomenon. Its cornerstone is the market system, an economic model that was not designed by anyone but has rather unfolded and expanded through the dynamic interactions of entrepreneurial, technical and organisational innovations across the world that outcompeted alternative models.

Today's major challenge therefore lies in finding modern and creative answers to the following question: "How can we replicate economic progress with its many social benefits in poor countries?" Replication is here understood as the adaptation of market models to local realities and countries' needs for organic development paths. The nature of the challenge is highlighted by the fact that:

- Although many regions have developed rapidly in the last 50 years and the relative numbers of people living in poverty is dropping, many countries are stubbornly unable to create socio-economic "catch-up".
- Never in history have we witnessed a gap between the rich and the poor as wide as it is today. This phenomenon exists between regions, between countries and even within countries at all development levels.
- Despite being a young phenomenon, the unfinished business of economic development has caused an enormous negative environmental impact. Finding ways to balance the need for economic progress while sustaining the economic and social functions of environmental services is a key challenge of our times that requires all the innovation we can muster.

Innovation can lever sustainability

How can we deal with the double challenge of uneven economic progress and its potentially negative social and environmental impact? One solution lies in the innovation capacity of entrepreneurs, not only in their ability to gradually adapt products and services, but in their ability to actually transform systems. Innovation is of central importance. Why? Simply because established forms of economic progress have failed in many developing countries. As David Bornstein tends to say: "We need better recipes, not just more cooking."

Productive innovation is the essential driving force behind economic progress. It requires the generation of new resources such as knowledge and technology as well as new configurations of existing resources. Because today's problems are the consequences of yesterday's solutions, innovation is the only way forward. Innovation is difficult and risky, and many entrepreneurs fail. Often, innovations remain marginal. This is particularly true for the types of innovations that corporations come up with. In the currently hypercompetitive markets, companies are locked into predictable competitive dynamics of ever-increasing quality to price ratios that put severe strains on costs and limit the resources available for radical innovations.

Corporations' primary social responsibility is innovation

With innovation as the only means to real progress, companies must overcome their cognitive and institutional hurdles to real innovation. This is a key responsibility for the corporation of the 21st century.

Social Enterprises

Establishing markets in the context of severe poverty is extremely challenging. Institutions are weak. Infrastructure is practically non-existent. Governments fail to set up sustainable healthcare and education, while markets fail to supply goods and services. Organisations that operate successfully in this context often have a locally grounded perspective on reality. They see the social underpinnings of poverty. They reflect deeply on cognitive, social, cultural and political hurdles to progress and develop entrepreneurial objectives and strategies from that understanding. Such organisations are often referred to as *social entrepreneurs*.

Companies must overcome their cognitive and institutional hurdles to real innovation

Social entrepreneurs overcome a number of hurdles to establish successful businesses in the poorest of countries. They use their entrepreneurial skills to solve social problems. Social entrepreneurs do not regard poverty as a natural state but rather as the result of an absence of social structures that enable progress. Their innovative ways of working do not only benefit individuals but also help to establish these missing structures and simultaneously develop a spectrum of choices for future generations. Some social entrepreneurs even manage to bring in high profits and become big players when their services and products are brought to established markets. In this way, they do not only provide quick fixes to the problem of poverty, but change the systems that otherwise keep re-creating poverty.

The hybrid business model

A social entrepreneur can be an important partner for a conventional company that is about to enter an emerging market as she or he will usually be able to think in unconventional patterns and to come up with innovative solutions. For larger, more conventional companies, identifying and supporting promising social entrepreneurs, incorporating their innovative ideas and scaling their innovations may be a platform for new profitable markets.

Our research shows that successful partnerships are often structured in the form of hybrid business models that have separate organisational entities and different strategic objectives. Both organisations are linked through an innovative business model that leverages the resources and competencies of both partners. This allows the for-profit entity to generate profits and to increase company value, while the not-for-profit part creates more social value than it could have without the corporate partner. Both sides complement one another although their individual objectives are not aligned. Since each side is better off if the partner fulfils his private strategic objective – thus contributing more resources to the shared model – partner conflict is minimized and partner competencies are put to their best uses.

Social entrepreneurs as an important partner when entering an emerging market

Seeing the future with new eyes

The following example illustrates the collaboration of a social entrepreneur, Aravind, and a conventional entrepreneur, Aurolab. The two created a new business model in India that is increasingly penetrating established markets in the West and already has a global market share of 15 per cent.

For-Profit and Non-For-Profit organisations can benefit from one another

The underlying social problem behind their business model is the widespread problem of preventable blindness in developing countries. About 40 million people are blind and over 130 million are visually handicapped in the developing world. The most common disease is the cataract, which can be treated by the insertion of an artificial lens. This is a treatment that most poor people can't afford. In the 1980s, social entrepreneur David Green started to collect donations for artificial lenses, which were then delivered to the Aravind Eye Hospital in India. When he started to run short of donations, Green decided to establish Aurolab, a manufacturing company that produced lenses. His objectives were clear: Aurolab had to make a profit; it had to build the capacity to treat as many poor people as possible; it had to be able to provide free surgeries for the poorest; and the quality of the surgeries had to be as high as in the best eye hospitals in Western countries. How did Green proceed?

What appears counterintuitive can become an innovative business model

Rather than letting wealthy markets determine the prices for artificial lenses, Green set a price at USD 4 and designed manufacturing through a target costing approach. Although 47 percent of the patients at Aravind Eye Hospital could not pay anything and 18 percent could only come up for two thirds of the costs, Aurolab had a profit margin of 50 percent. This appears to be counterintuitive but is the outcome of an innovative business model:

- Due to the high quality of the treatment, 35 percent of Aravind's patients were able and willing to pay significantly above costs and still save money compared to traditional profit-maximizing hospitals.
- By treating the poor, Aurolab had access to start-up funding from international financial institutions and foundations, which helped lower costs.
- A large advantage in terms of marketing was the fact that Aravind worked together with local NGOs, who had access to the poor. Most of these NGOs were happy to explain the benefits of eye surgery to the poor in the framework of their day-to-day work without charging for the service. This eliminated high marketing costs.
- Due to the high volume of surgeries, Aravind doctors are considered the best and most-productive in the world. Surgery flow-through is designed with maximum throughput and maximum resource productivity in mind.

Today, Aurolab and Aravind Eye Hospital are making progress towards their strategic objective to build the capacity to deliver one million eye surgeries per year until 2012.

Asking the right questions

Sustainable development and business profits are not necessarily a contradiction, as the above example shows. Currently, a number of companies are committing themselves in the developing world because poverty alleviation appears to be in vogue. Trendy or not, initiating socio-economic development is an extremely important and difficult job that has no place within traditional CSR departments but needs to be driven from the business side.

Companies that are willing to help initiate development while establishing future markets and making profits have to face a number of considerations:

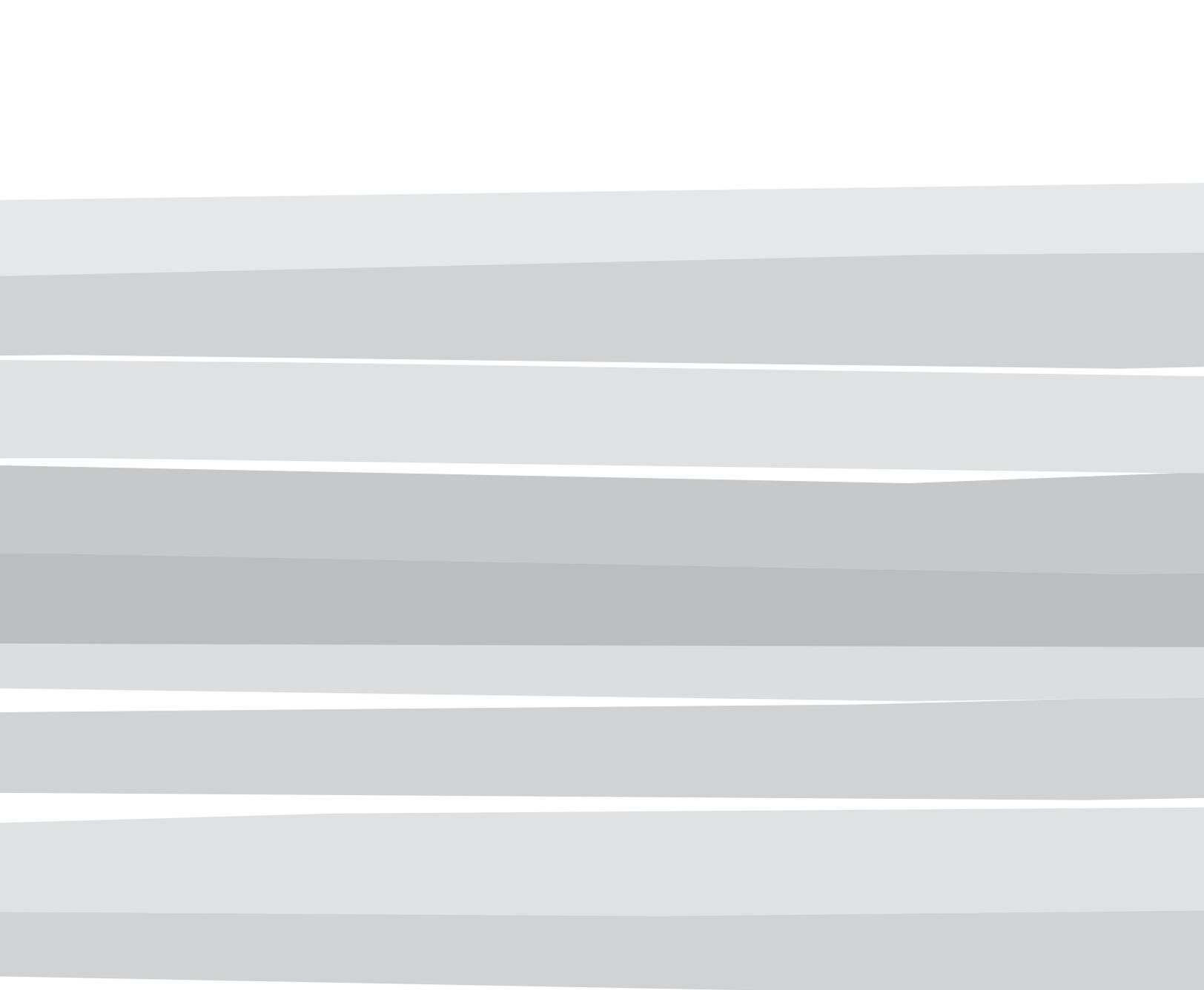
First, the companies have to perceive themselves as potential drivers of socio-economic development and have to be interested in topics and issues relevant to the developing world from both a business and a social perspective.

Secondly, the possibilities of establishing successful business models especially aimed at tackling the problems of the developing world may be limited, so a willingness to learn systematically and to accept the risks of experimentation must exist as well as the readiness to engage their best people and resources to such tasks.

Thirdly, companies must be aware of the fact that money, on its own, is not enough to achieve such feats. They also must remember that they will perform best in business and social terms if they stick to areas that make use of their unique competencies.

Finally, it is essential that companies assess and clarify their corporate identities. They need to be able to define a key non-economic reason for existence and shape values that create the kind of culture necessary to drive competitive advantage and sustainable development.

The major trends that define the needs of future societies and thus the space of corporate opportunities and threats are mostly clear. Inspired corporate strategy means “shaping a desired future” not just reacting to short-term changes. Market positions that explicitly target the challenges of sustainable development can thereby become an essential part of corporate strategies. ♦



Business Case

Suez: Bringing water and development to the poor in Manaus

It was an unusually windy day in Rio de Janeiro. It was October 2000 and Thierry Schock, CEO of Águas do Amazonas, a Brazilian subsidiary of Suez Environment, was in a taxi on his way to catch his flight back to the headquarters in Manaus (the capital of the state of Amazonas in northern Brazil). He had just attended a long meeting with senior managers of the Fundação Instituto Brasileiro de Geografia e Estatística (FIBGE – the Brazilian Public Institute of Geography and Statistics), located in Rio de Janeiro, and representatives of the municipality of Manaus. Schock was trying to digest the news he had just heard – news that could have been a bit brighter: He had just been told that FIBGE used the expression *a população urbana residente no município de manaus* (the resident urban population of the city of Manaus)¹ to refer to *all residents of Manaus*, both those legally registered and those who dwelled in the slums without legal registration. Why was this a problem for Águas do Amazonas?

In June 2000, Suez Environment had acquired 90 percent of Manaus Saneamento S/A, the public sanitation company of Manaus, for EUR 54 million and had founded Águas do Amazonas as its regional subsidiary. A month later, Águas do Amazonas and the municipality of Manaus agreed on a 30 year concession contract: The company paid EUR 192 million in order to obtain the right to act as a service provider by selling potable water and providing sewage disposal in the Amazonas state capital, located on the Negro River, near its confluence with the Amazon. This right was combined with the obligation to operate, maintain and to enhance the number of the city's inhabitants connected to the water network by 4 percentage points – from 91 to 95 percent – until 2006. A further increase in the connection rate by another 3 percentage points until 2011 and maintaining a 98 percent quota all the way through 2029 were also part of the agreement. The sewage disposal network connection rate (which stood at 11 percent in 2000, according to the concession contract) was supposed to be raised to 31 percent by 2006.

Shortly after the contract had been signed, while Águas do Amazonas had started to implement operations, the meaning of the expression *A população urbana residente no município de Manaus* became the subject of major disputes between the Suez Environment subsidiary and the municipality of Manaus. The problem was that

In Manaus, Brazil, Suez had more obligations than first perceived

the contract did not seem to take into account the enormous influx of peasants who literally poured into Manaus year by year in order to illegally dwell in one of the city's slums (also referred to as *invasiones* or low-income neighbourhoods). Or did it?

For the municipality of Manaus, the contract did include them. For Águas do Amazonas, it did not. This was only logical: Had the contractual expression referred to the legally registered residents only, Águas do Amazonas would have had to connect no more than 3,840 homes. But had it referred to *all* of the city's residents (both legal and illegal), Águas do Amazonas would have been obliged to link many times that number of households to the water network system in six years. Whose legal interpretation was correct? It was the municipality's – for the contract said that the meaning of *the resident urban population of the city of Manaus* is based on FIBGE's terms and definitions.² And FIBGE had just made clear that the expression meant *all of the city's inhabitants*.

As Schock's taxicab finally reached the airport, he was still trying to somehow digest the facts he had just heard. He also tried to picture how Águas do Amazonas could un-tangle this complex situation. His thoughts circled around one question that kept nagging him on his flight back home: "Suez Environment wants to see a positive cash-flow in Manaus by 2004. How can we meet this obligation if we also have to operate in the city's slums?"

A big player in the energy and utility market

Suez at a glance

As of 2006, the Suez Group was a leading, France-based multinational industrial and services corporation operating in two areas: energy and environment. The guideline of the company's business consisted in providing public utility services – namely, electricity, gas and energy services, as well as water and waste services – to local authorities, industries and end-consumers. The group structured its operations along four business lines: Suez Energy Europe, Suez Energy International, Suez Energy Services and Suez Environment. In 1997, Compagnie Universelle du Canal Maritime de Suez and Groupe Lyonnaise des Eaux, a leading French water company, merged to form the Suez Group.

Two centuries of reorganisations and corporate mergers

Suez was one of the oldest continuously existing multinational companies MNCs in the world with a line of corporate history dating back to 1822, when King William I of the Netherlands founded the Algemeene Nederlandsche Maatschappij ter Begunstiging van de Volkswijlt – the General Dutch Company for the Favouring of the National Economy (which later became the Société Générale de Belgique). The company resulted from nearly two centuries of reorganisation and corporate mergers. Its name came from the involvement of one of its founding entities – the Compagnie Universelle du Canal Maritime de Suez – in the building of the Suez Canal in the mid-19th century. With revenues standing at EUR 44.3 billion, Suez was the sixth biggest French company in 2006 (France Télécom was the country's fifth largest with EUR 49 billion in revenues).

Suez was one of the oldest existing MNCs in the world

On February 25, 2006, French Prime minister Dominique de Villepin announced the merger of Suez and the state-owned Gaz de France GDF, which would create the

world's biggest actor for liquefied natural gas LNG. In this way, the company also would be capable of fending off a looming bid for Suez by Italy's Enel. In September 2007, the two companies said their merger would be completed in the first half of 2008 (it was legally made effective on July 22, 2008). Together, their revenues reached EUR 71.9 billion in 2006 (GDF: EUR 27.64 billion; Suez: EUR 44.3 billion), thus turning the newly formed firm into the third largest France-based company in terms of revenues, after Total (EUR 153.8 billion in 2006) and Carrefour (EUR 74.4 billion). In addition, seeing things from a 2006 perspective, GDF Suez S.A. (as the new company was officially named after the merger) would be able to overtake the Russia-based Gazprom (whose revenues reached EUR 60.55 billion in 2006) as well as Germany's E.ON (with EUR 67.75 billion in revenues) in order to become the world market leader in the energy category of the Fortune Global 500.

The GDF Suez merger formed a world market leader in the energy and utility market

Trends shaping the energy and utility industry

In *Energy and Efficiency: Utilities global survey 2007*, PricewaterhouseCoopers stressed a number of challenges facing the global energy and utility market. These ranged from an ageing workforce alongside with shortages of engineering skills and knowledge, to reasonable concerns about the security of energy supply (e.g., in the survey, companies said that supply issues would be *significantly* or *immensely* challenging) and activities aimed at increasing demand-side energy efficiency. According to the survey, not only did companies believe in the large impact of eco-conscious end-consumer behaviour on the global energy market, but they were also willing to initiate investments to install effective demand-side efficiency measures. Short-term financial losses due to these investments were expected to be outweighed by the long-term trust of consumers in eco-conscious companies.

In its 2007 analysis of the energy and utility business *Moving from Liberalization Toward a Global Marketplace*, Deloitte emphasised what they thought to be a main trend that would form the entire industry in the coming years: They predicted that energy and utility companies would face less state control as they gradually moved towards a free market. This process, the analysis said, has already begun to take shape in the energy sector, the waste-disposal industry is in a transitory phase and water companies are at the dawn of their maturation. The strain caused by this transformation, Deloitte continued, *is enormous and affects all areas: finance, performance, administrative regulations, taxes, marketing and information technology.*

According to the report, the main effect of deregulation was *the emergence of a global utility market* for which companies ought to be prepared – for example, by increasing their size (which one could assume motivated the merger between Suez and GDF).

Experts said the energy and utility market was witnessing a process of deregulation

Suez in detail

In 2006, Suez's 140,000 employees generated revenues of EUR 44.3 billion. That year the group's EBIT was EUR 3.6 billion and the EBITDA was EUR 7.1 billion. In 2000, the year Suez Environment invested a total of EUR 246 million in Manaus, Brazil, the company's share had an annual low of EUR 27.36, which was just a bit higher than the share's monthly low in January 2006 (EUR 26.34), just before the announcement of Suez's and GDF's merger intentions. In 2007, the year Suez and GDF prepared for their friendly merger, Suez's stocks performed on a higher level: On March 5, 2007, the

Ownership of Suez S.A. in percent of total stock, Dec. 31, 2006			
Groupe Bruyelles Lambert (GBL)	8.0	CNP Assurances Group	1.6
Crédit Agricole Group	3.4	Caixa Group	1.1
Employee shareholdings	3.1	Sofina	1.2
CDC Group	2.8	Treasury Stock	0.3
Areva	2.2	Free Float	76.3

share had an annual low (EUR 35.06), only to then reach a year's high on December 7 (EUR 46.69). In 2006, shareholder equity stood at EUR 19.5 billion; a EUR 1.20 dividend per share was paid out to shareholders and the EPS was EUR 2.86.

In 2006, E.ON's share outperformed Suez's share

In 2006, the industry's peer was Germany based E.ON whose 81,000 employees generated revenues of EUR 67.75 billion, an EBIT of 8.15 billion and an EBITDA of EUR 11.35 billion. The EPS was indicated to stand at EUR 7.67, meaning that E.ON's share preformed 2.6 times better than Suez's share that year.

Suez's workforce was mainly based in Europe. Specifically, 89.35 percent of the company's employees worked in Europe (of which half worked in France), 3.78 percent were employed in Asia Pacific, 2.71 percent in North America, 2.57 percent in Africa and 1.57 percent in South America. Organised by activity, most of the employees worked for Suez Energy Services (46.5 percent), followed by Suez Environment (41.07 percent), Suez Energy Europe (9.14 percent) and Suez Energy International (2.70 percent). The group's revenue breakdown by business-line in 2006 saw Suez Energy Europe and Suez Environment accounting for 36 percent and 26 percent, respectively, of the company's revenues, followed by Suez Energy Services (24 percent) and Suez Energy International (14 percent). In terms of contributions to the EBITDA, Suez Energy Europe (43.20 percent) significantly outperformed Suez Environment (27.99 percent), Suez Energy International (22.10 percent) and Suez Energy Services (8.34 percent).

Suez strove to make their services accessible to all

As a contractual provider of a public service, the group always strove to make services accessible to all. Suez was well aware that many aspects of the group's business were potentially subject to legal regulations on trans-national, national and local levels, which could always affect (positively or negatively) pricing, margins, investments and operations – and, hence, the overall strategy and profitability of the group.

CSR at Suez

According to its 2006 *Activities and Sustainable Development Report*, Suez's CSR efforts mainly focused on the alleviation of climate change. To Suez, this was “the heart of its business strategy and the overriding concern of its business,” as the group's CEO, Gérard Mestrallet, said in the mentioned report.

In fact, slowing the accumulation of greenhouse gases in the atmosphere was very closely associated with the company's business since the production of energy and heat, like the burial of waste, constituted a major source of greenhouse gas emissions.

So what did the company do? In 1997, Suez started to reduce its greenhouse gas emission for all its operations. According to a PricewaterhouseCoopers analysis quoted in Suez's 2006 *Activities and Sustainable Development Report*, the group started to build up a *diversified production base in 1997, which is giving a growing role to technologies and energies that emit no CO₂*.

The outcome? By the end of 2005, natural gas – being a source of energy with limited CO₂ emissions – represented 43 percent of the group's energy production capacity, followed by hydraulic power (22 percent) and nuclear power (12 percent).

Suez also contributed to the socio-economic development of communities in structurally deprived regions in the developing world by providing water and sewage disposal services within the framework of the company's *Water for All* initiative. Water and sanitation is the "starting point for economical and social development," said Alain Mathys, programme manager for development and institutional relations at Suez Environment, in the 2005 Suez Environment publication, *Global Skills for the Environment*. Therefore, in 1994 the company started to "bridge the water divide", as Gérard Mestrallet put it in November 2001, by selling water to people living in relative poverty. By 2006 Suez Environment worked in partnership with local authorities and brought drinking water to nearly ten million people in emerging and developing countries (almost representing a third of Suez Environment's 35 million water services customers); during that same period, 4.5 million people were connected to sanitation networks in the developing world (which was roughly a sixth of the company's 30 million sanitation services customers).

Within the Water for All programme, Suez Environment usually provided water and sanitation services to people already connected to the networks and then extended these services and networks to the unserved population.

Through Water for All, Suez successfully contributed to the seventh MDG, which included the objective *to reduce by half the proportion of people without sustainable access to safe drinking water*. In 2004, the initiative was awarded a World Business Award for the Contribution to the Millennium Development Goals by the International Chamber of Commerce ICC and the United Nations Development Programme UNDP. But there was still a lot of work ahead.

In 2005, more than 1.2 billion people worldwide (most of whom lived in the developing world) did not have access to drinking water, while 2.4 billion could not access basic sanitation. Even though many state-run utility services in the developing world were incapable of meeting the needs of their populations, less than 10 percent of the world's public water and sewage disposal services was delegated to private operators in 2005.

By rendering services to inhabitants of structurally disadvantaged regions within the framework of public-private partnerships PPPs, Suez hoped to stress its CSR and thus become a trustworthy private service provider of public utilities around the world – a company that public authorities would want to contract in order to sell the distribution rights of water and sewage disposal to people both in the developing *and* in the developed world. Not being able to bring water and sewage disposal to the inhabitants of Manaus within the framework of normal business operations would have (possibly) eroded the credibility of Water for All, in addition to possibly impeding future business opportunities.

Suez contributed to the development of the poor with their Water for All initiative

In 2005, more than 1.2 billion people did not have access to drinking water

Legal implications in Manaus larger than anticipated

A false interpretation of a concession contract led to problems in Manaus

The contract Águas do Amazonas had signed in July 2000 implied much larger obligations for the company than they had originally perceived. A water network connection quota of 91 percent corresponded to 436,800 people (or about 87,360 households) out of those 480,000 inhabitants of Manaus who were legally registered (30 percent of the city's total 1.6 million population). In order to enhance the water network connection quota on the basis of these numbers to 95 percent (which meant 456,000 people or 91,200 homes), Águas do Amazonas only had to connect 3,840 legally registered households – at least this is how Águas do Amazonas interpreted the concession contract before signing it in June 2000.

After FIBGE had confirmed that *A população urbana residente no município de Manaus* meant *all of the city's residents*, the basis of calculation widened dramatically – from 480,000 to 1,600,000 (that is to *all of the city's residents*, including those living in slums). Now 95 percent corresponded to 1,520,000 people (or 304,000 homes).

Apart from that, providing water services to 95 percent of the population by 2006 and keeping water connection rates high (at 98 percent) until 2029 was going to be especially difficult due to Manaus' exponential population growth – from 200,000 inhabitants in the mid-1980s to 1.6 million in 2004. This growth was mainly due to the development of a free trade zone established in the mid-1960s by Brazil's then military government which eventually turned the remote city in the Amazon tropical rainforest into one of the country's economic success stories (often referred to as *Brazil's China*). According to Kieran Cooke's BBC online article, *Brazil's Resurgent Amazon Powerhouse*, companies such as Honda, Nokia and Harley Davidson employed a total of 125,000 people in the Manaus free trade zone in 2006. This attracted enormous numbers of peasants to the city, dazzled by its success and in search for a brighter future.

Manaus had a vibrant economy and concerns to become a victim of its own success

Manaus definitively had a vibrant economy, but it also had concerns of “becoming a victim of its own success,” as Cooke said. For many years, the free trade zone functioned as a low-cost assembly area. This had two negative consequences: (a) While most people in Manaus had a job (only 5 percent of the city's population was unemployed, which was half of Brazil's average of 10 percent), about 70 percent of population worked in the informal sector and lived in relative poverty of less than USD 7.2 per day³; and (b) infrastructure development had failed to keep pace with the city's growth. Slums started to spread. In 2000, 70 percent of Manaus' population lived in the city's invasões. Not being able to pay rents, peasants coming to Manaus usually built very small, poorly constructed houses (*palafitas*, meaning huts built on poles that stood in the Negro River). Due to the fact that they were not legally registered, they were unable to obtain the public subsidies that they would have been permitted to receive had they not lived in a slum district. That little bit of extra money would have possibly helped them to overcome poverty.

So what did peasants encounter after they arrived in Manaus? The co-existence of a strong economy as well as widespread poverty. A very ambiguous situation, indeed, but apparently reason enough for people from the rural areas of the Amazonas state to keep moving in, contributing to forecasts that the city's population was to double by 2030.

Águas do Amazonas in a dilemma

The day after Schock flew back from Rio de Janeiro to Manaus in October 2000, he rallied senior management in the morning for an update and a brainstorming session. Alain Mathys was connected to the meeting via telephone. “I have bad news from FIBGE,” were Schock’s opening words. He continued by giving a bullet point summary of the meeting he had attended in Rio de Janeiro the day before. The new, wider basis of calculation (including the slum inhabitants) posed a two dimensional problem, he said. First, Águas do Amazonas did not have the budget to set up enough technical infrastructure to actually bring water and sewage disposal to the slums. And, second, the poor simply did not have enough money to pay for Águas do Amazonas’ services.

There were no funds to set up technical infrastructure and the poor could not pay for water services

Finding a way to escape the dilemma

After Mathys had made clear that Suez Environment was not going to invest more money than it already had, a lively discussion unfolded. Renegotiating the concession contract was the most obvious thing to do, said Schock. But what else could Águas do Amazonas do, he asked. A basic idea started to emerge rather quickly. Setting up technical infrastructure in slums was cost-intensive and enabling the poor to generate income was hard work that had to be done by NGOs (who obviously also needed funding). This meant that Águas do Amazonas had to set up funds for both its technical work and for the human capacity-building.

They then set up criteria by which they wanted to discern their actions in the coming years:

- If they were able to set up external funds (lent or donated) for their technical work and for the human empowerment by June 2001, Águas do Amazonas would be able proceed with business as usual.
- If Águas do Amazonas was not able to fund its work and the work of the NGO by June 2001, Suez environment would have to find a feasible way to terminate its operations in Manaus.
- If they were able to set up funds for the human capacity building, but not for their technical work (or vice versa) by June 2006, Águas do Amazonas would try to generate a positive cash-flow – not by 2004 (as originally expected by Suez Environment), but by June 2006.

These thoughts implied that Águas do Amazonas had to build up relationships with NGOs, banks, possible international financial institutions – and with governmental bodies. Jardimilina Vasconcelos, community manager for Águas do Amazonas, explained why. The slum dwellers were not registered therefore, they were illegal *inhabitants* of Manaus and were not eligible for subsidies. If the municipality could turn them into *citizens*, she continued, they would obtain access to public funds and also turn Águas do Amazonas into a supplier of low-income citizens. Those companies, she elaborated, that supply utilities to low-income citizens are funded by public authorities.

Building relationships with numerous institutions was important

To Schock and Mathys this perspective was new and intriguing. Why should the municipality of Manaus not want to turn its slum dwellers into legal citizens?

It would be a win-win situation for all: Águas do Amazonas could set up technical installations and also develop a capacity-building program with local NGOs that would aim at initiating socio-economic development in the city's invasões and sensitising slum inhabitants with regard to the use, relevance and value of the regular supply of treated water and a functioning sewage disposal network. The expected benefits were various:

The benefits of regular supply of treated water were various

- Diseases (especially among children) would diminish.
- Water is within easy-to-reach walking distance (or even in a family household). Thus, time for productive work would increase.
- Water prices in slums generally drop when the utilities would be sold through public networks. (Why? Because the distribution of utilities is often controlled by informal leaders who establish monopolies and control prices.)

It would not be easy to initiate the socio-economic development of the poor, but what could Manaus welcome more than that? "And what would the cost structure of our tariffs look like?" asked Vasconcelos. Would rich and poor pay the same price? If so, she said, Manaus would probably not cooperate. From their experiences with Water for All, Mathys and Schock suggested the establishment of a so-called *cross-subsidised tariff system* in which high-income consumers would pay prices far above costs in order to subsidise low-income clients.

Their strategy seemed to fit. Schock, who had dealt with other water projects in developing countries, and Vasconcelos teamed up to implement Águas do Amazonas' strategy to confront the company's dilemma in Manaus.

Preparing to bring water to the slums of Manaus

In early November 2000, Schock and Vasconcelos started to define the measures necessary to implement Águas do Amazonas' way forward. Calling lawyers and giving instructions to go ahead with the re-negotiation was only a phone call away. The most complex aspect about Águas do Amazonas' new strategy was building relationships and setting up the funds.

Finding local NGOs, setting up funds and building relationship

From Suez Environment's experiences with Water for All, Schock knew that when people have access to water and sewage disposal services, the possible outcomes were a drop in infant mortality and an increase in people's free time – in particular for women. Turning up an in-home or next-to-home water tap is, to say the least, less time consuming than walking long distances to water merchants and back (in addition to it being a lot cheaper). The spared time could then be used well, especially when NGOs enable the poor to apply for new jobs, which leads them to higher income rates and turns their poor families into families with new possibilities.

For Essor (a French NGO operating in Brazil for more than ten years) and Cidade Brasil (an urban development programme initiated jointly by the French Ministry of

Access to water saved time that could then be used well by the poor

Foreign Affairs and Brazil's Caixa Econômica Federal) these insights were convincing enough to start a cooperative venture with Águas do Amazonas as early as January 2001. Essor had an impressive community-development track-record and was eager to work in Manaus. Cidade Brasil was willing to set up funds for Essor's work.

Together with the representatives of Essor and Cidade Brasil, Schock and Vasconcelos defined their joint objectives with regard to their activities in Manaus' invasions. They wanted to socio-economically develop community groups living in the low-income communities (Essor's part of the job which was funded by Cidade Brasil) along with installing fresh water connections (as well as sewage disposal connections), which was Águas do Amazonas' task.

By February 2001, Schock and Vasconcelos had set up fluid information channels to a number of governmental bodies on the municipal level. They had talked frequently with the city's prefecture, its secretary for development and the environment, its institute for the protection of the environment, its secretary of health, as well as with its coordination bureau for sewage disposal and urbanisation. Apart from that, they also frequently met with Arsam (an agency that regulated conceded public services in the Amazonas state), with the federal public development bank, two religious institutions, as well as the French embassy. Were they able to convince the municipality to actually legalise slum dwellers in order to set up funding? Unfortunately not. The officials did not seem to be interested in the issue, possibly due to the process of re-negotiations that had not been brought to an amicable solution.

Fluid information channels to a number of governmental bodies were set up quickly

By June 2001, Águas do Amazonas still had not set up external funding to install water connections within the cities slums. Was the cross-subsidised system going to generate enough profits by June 2006 to compensate the missing funds? If average money collection rates (within the wealthier and low-income areas) would reach 70 percent by 2002 and remain at that level for at least four years, Schock knew that Águas do Amazonas would achieve a positive cash-flow within the given framework.

Final preparations

In July 2001, Schock and Vasconcelos had gathered enough information to set up what they thought to be a fair cross-subsidised tariff system. The poor would pay BRL (Brazil real) 5 (USD 2.17)⁴ to BRL 12 (USD 5.21) for 12 to fifteen square metres per month. This amount was half the amount the water monopolists demanded, calculated Essor.

In order to enhance the level of the political acceptance of their operations Águas do Amazonas, Essor and Cidade Brasil set up a steering committee incorporating all the institutions and organisations Águas do Amazonas had been talking to since the end of 2000. The committee met twice, in August and in November 2001, and helped establish criteria to choose the low-income communities in which Águas do Amazonas and Essor would actually operate (see *Exhibit 1* for more details on the criteria that helped choose the communities).

A steering committee was installed to enhance the level of political acceptance

Before the steering committee met for the third time in April 2002, Águas do Amazonas, Essor and Cidade Brasil had already screened the city's 57 low-income communities and identified five (Mauzinho II, Parque Mauá, Comunidade de Deus, Vale Sinai and Campo Dourand) that matched the aforementioned criteria. Together these communities had 6,236 family households. Within three years, these households would be connected to the water network system. Best practices and experiences

gained within this time were then going to be scaled up. These efforts were meant to be implemented parallel to Águas do Amazonas' work in the wealthier areas of the city, in which households also had to be connected to the water network.

Installing a water network system in a context of poverty

In May 2002, Essor, which had established a local NGO called *Adeis* just for this one project, tried to mobilise the communities in order to identify their needs in terms of water and sewage disposal, but also to stress health issues and the possibilities of socio-economic development that go alongside with the installation of a public water and sewage disposal network.

Communities had to be mobilised to identify their needs in terms of water services

At first, Adeis hoped to do so via informal community leaders. But very quickly it became apparent that these leaders did not always represent the interests of the community groups but rather their own. Therefore, Adeis created community associations, which were platforms of dialogue between the people of the low-income quarters and themselves. The vast majority of the platform participants were women who seemed to show interest in tangible socio-economic development.

From these, Adeis then chose ten volunteers in each of the five communities. They were to be trained and sent from house to house in order to explain the benefits of an efficient water and disposal network system; but also to assess the communities' demands and needs. Having thus assessed the communities, Águas do Amazonas and Adeis then were able to discuss realistic technical solutions and possible commercial proposals that were presented in each of the 5 communities.

First successes

By the end of 2002, agreements were signed in all of the five communities due to obvious price advantages: As mentioned, Águas do Amazonas demanded the relative low amount of BRL 5 (USD 2.17) to no more than BRL 12 (USD 5.21) for twelve to 15 square metres per month (see *Exhibit 2* for Águas do Amazonas' negotiation results in Mauzinho II and Comunidade de Deus).

Schock was pleased with the way awareness building and negotiations went. These were early successes. The next steps were installing the networks (which he knew would be no problem from a technical perspective) and increasing money collection rates to 70 percent and keeping them at that level (which, he also knew, was going to be a monumental task).

Installing the network, building social capacity and trying to collect money

In October 2002, after negotiations within the communities had been brought to an end, Águas do Amazonas started to connect households to the water and sewage disposal network. This was accompanied by activities from the side of Adeis: Teachings on health and sanitation as well as on job-related and entrepreneurial issues were held; lessons for reading and writing were given; bureaus for job orientation were installed; and meaningful activities for the young were implemented.

Fresh potable water started to flow by the end of 2002. Águas do Amazonas, Essor, Adeis and Cidade Brasil were very content. But were they going to be able to collect 70 percent of the billed money? Nobody knew it.

Households were connected to the network at the same time as human capacity was being built

From similar experiences, it was clear to Essor that an incentive system had to be set up to initiate substantial money collection. Volunteers, who were made responsible for the money collection, received BRL 0.11 (about USD 0.047) for every paid bill. If collection rates were above 50 percent, up to 7 percent of the collected money was to be donated to social funds of the five communities, against Águas do Amazonas' margin.

Major problems with the cross-subsidy tariff system

The incentive seemed to work. By the end of 2003 average money collection rates climbed to reach about 70 percent.⁵ But they started to crumble in 2004. Why? The cross-subsidised tariff system turned out to privilege the rich, not the poor: Yearly unilateral re-evaluations of tariffs to account for inflation (around 10 percent), as well as two exceptional, additional increases since 2000 – the last of which, in January 2004, reached 31.5 percent – were legally applied uniformly to all the users. But they had different de facto effects on the user categories. Higher income segments had tariffs that were based on actual consumption (not on lump sum agreements as in the case of the five poorer neighbourhoods). As the prices notably started to climb in early 2004, the digging of wells effectively left numerous high segment clients out of the cross-subsidised system. Poorer customers thus had to experience an effective price increase and therefore stopped paying their bills.

The problems with the cross-subsidised tariff system did not only affect the collection rate within the five communities. By the end of 2005 Águas do Amazonas was confronted with an average payment recovery rate of only 16 percent in all of Manaus.

After money collection rates had climbed they started to crumble dramatically

Looking back: A social and economic success in a problematic setting

Seeing things from a social perspective the project was a success: Already by 2004 more than 200 volunteers had been trained; more than 3,000 people (meaning about one person out of every second household in the five communities) had been made aware of the rational and responsible use of water and environmental protection; 403 educational workshops had been held; 179 women had participated in the development of activities aimed at generating income and providing education (30 percent of these managed to create a productive activity at home); professional qualification classes had been provided to 408 students; 280 people had participated in literacy courses; and, finally, the collection rate participation incentive had reached an average yearly investment total of BRL 2,000 (USD 869.56) for social funds in each of the communities.

Ana Christina Lima Barroso (a mother of three children) from Comunidade de Deus, whose home was connected to water services by Águas do Amazonas, said: “Before I had to go and get drinking water from a fountain in the school several hundred meters from my home. To wash, my neighbour let me use the water in her well ... All my mornings were devoted to getting water.” But Ana took trainings in accounting and hoped to set up a small business herself. She then started to sell dindin, a popular fruit ice cream in Brazil, based on potable water.

The project was a success when seen from a social perspective

From a business perspective, Suez's efforts in Manaus failed

From a business perspective, Águas do Amazonas' efforts in Manaus were a success story set in a problematic context: By March 2005, 5,203 new connections were installed within the five low-income neighbourhoods. Clandestine connections went down from 1,121 to 150. But was this project sustainable in financial terms? Not exactly, as the initial investment of EUR 246 million led to a cumulative negative cash-flow of USD 552,000 by 2006 and not to a positive one as prescribed by Suez Environment in October 2000. BRL 2.6 million (or USD 1.13 million) were invested by Águas do Amazonas from February 2002 until February 2005 to install the network in all of Manaus. Between the beginning of 2002 and the end of 2005, BRL 2.18 million (USD 947,000) were invoiced but only BRL 1.33 million (USD 578,000 million) had been collected (see *Exhibit 3* for an overview of the invoiced and actual paid-for sums).

Considering all the aspects involved, as well as the socio-economic impact of Águas do Amazonas' efforts in Manaus, the legal setting and financial sustainability of the project, Suez Environment decided to terminate their agreement with the municipality of Manaus in June 2006.⁶ Schock said:

“We have given our best in the last six years and we have seen a process of transformation in the invasões due to our partnership with Essor, Adeis and Cidade Brazil. But the given legal setting has imposed major financial losses upon us – too much to let us render that extra amount of service that is of utmost importance when bringing water to the poor. We will definitively profit from the experiences we have made here while we continue to bring water to all. I hope the municipality of Manaus will find a way to successfully enhance the quality of life in its very own slums”. ♦

Notes

¹ The expression *A população urbana residente no município de Manaus* is taken from the concession contract signed by the government of the state of Amazonas and Manaus Saneamento S/A on July 4, 2000, p. 33.

² On p. 33 of the concession contract, it says: “A população urbana residente no município de Manaus será calculada pela multiplicação do valor do último dado de população urbana do município, (último dado de crescimento anual verificado nos dois últimos dados fornecidos pela FIBGE, extraídos de Censo Demográfico ou de Contagem populacional).”

³ See Breuil, *Renouveler le Partenariat Public-Privé pour les Services D'eau dans les Pays en Développement*, Paris 2004, p. 228. Breuil quotes the 2000 population census, which said that 70 percent of the population of Manaus lived off of less than BRL (Brazil real) 500 per month (USD 217 per month or USD 7.2 per day, given an exchange rate of 1 USD/2.3 BRL).

⁴ Given an exchange rate of 1 USD/2.3 BRL.

⁵ See Breuil, p. 240.

⁶ See Alain Mathys, *Water and Sanitation in Africa*, Paris 2006, p. 5.

Exhibits

Exhibit 1: Criteria of technical, social and legal feasibility that helped managers choose the communities.

Technical Feasibility	Social Feasibility	Legal Feasibility
Basic technical infrastructure had to be given. Potable water networks had to be absent or in precarious conditions.	The quarter had to have informal representatives that were already engaged in social work.	The quarter had to be known by the prefecture.
The principle pipes of the network had to be accessible.	The community had to be interested in developing the project.	
70 percent of a quarter had to manifest interest for the service.	Adhesion to the objectives of the project had to be given	
The community had to exist for at least five years	A minimum amount of social infrastructure had to be given	

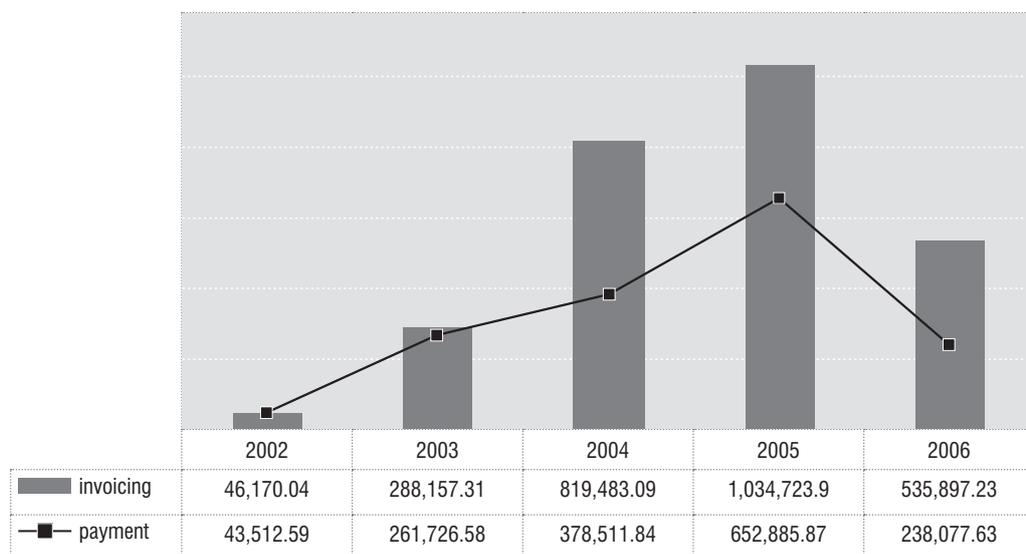
Source: Breuil

Exhibit 2: Águas do Amazonas' negotiation results in Mauzinho II and Comunidade de Deus.

	Mauzinho	Comunidade de Deus
Number of families	ca. 600 (2,550 people)	ca. 550 (2,400 people)
Average monthly income	BRL 291	BRL 254
Number of volunteers	14	Five
Type of connection to water net	Individual connections with collective meter	Individual connections with collective meter
Stand by duty	24 per day	Three to six hours per day
Costs for connection to water net	BRL 15 for registration and BRL 5 monthly for 17 months	BRL 15 for registration and BRL 10 monthly for eight months
Factorisation	Individual lump sum invoicing on the basis of a consumption rate of 12 to 15 m ³ per month per family, equalling BRL 12 per month	Individual lump sum invoicing on the basis of a consumption rate of 12 to 15 m ³ per month per family, equalling BRL 5 per month
Initial adhesion quota	92 %	85 %
Definite adhesion quota based on payment	98 %	87 %

Source: Essor, quoted in: Breuil

Exhibit 3: Overview of the invoiced and paid for sums in the five communities from January 2002 until September 2006 (in BRL). Payment rates start to drop significantly in 2004.



Source: Águas do Amazonas

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Suez: Bringing water and development to the poor in Manaus presents Thierry Schock, CEO of Águas do Amazonas, a former Brazilian subsidiary of Suez Environment between October 2000 and June 2006. When Suez Environment acquired the public sanitation company of Manaus in June 2000, it also acquired the right to act as a service provider for 30 years, selling potable water and providing sewage disposal in the Amazonas state capital. But the company misinterpreted its concession contract. It had to connect many more homes to the public water network than it had anticipated when signing the agreement – and most of these homes were in slum-like areas.

The case shows how Schock tried to cope with this challenge: He and his team started to:

- renegotiate the concession contract (which did not lead to a new, amicable agreement);
- set up external funds (aimed at financing Águas do Amazonas' technical work and the efforts of local NGOs meaning to socio-economically empower slum inhabitants);
- design a cross-subsidised tariff system in which high-income consumers would pay above costs to subsidise low-income clients.

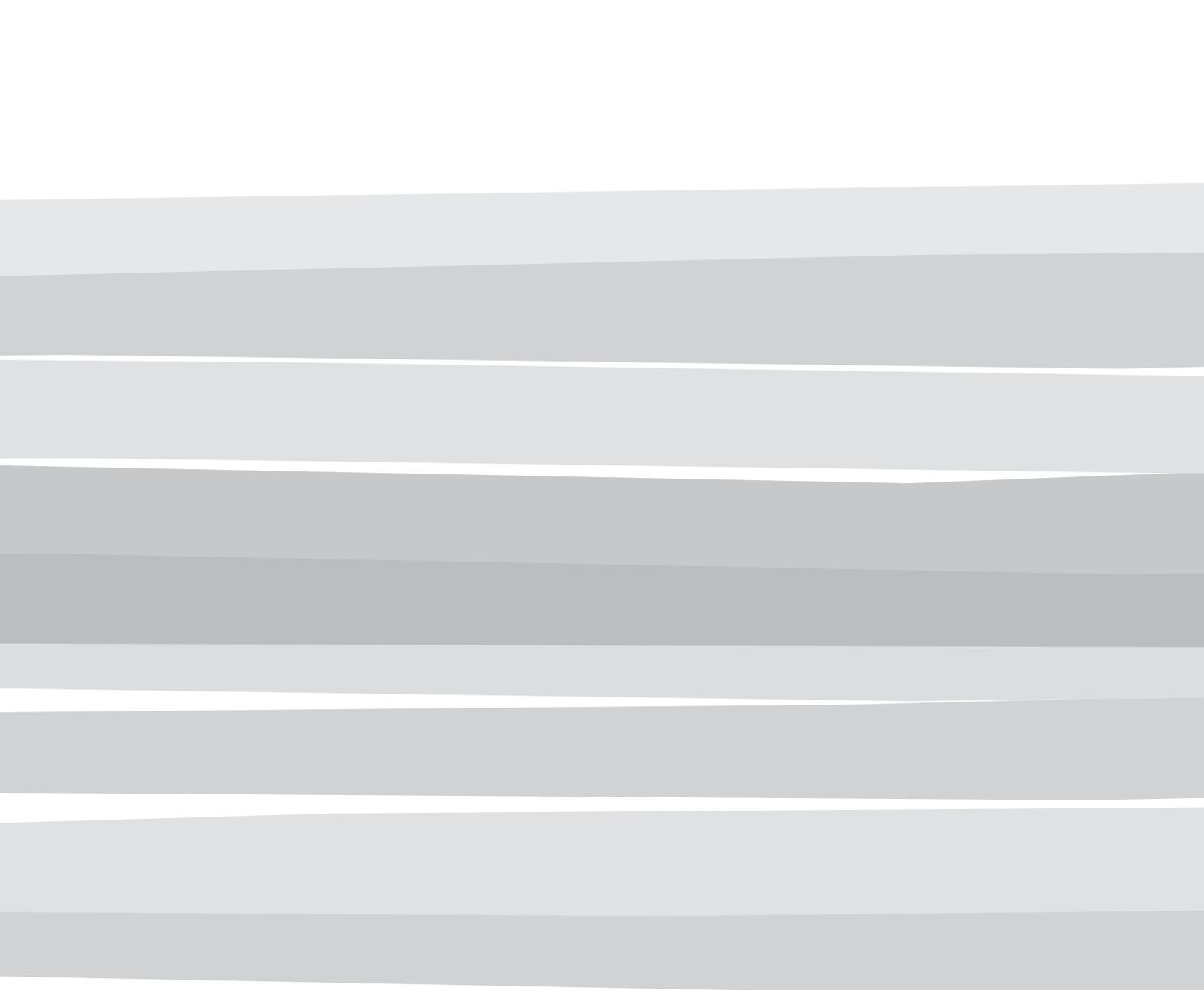
The outcome? Funds for the NGOs' work could be set up. First efforts aimed at empowering the poor went well. A thoughtful incentive system aimed at increasing money collection rates brought first fruits. But the cross-subsidised tariff system proved to be a major problem. Inflation driven re-evaluations of tariffs as well as exceptional price increases were legally applied to all users. But wealthier clients (who paid consumption based tariffs) tapped water from private wells as soon as prices went up and, thus, disproportionately burdened poorer clients (who had lump sum agreements). By 2006, Suez Environment decided to terminate its operations in Manaus.

Entering a market scarred by poverty is a challenging task for any company. As these markets are heterogeneous (at least when compared to traditional, saturated markets), centrally designed products or services do not meet the needs of the poor in situ and often fail to generate profits. This thought can be considered to be common knowledge among those who are familiar with the bottom of the pyramid concept.

It touches upon the consequences of poverty: The poor have needs that are specific (to say the least). These can only be turned into market driving demands when met thoughtfully – for example by developing innovative services and products or by contributing to socio-economic development. The most interesting aspect about *Suez: Bringing water and development to the poor in Manaus* is that it shows that conducting business in a context of poverty is also challenging due to

the reasons that lead to poverty. One of these is the lack of societal institutions and structures that protect ownership rights, seek responsible allocation of resources and share short-term economic risks to spark long-term economic and social value.

Even if Suez Environment eventually failed to set up a profitable business model in Manaus, the case implies that it is of utmost importance to examine and understand the socio-economic setting of a developing market or region before investments are made. For western companies there is probably always enough room for improvement with regard to the perception of the various symptoms, consequences and reasons of poverty. ♦



Business Case

Unión Fenosa: Taking its focus from the financial to the social

Early in the morning of June 21, 2002, Víctor Cruz, general director of Unión Fenosa, S.A. in Colombia, a Spanish energy supplier with global operations, dashed through the Bogotá traffic on his way to his office, eagerly awaiting Honorato López Isla's phone call. López Isla was Unión Fenosa's first deputy chairman and CEO, working at the company's headquarters in Madrid. The night before, Cruz had e-mailed López Isla concerning the severe social tensions on Colombia's Atlantic coast and the financial risk for Unión Fenosa. Cruz knew that López Isla would call him at 8 a.m. sharp, Bogotá time.

What had happened? Two years earlier, when Unión Fenosa entered the Colombian electric energy market, the company's main objective was to distribute electricity to the big industrial plants on the Atlantic coast. Unión Fenosa also served end-consumers, but they only played a minor role within the company's business strategy. After one year in the market, Unión Fenosa encountered problems. Not only did many of the private customers refuse to pay for the services, but the inhabitants of the region's slum-like poor quarters illegally tapped electricity from the distribution network. Severe energy shortages occurred. Supplying the industrial plants on the Atlantic coast turned out to be more difficult than expected.

What made things even more difficult was that the official socio-economic stratification of the population failed to include the inhabitants of the disadvantaged quarters; some observers felt that for the government, these people essentially did not exist. When Unión Fenosa began to cut off energy supply in June 2002, protesters took to the streets. The angry mob jammed the main commercial route, chanting *Unión Penosa* (Painful Union). The disruption of public order was too great to be ignored; the protests even reached Colombia's President.

Cruz entered his office at 7:45 a.m. He was not sure whether some of his proposals sounded too unusual for an electrical company. When the phone rang at 7:50 a.m., the display indicated the awaited call from Spain. From the start of their conversation Cruz and López Isla focused on the core question of Cruz's late night e-mail: "Should we leave the Colombian energy market?"

Unión Fenosa: An integrated energy company

**The company at a glance:
producing and distributing
energy**

Unión Fenosa, an integrated energy company, operated in 13 countries on two continents. It was involved in producing primary energy and in generating, distributing and supplying electricity and natural gas to industrial and household consumers.

History and competitive environment

Unión Fenosa was created in 1982 by the merger of the Spanish energy suppliers, Unión Eléctrica and Unión Eléctrica Madrileña y Fuerzas Eléctricas del Noroeste, S.A. In 1986, the company started to expand internationally and to diversify its services, starting with a consultancy agreement in Uruguay. By 2006, Unión Fenosa had become a multinational electricity and gas conglomerate with EUR 6 billion in revenues. This made it Spain's third biggest energy supplier behind Iberdrola, S.A. (the largest wind energy producer in the world) with EUR 11 billion operating revenues in 2006 and Endesa, S.A. (the biggest private energy supplier in South America) with operating revenues at EUR 20.60 billion in the same year.

The challenges facing the energy industry were “so large and so complex”, said Daniel Yergin, chairman of Cambridge Energy Research Associates, in *Energy's Challenges* published on Forbes.com on April 23, 2007, because they were “created by two forces.” The first is globalisation and, in particular, the success of globalisation. High growth rates, the emergence of a large middle class in countries like China and India, the continuing integration of the global economy, “all required energy. To keep it going requires energy, lots of it.” He highlighted that over the past three years, China added 200 GW of coal-fired electric power capacity, which was equivalent to 20 percent of the entire installed capacity of the United States. By 2030, the “world's energy demand will have grown by 75 percent.” According to Yergin, the second force involved the consequences of energy use: “How are we going to cope with carbon? It is these cross-cutting concerns – the need for energy, and the need to manage the consequence of energy use – that are creating the energy challenge that will dominate the decades ahead.”

**Global energy demand
seen as a business
opportunity**

Apart from being a global challenge, coping with carbon was one of the opportunities for the future of energy businesses. The McKinsey Global Institute talked about the opportunities in their in-depth May 2007 survey *Curbing Global Energy Demand Growth: The Energy Productivity Opportunity*: “Vast opportunities exist to curb demand by improving energy productivity through investments that yield rates of return 10 percent or higher.” Capturing these opportunities would contribute “up to a half of the greenhouse gas GHG emissions abatements required to cap the long-term concentration of GHG in the atmosphere at 450 to 550 parts per million,” a range that experts suggest was required to prevent “the global mean temperature from increasing more than 2° centigrade.”

Unión Fenosa in detail

As of 2006, the company's 17,000 employees rendered services to almost 8.7 million customers around the world, to whom, 81 million kWh were billed – an amount roughly corresponding to the annual electricity consumption of countries like Belgium, Finland or Egypt. The company's total installed generation capacity stood at 10,289

Ownership of Unión Fenosa, S.A. in percent of total stock, Dec. 31, 2006			
ACS	40.5	Caixanova	5.0
Caixa Galicia	8.0	Banco Pastor and Fundación P. Barrié	3.7
CAM	5.2	Free Float	37.6

MW. Unión Fenosa had revenues of EUR 6.05 billion, EBIT of EUR 1.31 billion and EBITDA of EUR 1.90 billion in 2006.

Right after entering the Colombian energy market, in early January 2001, Unión Fenosa's share price was worth EUR 17.92. It then dropped to EUR 9.60 on October 9, 2002 (four months after the aforementioned riots spread), reached a temporary high of EUR 41.60 on November 22, 2006, and stood at EUR 37.50 on December 31, 2006. The company's stock market capitalisation then was EUR 11.42 billion. For the fiscal year EUR 316.90 million of dividends were distributed to shareholders and EPS stood at EUR 2.09.

By means of comparison, Europe's largest electricity company, Germany's E.ON, generated revenues of EUR 67.75 billion, EBIT of 8.15 billion and EBITDA of EUR 11.35 billion in 2006. The company had 81,000 employees worldwide and an EPS of EUR 7.67, outperforming many industry peers including Unión Fenosa.

Although operating internationally, Spain remained Unión Fenosa's main market in 2006 with 3.5 million clients, generating capacity of 7,516 MW, a billing amount of 34 million kWh and investments that added up to EUR 1.10 billion between 2001 and 2005. In 2005, 27 percent of Unión Fenosa's total investments were international (see *Exhibit 1* for the company's investment split in 2005). This led to a generation of 2,773 MW of installed capacity in 2006 in Mexico, Colombia, Costa Rica, Dominican Republic, Guatemala, Nicaragua, Panama, Portugal, Republic of Moldavia, Egypt, Oman and Kenya. According to the 2006 annual report, Colombia was the main distribution market outside of Spain, since it concentrated 40.2 percent of all customers and 52.7 percent of the billed energy outside of Spain (see *Exhibits 2* and *3* for an overview of Unión Fenosa's clientele and annually billed energy in Colombia and other operating countries.)

With the tensions in Colombia, the share price momentarily dropped

Even with international operations, Spain remained Unión Fenosa's major market in 2006

CSR at Unión Fenosa

In 2002, Unión Fenosa established a strategic plan for the period of 2003-2007 based on four criteria: (1) Unión Fenosa's development as an integrated energy company, (2) operational optimisation, (3) reinforcement of the financial structure and (4) the enhancement of alliances with strategic partners. The original financial objectives were surpassed in 2006, twelve months in advance. As a consequence, Unión Fenosa drew up a very ambitious growth plan for the years ahead called *Bigger*. The plan expressed its commitment to doubling EPS by 2011. Within this context, Unión Fenosa launched a process of improving its CSR management model. The company wanted to reinforce its business of interrelated communication and dialogue with two groups

of stakeholders: primary (investors and shareholders, employees and customers) and other (governmental and legal institutions, suppliers and society). Unión Fenosa listened to the expectations and needs of every group, assessing their coherence with the company's business strategy in order to develop specific CSR initiatives.

Expanding to new markets: Colombia

Failure to expand encouraged to step up international purchases

In early 2000, the Spanish authorities vetoed Unión Fenosa's EUR 2.6 billion take-over of Hidrocantábrico, the country's number four electrical company. Unión Fenosa's failure to expand in its domestic market encouraged it to step up its international purchases. By the end of 2000, Unión Fenosa had picked up new operations in Colombia, Costa Rica, Nicaragua and Uruguay.

In Colombia, the company acquired two distribution plants on the Atlantic coast for USD 400 million (Unión Fenosa's single biggest investment in Latin America), namely Electricaribe and Electrocosta, which served about one million customers. It also purchased a generation and distribution company in the country's south-west coast, Energías del Pacífico EPSA, for USD 55 million, which provided electricity to about 400,000 customers. All three companies – Electricaribe, Electrocosta, Energías del Pacífico – had been state-owned until 1998.

Colombia's Región Caribe (132,000 km², approximately the size of Greece) on the Atlantic coast had encouraging indicators for an energy provider: It was mainly an industrial region where large international companies could invest in a safe place – in a country troubled by armed conflicts – that was well connected in terms of infrastructure. With a population of nine million people living in and around the seaports of Cartagena and Barranquilla, the region was home to almost one-quarter of Colombia's entire population.

The population in the Caribbean part of Colombia did not represent a homogenous market. Many conditions differed remarkably between the cities and the rural areas. Additionally, some population groups had a somewhat care-free economic situation. Others living in poor quarters, in both urban and rural surroundings, suffered from sub-standard electricity and illegally tapped energy from the distribution network. Nevertheless, in terms of energy subscriber market shares, Unión Fenosa's position in Región Caribe was favourable. After having bought Electricaribe and Electrocosta, 97 percent of the private energy subscribers were customers of the company.

Unión Fenosa confronted with massive problems

Steady energy supply was more costly than expected due to locals illegally tapping energy

Pursuing its core economic interests within the first business year, Unión Fenosa mainly focused its efforts and activities on the company's industrial clients. Throughout the year, illegal energy tapping continued. By the summer of 2001, Cruz knew that steady energy supply to industrial customers was more costly than expected. He started to analyse the situation. The government was reluctant to care for the people living in the poor quarters on the Atlantic coast because they did not hold legal residency. Unión Fenosa had obvious economic interests but could not act. It simply was not possible to turn the illegal electricity tappers into customers due to lack of legal registration. He had to talk with the government. But what could he offer to win their cooperation?

Unión Fenosa conducted a quantitative and qualitative study exploring the living conditions of the inhabitants of the poor quarters on the Atlantic coast. Cruz then made use of his contacts within the relevant ministries and suggested that they legally regulate these quarters according to resolution 120/2001 passed by the Comisión de Regulación de Energía y Gas (CREG – the Colombian Commission for the Regulation of Energy and Gas). Finally, the quarters obtained the following designation: “areas with sub-standard electrification; human settlements in the suburbs that do not have local public energy service or that tap energy from the local circuit without approval from the network operator.”

Slum inhabitants were legally registered and Unión Fenosa was thus granted public funds

The joint efforts proved successful. Following the regulation of their quarters, inhabitants found their way into the socio-economic stratification being designated as *bajo-bajo* (low-low), the lowest status of six stratas. This was important. From that moment on, the people living in the poor quarters officially became Unión Fenosa customers, and Unión Fenosa – as an energy provider – was granted subsidies adding up to 50 percent of the invoiced consumption. A contribution paid by the government to all companies provided services to *bajo-bajo* population groups that was separate from the amount of money collected directly from consumers.

However, the illegal electricity tapping continued unabated during early 2002. Unión Fenosa decided to shut down the energy supply in the Región Caribe, which backlashed and sparked the aforementioned riots.

A financial problem of relevance

Cruz commented: “In 2002, the loss of energy in all of Región Caribe due to illegal tapping was huge. We lost 42 percent of the energy in the regional network. This represented a financial loss of USD 300 million per year within our core industrial business.”

Overseeing Región Caribe’s end-consumer market in June 2002, Cruz was confronted with low margins, unpaid bills valued at COP (Colombian peso) 500 billion (EUR 170 million, or EUR 121 per client) and losses of about COP 100 billion (EUR 34.5 million). What would have been the financial result without the 50 percent subsidy?

Illegal energy tapping left Unión Fenosa with huge financial losses

Reflecting upon the magnitude of the problem in the Atlantic coast area, José Manuel Velasco, the company’s director of communications, said: “The situation started to be a risk for the survival of the Unión Fenosa companies in Colombia and also threatened the financial situation of the holding. The investments in Colombia represented more than 50 percent of all the group’s investments in the distribution business.”

Were Unión Fenosa’s investments in Colombia about to become a write-off?

Take the challenge or leave the country?

Immediately after the air conditioner had broken down at Unión Fenosa’s headquarters in Bogotá, at about 8:30 a.m. on June 21, 2002, Cruz and López Isla decided not to leave the Colombian energy market. The possibility of sliding into financial quicksand was grave and realistic, but Unión Fenosa had just invested USD 455 million in Colombia, not taking into account the first year’s operating costs. The South American country was Unión Fenosa’s main distribution market outside Spain. It was not feasible to just pick up and leave.

Recent investments in Colombia made it illogical to leave that market

During their conversation, Cruz talked about the need to commit to the social roots of the problem in the poor quarters. But he was interrupted by López Isla: “Let’s not be too academic. We are facing pressing financial problems. I do not know if we

can cope with them by focusing on social issues. But, hey, if we come up with an idea that can solve social and financial problems we ought to give it a try! But let's not forget: Our financial situation should be improved!"

López Isla started enumerating things that went wrong on the Atlantic coast. But Cruz was not listening. The distinction between social problems and financial problems made him realise that Unión Fenosa needed a new perspective on their problems in Colombia, one that combined the company's interests with the socio-economic needs of the population groups living on the Atlantic coast. Until then, they had been thinking solely from a business-interest perspective. Although legitimate, given to the company's investments, it had turned out to be counterproductive. Could it not have been that the issue at stake was not only about financial problems, but about financial problems *and* social problems? With this question in mind, Cruz waited until López Isla paused for a moment, then made the following suggestion:

The amount of energy actually sold to the company's end-consumers only summed up to 60 percent of the invoiced amount. The missing 40 percent could be attributed to the clients living in poor quarters. Of these, 99 percent did not pay for electric energy. Unión Fenosa, he proposed, should stop shutting down energy supplies. "This measure has no effect at all. Instead I suggest that we create payment-awareness in the poor quarters in order to collect money. We already have the 50 percent subsidy, no matter what. We only have to get the remaining 50 percent."

López Isla did not react, so Cruz continued with a second suggestion:

The poor quarters were sub-standard in terms of electrification. Clients most probably did not value the electricity because the wiring was hazardous, old and poorly installed. The government (as the regulator of the electrical system) not Unión Fenosa (as the distributor of energy) was responsible for a fully functional electrical network. Still, Cruz recommended that Unión Fenosa should start standardising wirings in the poor quarters.

Unión Fenosa needed a new perspective which combined company and social needs

Looking for a way out

López Isla did not like the second, but was open to Cruz's first suggestion. To him, creating payment awareness in the poor quarters appeared to be attainable. Toward the end of their telephone conversation on June 21, Cruz and López Isla committed themselves to the idea of creating payment awareness *on the ground*.

It was not easy to tackle the tasks of creating payment awareness and collecting money when facing poverty. What made this undertaking even more problematic for Unión Fenosa was the fact that the company did not have enough capacity and social know-how to do the job properly. Cooperation with local NGOs was not even considered because their assignment would only have consisted of payment-awareness creation and money collection, responsibilities that are not common for NGOs. Two possibilities surfaced: working with people from the poor quarters and coordinating efforts with local SMEs. Cruz decided to engage unofficial communal leaders. He explained: "The communal leaders were trusted within the poor quarters, and they knew that it was fair to pay for their consumed energy. We hoped that the communal leaders would mediate between our company and the people."

Unión Fenosa saw possibilities to create payment awareness in the poor quarters

Advances and problems

By early December 2002, the project was up and running and, during the first five months, things seemed to run smoothly. Earnings within the consumer market in the Atlantic coast region had grown slightly by 9 percent compared to the earnings prior to June 2002 (see *Exhibits 2* and *3* for the company's client and billed energy development in Colombia and in all its operating countries outside of Spain). But in May 2003, money collection stagnated and the communal leaders began to oppose their work. In some cases, the community rejected them because they were not representing their interests but those of Unión Fenosa. In other cases, the lack of infrastructure and organisation and the poor corporate image started to spur confusion in the process of invoicing, increasing the lack of confidence toward the company within the communities. Even worse was that many communal leaders never showed up for work again and took valuable customer information with them.

Cruz was not satisfied with the situation. It was still necessary to substantially improve customer payment. Once again, Cruz sent an e-mail to Spain assessing the situation, eagerly awaiting a phone call from López Isla.

Adopting the new perspective

In their telephone conversation on June 19, 2003, Cruz and López Isla brainstormed:

- Working together with communal leaders was not as successful as expected. Was it time to contact the local SMEs and ask them to do the collection of money? Surely they would have had an entrepreneurial approach toward their task and most probably be more reliable. But how would the people in the quarters react?
- They had foreseen widespread non-payment within the poor quarters, but did not perceive how deeply it was rooted. Just as he had a year earlier, Cruz stressed the importance of standardising electrification. Only by upgrading the value of their electrification, he argued, would people pay for electricity. This time López Isla agreed. But who was going to do the job? Unión Fenosa, the energy generator and distributor, was not legally responsible for the functioning of the network system.

Non-payment originally was not perceived to be so deeply rooted

Was it thus sensible for the company to standardise electrification and, if so, under what conditions? How was the government, the regulator of the electrical system, going to react?

Cruz revisited a thought he had a year earlier: Was it enough for Unión Fenosa to focus on the company's financial situation in Colombia to cope with the problem at stake? Was it not equally important to have the socio-economic needs of their clients in mind? López Isla agreed. The question was: How could Unión Fenosa combine its interests with those of its clients?

Cruz and Unión Fenosa's employees were deeply engaged in creating payment awareness in the poor quarters. At times, they were not able to fulfil other important duties. Was it time to appoint somebody to be responsible for this project alone? Was it time to structurally conduct the project outside of Unión Fenosa?

Until June 2003, Unión Fenosa had considered the problem only from a financial perspective. But after Cruz and López Isla had repeatedly discussed these ideas, and

A new perspective evolved that combined economic and social interests

after they had talked to people inside and outside the company, they decided to manage the project outside of the business structure of Unión Fenosa. The idea was to combine the company's economic interests with the socio-economic interests of the Atlantic coast population groups. Voluntarily conducted social action would be the main axis of a new business strategy – and, thus, *Energía Social* (Social Energy) was born.

Energía Social

Energía Social began operating in early 2004. As a subsidiary to the company, it was only responsible for the commercialisation of energy in districts with sub-standard electrification. Out of several candidates for the post of director, Hernán Maestre was chosen because his appraisal of the situation was in line with that of Cruz and López Isla. Maestre, too, adhered to a holistic perspective: “One of the things that caught my attention were the consequences this project promised to bring about. If we solved this energy problem, the inhabitants of the poor quarters would benefit in multiple ways.”

Maestre and his colleagues had information from Unión Fenosa's 2001 survey: The company had about one million customers living on the Atlantic coast. Apart from that, the CREG resolution had officially turned 300,000 families (dwelling in 427 poor quarters for almost 30 years and illegally tapping electricity ever since) into Unión Fenosa customers. One of the main reasons for their energy consumption was the use of electric fans, which were necessary because of the quick heat build-up in poorly insulated houses. Many of the 300,000 families were part of the 70 percent of the coastline population living under the poverty line.

Pilot project involved plans to standardise electricity in 19 poor quarters

By December 2004, Energía Social had finished planning its pilot project and was ready to act. The pilot project called for the standardisation of electricity in 19 out of 427 poor quarters on the Atlantic coast to enable positive social transformation and electricity payment. The federal government was willing to pay for 90 percent of total expenses. The local authorities agreed to pay for the remaining 10 percent. The expectations of Energía Social behind this project were clear. They wanted to create a management model for the other 408 quarters. This, they hoped, would make them an interesting target for further governmental subsidies and development-partnership aid to standardise electrification and electricity payment in all of the remaining 408 quarters. For Cruz and Maestre to achieve these ambitious aims, many steps were necessary.

Jornadas Técnicas and Proyecto Switche

Energía Social brought together local wire-tappers and professional electricians on 870 *Jornadas Técnicas* (Technical Days) in 2005 and 2006 to repair the old and hazardous wiring installations in the 19 quarters. The local wire-tappers knew the wiring installations and the professionals could rely on them for standardising electrification. In *Proyecto Switche*, professionals and electrical students installed 4,000 domestic fuses. These devices helped people control their consumption and improved the safety of the domestic electricity circuits. Maestre said: “The message we wanted to spread was that standard electrification was beneficial for the people living in the quarters.”

Jornadas Técnicas and Proyecto Switche actually turned out to be very successful projects and popular among the people. New wiring installations substantially reduced

New installations nearly eliminated all electrical risks and reduced the waste of energy

the amount of wasted energy and eliminated nearly all electrical risks. The people in the 19 quarters saw that standard electrification had its advantages, even though they had to pay for the energy consumed. In summer 2005, a new sense of entrepreneurship had rooted and was yielding favourable results. New wiring was especially useful for small businesses as they now had a steady electric supply. For the first time, fighting widespread non-payment seemed to be a realistic task.

Individual energy supply

Previously, both Unión Fenosa and the communities had experienced collective energy cut-offs as threatening lose-lose situations. The company lost its few paying consumers while the other consumers reacted with riots. However, Unión Fenosa still wanted the ability to cut-off energy in the future in case of non-payment. Therefore, Energía Social installed individual and accessible meters in the 19 quarters allowing inhabitants to control their actual consumption. Maestre said: “If you do not do cut-offs people don’t feel obliged to pay. Hence, in order for a cut-off to be efficient for the company, individual cut-offs were necessary.”

Collecting money with SMEs

Parallel to the Jornadas Técnicas and Proyecto Switche, Energía Social decided to collaborate with local SMEs. They were made responsible for the charging, invoicing and payment collection while using the Unión Fenosa brand image. Some quarters preferred to carry on with the communal leader model, but taken as a whole these attempts were not very successful. The chosen SMEs had to meet the following requirements:

- located in the community they were working in;
- run by people who had an entrepreneurial approach towards the tasks at stake;
- accepted by the Junta de Acción Comunal (JAC – Alliance for Communal Action), a group of people with the status of a legal entity representing the community. Unión Fenosa passed on business and administration basics to the SMEs and granted them a 14 percent commission of the money collected.

SMEs were made responsible for charging, invoicing and payment collection

Energía Social worked, but it had to speed up

The communities appreciated Energía Social’s work and perceived it as an improvement to their standard of living. More than 8,000 families were now able to generate employment through small business using equipment that could have never run on old electrical installations. All of this, eventually altered the non-payment attitude. Joaquín Gómez, a baker in the town of Magdalena, said: “People only pay for the bread they actually take from the shelf and only if it’s baked properly. The same goes for electricity. They only pay for the amount they consume and only if it’s safe. Many people I know have started to pay for the electricity they consume. And I’m one of them.”

The change of attitude spawned a growth of financial returns for Unión Fenosa by the end of 2005. Unión Fenosa’s earnings grew by 19 percent compared to the

Change of attitude spawned a growth of financial returns for the company

earnings achieved prior to June 2002. In addition, the new wiring installations lowered the actual use of electric energy.

By early 2006, it was clear that Energía Social had the potential to satisfy both the company's and the population's most pressing needs. But there was a problem: Energía Social was too slow. If standardising electrification in the remaining 408 poor quarters continued running at that speed, the entire process would take 21 years. Maestre was well aware of this problem.

Quick expansion as the main challenge

Energía Social counted on the Colombian government for further financial aid. They also applied for funding from the Spanish government. This would prompt a quick expansion of standard electrification in the poor quarters and would help to increase Unión Fenosa's earnings. It would also create a favourable environment for small businesses, thus essentially contributing to the development of a formal economy with regular taxpayers. But the question of how to finance a quick expansion still remained unsolved in late 2006.

The alternative was that Unión Fenosa would fund the project itself. But would this drag the company into financial decline? Cruz and Maestre looked for possibilities aside from increased funding:

- The operational work-flow could still be improved. The pilot project showed that a lot of information was lost between wire-tappers and professional electricians. Better communication between these two groups could help many households improve their wiring.
- Were there other ways to lower the use of electricity apart from standardisation? New wiring installations in the slums reduced the amount of energy wasted. This helped lower consumption to reasonable levels. As a result, people were more willing to pay for their electrical energy usage. One new idea came to mind: The houses in the quarters were constructed without insulation. When temperatures rose outside, they soared inside. Energía Social planted fruit trees around the houses to create a bio-environmental climate that cooled the temperature in these dwellings, hence reducing the excessive use of electric fans.
- A convenient and transparent payment system was needed that made it easy for people to pay their electricity bills. Not only did people have no addresses, but very few of them had bank accounts. In addition, many of the inhabitants worked as day-labourers and were not in the habit of saving for monthly bills. The government thought about introducing pre-paid cards. But Maestre did not consider this to be an adequate solution because it required costly installation systems. Secondly, it was too late to change the current way of payment because it was already in progress. Instead Maestre looked for other ways to make it clear to everybody that there was a direct relation between consumption and cost. This would help people to better adjust their consumption to an amount they could afford.

For quick expansion the company sought financial help from the government

Transparent payment would allow locals to control consumption

Energía Social's future

In total, Cruz and Maestre felt proud about what they had achieved. They were able to communicate with people in the quarters, at least with those inhabitants who perceived sub-standard electrification as a disadvantage. People were willing to pay for energy consumption as soon as the wiring was upgraded. Earnings had risen. Economic potential within the slums was unlocked. In many cases, in-house workshops were established, which led to the quarters' integration into the formal economy. The government now paid more attention to these communities. The project proved beneficial for both Unión Fenosa and the people in the quarters. Energía Social really had gained ground, but was far from reaching a financial break-even, let alone from being a lucrative business. The vast majority of quarters were still sub-standard in terms of electricity services.

Unión Fenosa was present in other regions of Colombia and in various Latin American countries, in which the company encountered similar problems. Could Energía Social be replicated there? Cruz and Maestre had their doubts if this model was applicable to Colombia's Pacific coast. But they thought that Energía Social might work in Nicaragua where the setting was comparable.

Energía Social with high publicity

By January 2007, 33,538 families had standard electrification and the company's earnings had grown by 67 percent in comparison with June 2002. The implementation of Energía Social created 130 jobs directly and another 1,200 jobs through emerging small business activity. Although there were still about 266,400 families without standard electricity services, international bodies such as the World Bank and the Inter-American Development Bank showed interest in applying the Energía Social model elsewhere. The project was also declared *the most innovative in CSR* by a renowned European CSR organisation in Brussels, Belgium. In early 2007 as Cruz looked back at the events he commented: "If we receive financial aid from the government, things will run very smoothly on the Atlantic coast. We'll break even very soon. If not, we will have to look for other ways to make our business profitable in that region without neglecting the social dimension of Energía Social. We've come a long way and we will not turn back. Even if this project takes time, we will continue. I am very confident." ♦

Energía Social gained ground but was still far from breaking even financially

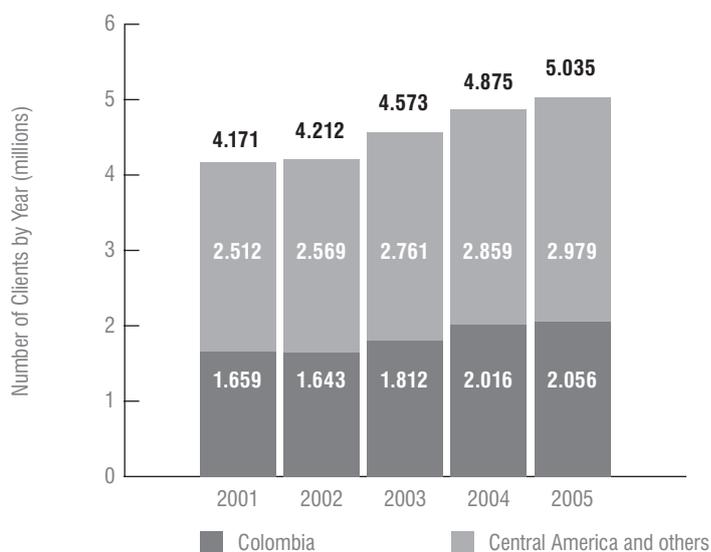
Exhibits

Exhibit 1: Unión Fenosa's investment split in 2005 (in millions of EUR and percent)

	Value of investment	Share of investment
Energy in Spain	697.4	66.7
Energy outside of Spain	284.1	27.2
Other Unión Fenosa Business	35.7	3.4
Subsidiary Company "Soluzia"	29.0	2.8

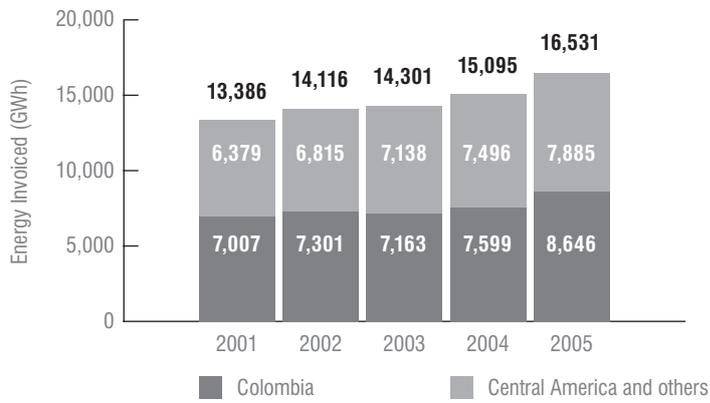
Source: Memoria Unión Fenosa

Exhibit 2: Unión Fenosa's clientele in Colombia and in its operating countries outside of Spain



Source: Memoria Unión Fenosa

Exhibit 3: Unión Fenosa’s annually billed energy in Colombia and in its operating countries outside of Spain



Source: Memoria Unión Fenosa

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Teaching Note: Unión Fenosa

Unión Fenosa: Taking its focus from the financial to the social portrays Víctor Cruz, Unión Fenosa's general director in Columbia, coping with electricity thievery in the slums of the country's Atlantic coast region. The illegal energy tapping posed major financial problems for the Spain-based integrated energy company and led to severe electricity shortages, which sparked enormous social tensions.

The case opens in 2002 and outlines a five-year process of trial and error initiated by Cruz, which eventually led to a solution that benefited both, the slum dwellers and Unión Fenosa. After realising that shutting down energy supply and raising payment awareness within the slums led neither to an increase of money collection nor to an ease of social tensions, Cruz and his colleagues started to think beyond their financial objectives, and created added value opportunities within the population – in order to maintain their own financial interests. Unión Fenosa started to standardise electrification in poor quarters (a job that was largely financed by the government and conducted by Energía Social, a newly established company subsidiary).

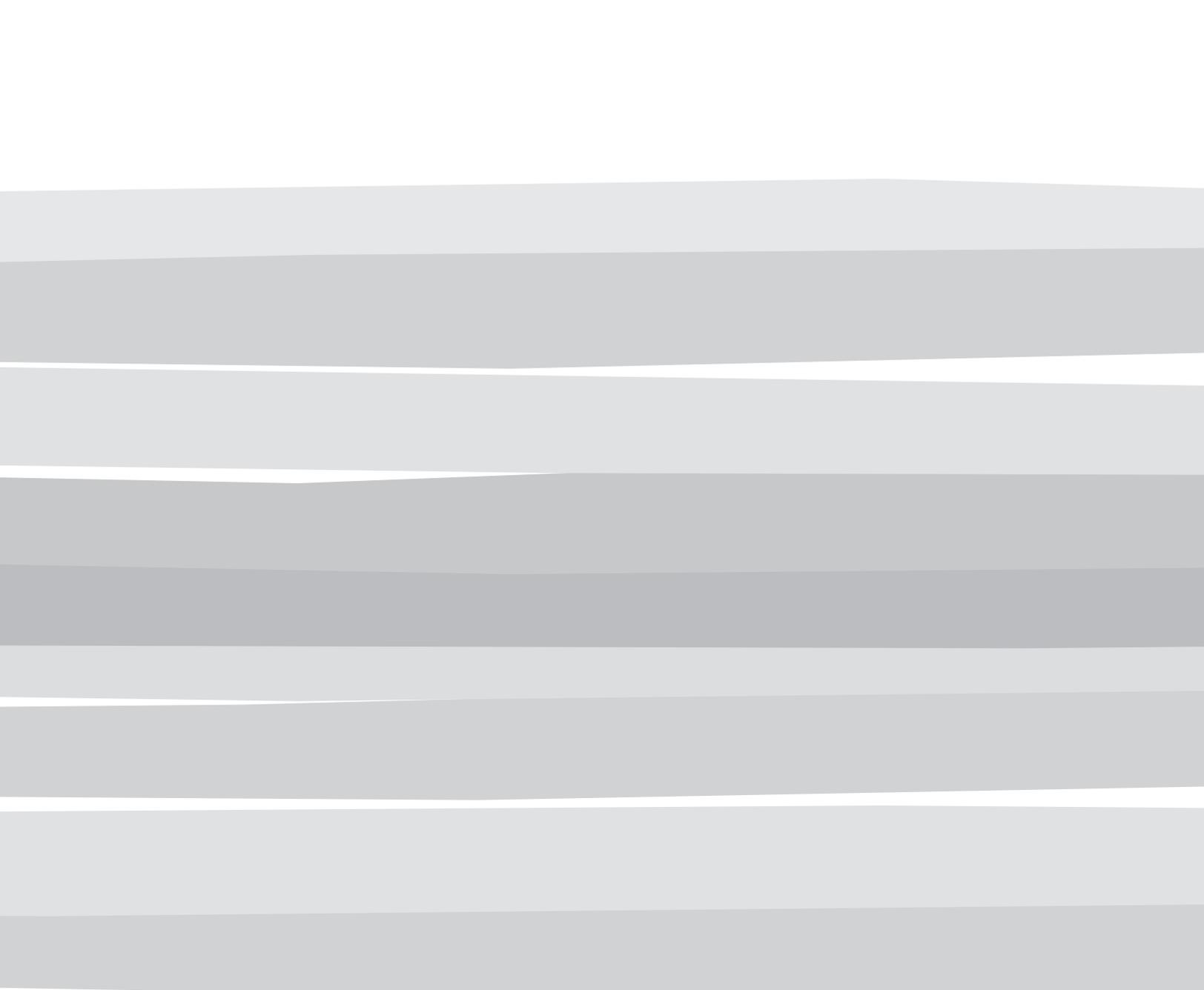
What was the effect?

- Standardised electrification created a setting that helped microbusinesses emerge within the slums.
- Slum inhabitants started to perceive the advantages and the value of standard electrification (socio-economic development and the elimination of electrical risks), which led to noticeable increases of Unión Fenosa's earnings.

From an economic perspective conducting business in the developed world is challenging. The particularly challenging aspect for managers operating in the developing world is that social problems tend to interlock with business operations, thus transforming the inherent quality of business. Underdeveloped physical infrastructure, political instability, widespread poverty, a large informal sector: These social problems, among others, form specific milieus, which demand specific solutions from businesses – solutions that essentially are socio-economic. Serving low-income customers with newly developed, innovative services and products is one way of responding to that demand. *Unión Fenosa: Taking its focus from the financial to the social* suggests that another way can be increasing the socio-economic convenience of already provided services and products.

The case shows: Even if a service or product – like the provision of electricity – is already fully developed, companies can re-design it along the lines of efficiency, functionality or social value creation in a way that benefits the company and society.

The case also shows how business executives can manage to do so: Companies are challenged to interlock their economic interests with the socio-economic interests of the communities they operate in. What was the basic structure of the case? Company income (a company interest) didn't increase via energy cut offs or awareness raising, but because old and hazardous wiring installations were replaced by standard electrification (a community interest). By improving living conditions, company earnings grew. ♦



Chapter 3

Community and Development

CSR and CC: Social responsibility and corporate citizenship

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Abstract

CSR and corporate citizenship CC programmes have expanded around the globe. Hence, the understanding of CSR and CC has become widespread. Still, strong differences, based on historical and cultural norms, remain. Apart from shedding light on the various driving forces that internationalize the CSR and CC debate and giving an outlook on its possible future development, this essay mainly focuses on corporate volunteering and corporate partnerships. From an historical perspective, the two can be perceived as new elements of CC. Therefore, the author gives a brief overview of their meaning, interpretations and benefits. A categorization of common types of corporate partnerships is meant to help the reader understand and discern this complex form of CC from others.

**CSR and CC
programmes appear
in diverse forms**

Introduction

For more than a decade, CSR and CC programmes have started to appear across a number of enterprises and in diverse forms. Fair trade, labour conditions and environmentally compatible production have become central CSR issues. In a typical CC programme, employees are sent to social institutions or take part in social projects. In recent years, CSR and CC have been seen as a part of sustainable management. The main aim is to incorporate social and ecological aspects rather than solely taking economic indicators into account. CSR and CC are essentially entrepreneurial initiatives which originated in the US more than two decades ago. Since the beginning of the 1990s, CSR and CC programmes emerged in various parts of the world, outside the US. In Europe, CSR and CC initiatives began appearing in the mid-1990s.

The emergence of CSR and CC is best explained with sociological arguments. It reflects a process that obliterates the boarder between the economic world and society in general. The two can no longer be seen as disconnected and independent spheres. We have become aware of the fact that society itself is a precondition for economic and entrepreneurial management and thus is considered to be a key enabler. Hence, preserving and ensuring the reproduction of social and ecological resources is not only seen to be rational from a social, but also from an economic perspective. CSR and CC can be seen as an investment in social, as well as in environmental capital.

Various understandings

The emergence of CSR and CC all across the globe, however, led to varied and diverse interpretations, that barely correlate with the original application initiated in the US. In part, we have a tower-of-babel like confusion which is certainly understandable: CSR and CC processes have both historical and cultural features and, hence, the respective regional or national understandings are diverse: The idea of CSR and CC originated in liberal market economies, which generally contain only a few social state institutions. In social market economies or welfare states, which are predominant in Europe, collective bargaining and corporatist structures lead to a different understanding of responsibility and civic commitment. Social market economies with powerful state institutions, such as the People's Republic of China, yet again have separate CSR conceptions and forms of practice.

**The idea of CSR and
CC originated in liberal
markets**

Corporate Social Responsibility

CSR refers to the core business of an enterprise – to its economic activities. These include social issues, such as fair trade, improvement of working conditions, control of the value-added chain, etc., as well as ecological issues, such as eco-friendly production processes at domestic and international production sites, etc.

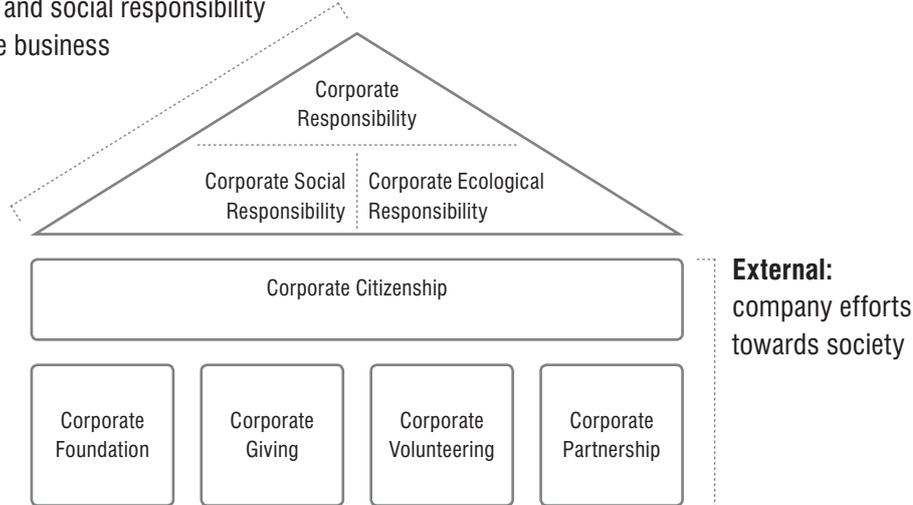
Corporate Citizenship

CC, in contrast, is not directly related to business activities, but rather focuses on how companies relate to society in general; that is on the civil efforts of companies and their employees.

CC is based on the Anglo-Saxon concept in which the enterprise is seen as a corporate citizen, which, as a member of society and like individual citizens, not only has rights, but also duties. The US is dedicated to an idea of citizenship, which is related to the aspiration to behave as a good citizen. CC contains traditional concepts

Internal:

ecological and social responsibility
within core business



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such as corporate giving and corporate foundations, as well as modern forms of corporate volunteering and corporate partnership. The latter are directly linked to social and environmental aspects and are often seen as community building processes. Corporate giving mostly involves sponsoring local associations and initiatives. Sometimes enterprises heighten the quantity of employee-donations in so-called *matching programmes*. The main task of corporate foundations is to support and foster the social environment of their parent companies. Their objectives thereby stretches from funding already existing social, cultural and environmental projects to initiating new programmes, which incorporate their companies' employees.

Corporate volunteering

Corporate volunteering and corporate partnerships are relatively new elements of CC. Companies, which initiate corporate volunteering, do not take action themselves. They rather support their employees in their commitment to the company's social and cultural environment. It is essential to keep the difference between corporate volunteering and corporate giving in mind: Corporate volunteering does not deal with granting funds to the employees or to non-profit institutions on behalf of the enterprise. It rather encompasses the deployment of employees to the benefit of companies' social and environmental context. It can include single-day or week-long as well as so-called *secondments* (meaning, for example, long-term deployment of employees to NGOs).

Corporate volunteering in Europe differs from its origins in the US, where it is a question of either supporting already existing civil initiatives or encouraging employees to engage in these. America's history of citizenship, the widespread of citizen activities and a common commitment of Americans to their communities, is the underpinning to this kind of volunteering tradition that is less prevalent in Europe – which is why it was necessary to convince European enterprises of the economic benefit of corporate volunteering in the 1990s.

This discussion on corporate volunteering's benefits is still prevalent and goes in two directions. Firstly, it is assumed that corporate volunteering enhances employees' social qualifications or skills. Secondly, projects are linked to the

Corporate volunteering and corporate partnerships are relatively new elements of CC

Corporate volunteering becomes an instrument of corporate human resource development

expectation to strengthen the common bond and teamwork and cooperation capacity among employees. Seen from this perspective, corporate volunteering turns into an instrument of corporate human resource development. And actually, in many European countries it is still rarely of concern if and to what extent corporate volunteering projects strengthen society. But this leads to undesired consequences: It is rarely reflected upon, whether corporate volunteering initiatives align to the overall picture of companies. Instead, corporate volunteering packages are bought or carried out in licence. Often, employees feel pressured to participate in corporate volunteering events. Their willingness to volunteer thus is abused. Finally, if corporate volunteering is seen one-sidedly in terms of corporate benefits only, the social gap between companies and NGOs deepens.

Corporate partnerships

The issue of a one-sided perspective on corporate benefits also arises in the context of corporate partnerships, as they are initiated by the enterprises themselves, rarely by employees or NGOs. The following three forms of corporate partnerships can be distinguished:

Type	Pattern of action	Objective
Benefit-oriented	Weighing options	Create a win-win situation
Philanthropical	Giving	Help a target group
Image-oriented	Visualising	Raise public attention

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Corporate partnerships differ in type, action and objective

The *benefit-oriented type* seeks a win-win situation: It is a matter of balanced cooperation in the sense that both sides benefit. But this does not mean that the hierarchy or the unequal relationship between the actors are called into question or are even overcome. Other forms of cooperations, which are based on a *philanthropy*, understand the engagement as a time-donation from the entrepreneurial side in order to deal with certain social problems or to help a specific target group. In doing so, a relation of solidarity between the actors is created, but it remains one-sided. Thereby, the power-decline is maintained and at times even reinforced due to the one-sided logic of giving.

The *image-oriented type* – as the name suggests – typically focuses on the generation of a positive image. And this objective is not only defined by companies. NGOs also benefit from this type of cooperation, as the topics they advocate are very often enhanced and made visible in framework of public discourse.

The differentiation of corporate partnerships is a static categorisation. In reality, the objectives and motives blur. Still, it can be said that the *benefit-oriented type* predominates in most of the European countries, whereas the *philanthropic type* is much more common in the US. Philanthropic motivation often aims at community development and CC is mostly a part of comprehensive corporate community involvement strategies. And the *image-oriented type*? Currently, it is on the rise all around the globe.

International networks and standards

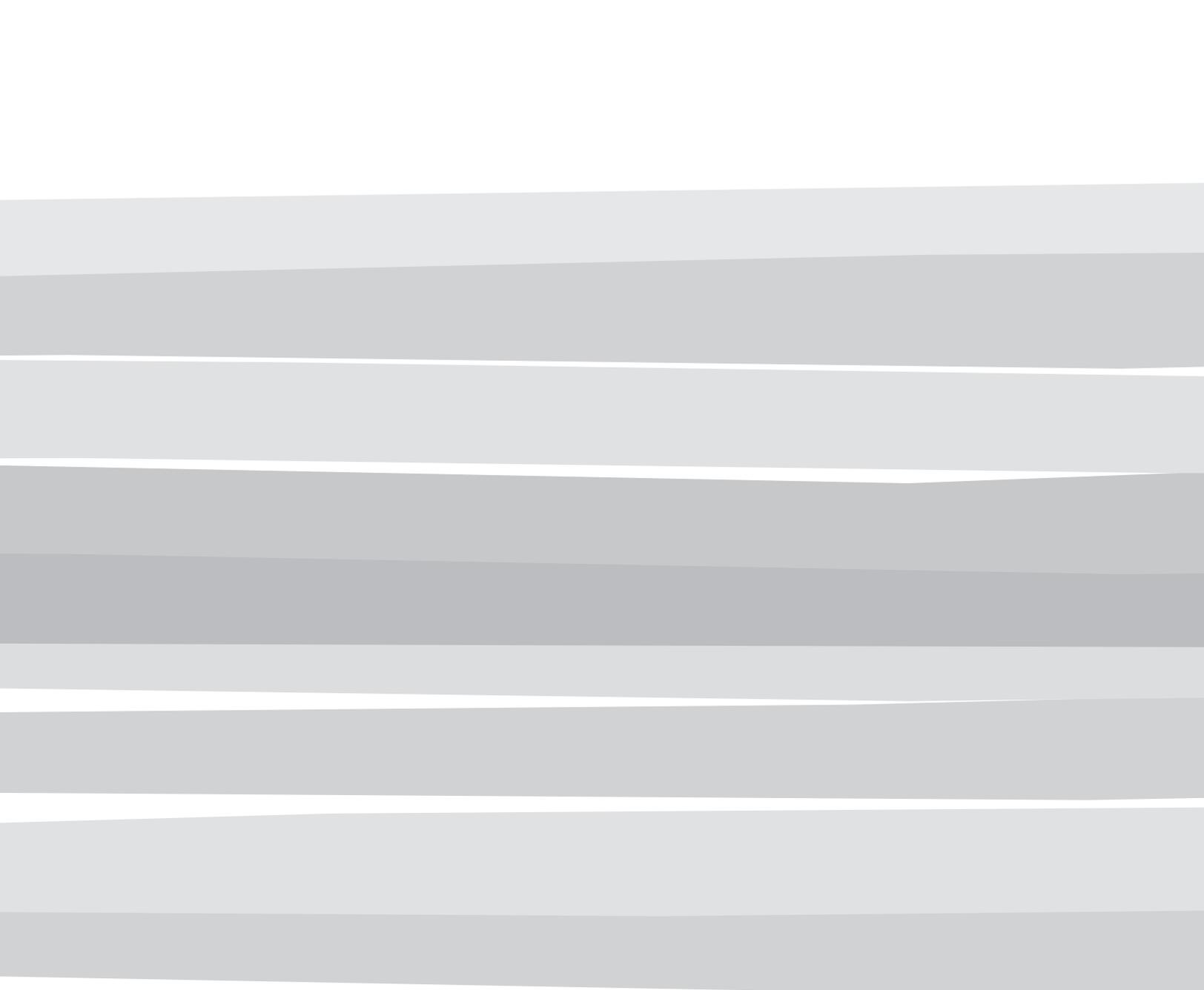
The debates within the CSR and CC process have become international in recent years. What are the reasons? First, the increasing worldwide expansion of European enterprises accompanied by their growing international orientation. Hence, there is more competition with those enterprises which have already established CSR and CC cultures and communicate them to the wider public, particularly to their stakeholders and consumers, who somewhat force an increasing number of corporations to deal with CSR and CC topics. A second reason is the growing number of international networks, such as Global Compact, the Declaration on Fundamental Principles and Rights at work adopted by the member states of the International Labour Organisation ILO, International Organisation for Standardisation ISO, CSR Europe as well as the implementation of international standards, such as: AccountAbility 1000 AA1000, Social Accountability 8000 SA8000, and Global Reporting Initiative. These forms of internationalisation enormously strengthen globally operating NGOs, which engage in economic and business related issues apart from intervening as soon as socially and ecologically problematic topics arise. Stakeholders – regardless of type – nowadays play the most important role in the implementation of CSR and CC, whereas governmental and national institutions noticeably contain themselves with regard to CSR and CC's general framework and governance.

Most important role in the implementation of CSR and CC: the stakeholders

The triple bottom line

Participants of the ecologically-oriented debate on sustainability are of special importance. Within the last years they have managed to contribute greatly to the discussion over CSR and CC. These stakeholders can build on years of negotiation-process experiences with corporations and governmental institutions. They have developed a certain understanding, strategy and form of cooperation. These experiences could be quite helpful in discussions about CSR and CC, even if they lack the reflection on CSR and CC's economic and social relevance. This is why amalgamations of various contents occurs; this is also why attempts to subsume CSR and CC under the well-known paradigm of sustainability are undertaken. A real integration of the debates has yet to occur. Nevertheless, the prevalence of CSR and CC will most probably increase, if a common interpretation of sustainability is developed. Conceptually, the idea of the three basic dimensions of sustainability will probably held spark this development: Sustainability *equally* refers to social, environmental and economical issues. Social responsibility and citizenship of corporations actually consists in positively affecting all the three. Among companies, the concept of sustainable management – relating to the *triple-bottom-line* – could further prevail: Accordingly, economic success goes hand-in-hand with the creation of environmental and social value. In this sense, the sustainability paradigm would doubtlessly be a gain for CSR and CC. It also is predictable, that this integration incorporates great potential for the responsible handling of social and ecological resources. Processes, which obliterate the border between society in general and the business world, will probably enhance collective learning processes towards a global civil society. ♦

Sustainability is about economic, social and ecological issues



Business Case

Mondi: The importance of stakeholder dialogue

It was a sunny morning in late July 2003 as Viv McMenemy entered the headquarters of the then South African-based Mondi Group (Mondi, hereafter) in downtown Johannesburg, South Africa. McMenemy had a master's degree in economics, had previously worked for the African National Congress ANC and was considered one of the country's foremost economic development experts – the type of person David Hathorn, CEO of Mondi, was looking for. Hathorn and top-level executives decided to evaluate and streamline sustainable development SD across the group as Mondi's business units, Mondi South Africa (Mondi SA, hereafter) and Mondi Europe, were in the process of being vertically restructured into Mondi Business Paper and Mondi Packaging. (In this way, both units would thereby end up managing their specific functions across national borders). One of the first steps in that direction was to appoint a group SD director to develop and lead a global SD strategy.

During their discussion that morning Hathorn was impressed by McMenemy's knowledge and analysis of Mondi's local SD activities in South Africa. To her, bullet-pointing these projects was not a problem. They ranged from adult literacy and waste paper recovery programmes, contributions to the creation of SMEs, the set-up of schools for disabled, the rehabilitation of large areas of forestry plantations into wetlands and grasslands, to bee farming projects aimed at preventing forest fires (as beehives were often robbed on Mondi's property by 'smoking' the bees from their hives, resulting in forest fires). The problem with these activities, said McMenemy, was that these projects were mostly managed at a local level and there was a need to comprehensively assess the economic, environmental and social values from a corporate and national perspective. Their diversity, she continued, probably reflected a reactive compliance with Anglo American plc's requirements (a mining giant founded in South Africa and the group's owner until 2007) rather than a Mondi-specific strategy.

Hathorn complemented her remarks by explaining that her thinking was probably applicable to most of Mondi's SD activities throughout the world. If she were to accept his offer, he said, she would not only be made responsible for SD in Mondi's South African operations, but for all of the group's respective SD activities around the world. He hoped she would. Why?

During the early post-apartheid period South Africa saw the outsourcing of labour

South Africa was the “hot-spot” of the group with regard to its social SD activities: Mondi’s country of origin was still in a complex transitional process from apartheid to democracy. During the early post-apartheid period the country experienced the outsourcing of labour and subcontracting within Mondi and practically throughout the country’s entire industrial sector due to the implementation of new labour market regulations that experts perceived to be disproportionately employee-centred.¹ This had positive, short-term economic effects for companies, but the socio-economic consequences, such as high unemployment rates (with all the corresponding implications), proved to be pressing. Many of the mentioned Mondi SD projects within South Africa were designed by individual business units to cope with these challenges.

So, it was clear to Hathorn that inside-knowledge of the societal and political dynamics in South Africa was an important requirement for Mondi’s new SD director – and McMenamin had that knowledge. Coming from outside of the corporation, he thought, she would also have an unbiased perception of the socio-economic impact of Mondi’s business and SD activities in South Africa, which would allow for their objective assessment and the improvement of Mondi’s social performance within the country – “one of our most prominent challenges”, said Hathorn, next to developing the new group-wide SD strategy. Two weeks after their discussion McMenamin agreed to accept Mondi’s offer. She was officially appointed as the group’s SD director in March 2004 and was anxious to do a good job.

The Mondi Group

By 2007, Mondi was an international paper and packaging group with key operations in western and emerging Europe, Russia and South Africa. The group was principally involved in the manufacture of packaging paper and converted packaging products, uncoated fine paper as well as speciality products and processes, including coatings, release liners and consumer flexibles. The group was fully integrated across the paper and packaging production process, from the growing of wood and manufacture of pulp and paper, to the converting of packaging paper into corrugated packaging and industrial bags. Based on its 2007 sales, the group was Europe’s number-one producer of kraft and office paper and the continent’s leading bag converter. In addition, Mondi was South Africa’s number-one manufacturer of corrugated and plastic packaging as well as containerboard.

Trends shaping the paper and packaging industry

In his 2008 survey, *Top Ten Issues: 2008, Paper and packaging industry*, published on Deloitte’s corporate website, John Dixon presented trends which he thought would affect the industry in the near future. He predicted that paper and packaging companies would perpetuate their process of consolidation and thus make costs and pricing more stable – as they strive to find creative ways to cut energy costs (which already account for up to ten percent of total costs in industry-typical companies). Organisational structures would continue to flatten, he presumed, while the industry’s vertical integration was being questioned due to massive timberland sales conducted by some of the market leaders. End-consumers in the developed world, he projected, would continue to exert pressure up the supply chain as they increasingly demand

End-consumers in the developed world will continue to exert pressure up the supply chain

environmentally friendly production processes. Emerging markets, he finally stated, would become large consumer markets as the use of copiers and printers increased, while continuing to be low-cost locations for routine operations. This remark echoed Mondi's own wording in its 2007 sustainability report, which expressed their group-aim to be "the lowest-cost producer in our market, by selectively investing in forestry and production capacity in low costs regions."

Mondi in detail

Mondi's roots reach back to 1967, when Anglo American built the Merebank Mill. Following more than twenty years of growth and consolidation in South Africa, Mondi came to Europe in the early 1990s and started a long period of expansion through acquisitions. Businesses were bought in the UK, France, Russia, Slovakia, Poland, Hungary, Denmark, the Netherlands, Bulgaria and Italy, as well as Austria (where the 200 year-old paper producer Neusiedler AG was taken over in 2000). In November 2004, Mondi's business units (Mondi SA and Mondi Europe) were restructured into Mondi Business Paper and Mondi Packaging. By 2008, after having successfully demerged from Anglo American the previous year, the group operated two divisions – namely Europe & International and South Africa, with corporate offices in the UK and South Africa.

In 2007, Mondi had production operations running in 127 sites across 35 countries and an average of 35,000 employees. Its three primary business streams were *Corrugated* (products ranging from shelf-ready packaging solutions to heavy duty packaging), *Bags and Specialities* (such as kraft paper, market pulp, industrial paper bags and flexible plastic-based products), *Uncoated Fine Paper* (office paper, market pulp and specialised paper-based print products).

Mondi had a dual listed company DLC structure comprised of Mondi Ltd., a company registered in South Africa, and Mondi plc, a company registered in the UK. Mondi Ltd. had a primary listing on the Johannesburg Stock Exchange, while Mondi plc was primarily listed on the London Stock Exchange. Nineteen Mondi Ltd. shareholders held 49.96 percent of company shares on December 31, 2007; 53 shareholders had 79.65 percent of all the Mondi plc shares that same day. As of 2007, the company had revenues of EUR 6.2 billion and an EBIT of EUR 502 million. Packaging product sales accounted for 62.9 percent of total revenues and paper sales accounted for 37.1 percent. For comparative purposes: International Paper was the industry's peer in 2007. It's 51,500 employees generated revenues of USD 21,9 billion with an EBIT of USD 1.1 billion.

Mondi came to Europe in the early 1990s and started a long period of expansion

Mondi had a dual listed company structure and was based in the UK and South Africa

Sustainable Development at Mondi

Mondi's mentioned aim to be the lowest-cost producer in the industry was reflected in the following facts: In 2007, Mondi owned or leased 1.9 million hectares of forest in the low-cost regions of Russia and South Africa (which corresponded to 47.9 percent of Austria's entire forest area that year). This allowed an annual cut of eight million solid cubic meters of wood, which were then processed into 3.8 million tonnes of pulp. In his opening statement of the group's 2007 sustainability report, Hathorn expressed his commitment to community engagement and global standards of employment throughout the company's operations, including in the low-cost regions, in addition

to focusing on issues such as responsible procurement of wood and the reduction of CO₂-emissions.

In fact, as Mondi experienced rapid growth in transitional economies, it was of particular importance to the company to enable the integration of employees and external stakeholders within local, regional and global value chains. The company's proprietary socio-economic assessment toolbox SEAT, developed by Anglo American in 2002, was designed to help initiate that integration process by assessing the social impact of its business operations.

Historically, the forestry industry had often been a focus of criticism for its less than acceptable environmental practices. The impact of some operations – especially the unsustainable exploitation of northern and tropical forests – was too drastic to be easily forgotten. Mondi has addressed these concerns by implementing scientifically sound environmental practices in its forestry operations, while taking into consideration those communities which rely on the forests for their livelihood. In Russia, the company initiated a multi-stakeholder dialogue process to set aside areas of pristine virgin forests while enabling rural people to continue making their living from these forests. In South Africa, wall-to-wall planting and the inappropriate use of grasslands and wetland areas created environmental and social problems on Mondi properties. As of 2002, Mondi was creating plantation-free buffer zones around wetlands and riparian zones (areas close to rivers, streams or lakes) to conserve water resources and associated biodiversity on its 350,000 hectares in South Africa.

The forestry industry had often been a focus of criticism for its environmental practices

Mondi challenged to address forest fires in South Africa

A decade earlier, in the 1990s, Mondi was confronted with an unusually high occurrence of forest fires in South Africa, particularly in the Mkhondo business unit. Company estimations suggested that a yearly average of circa 1,000 forest fires on the 75,000 hectares of the Mkhondo business unit alone resulted in losses of ZAR (South African rand) 50 million (EUR 5.5 million).² Why did this occur? It was difficult to find a direct answer to that question, but probably some of the main reasons were outsourcing and subcontracting.

Between 1994 and 2004 (the first ten years after apartheid) South Africa experienced an enormous economic catch-up: A yearly real GDP growth rate of 3 percent between 1995 and 2003 was about double the rate recorded between 1980 and 1994. But the official unemployment quota remained high, namely at 26 percent in 1994 and in 2004. What were the reasons? One was the implementation of somewhat employee-focused labour market regulations, which not only nourished unemployment, but also employment avoidance from the corporate side: Firms developed complex mechanisms to avoid labour legislation costs, including outsourcing and subcontracting³. This was also the case with Mondi as the following facts referring to the Mkhondo business unit show.

With its 75,000 hectares of forestry plantations, the Mkhondo business unit produced wattle pulp, mining timber, gum pulpwood and pine pulpwood. In 2004, it had an average yearly wood-product output of 1.1 million tonnes and directly supplied the company's packaging mills in Piet Retief and Richards Bay, as well as the Mining Timber mill in Piet Retief. This business unit was located in the Mkhondo Local Municipality, which was a part of Gert Sibande District Municipality, one of the three district municipalities in the Mpumalanga province. Mkhondo covered 4,868 km² and

South Africa experienced an enormous economic catch-up, but unemployment rates remained high

had a population of about 147,000, which meant that it was practically double the size of Luxembourg while having one third of that country's population. The predominant language in Mkhondo was Zulu, one of the eleven official languages in post-apartheid South Africa. By 2004, the Mkhondo business unit had 41 direct employees; another 4,000 were employed indirectly via eight contractors appointed by the unit to run its silviculture and harvesting operations in five sub-units called *Amsterdam*, *the Bends*, *Zoar*, *Vrede/Mooihoek* and *Tower Forest/Derby*. But business operations had not always been managed that way.⁴

The Mkhondo business unit had 41 direct employees; another 4,000 were employed indirectly

In the course of its long period of expansion and consolidation within South Africa, Mondi bought Natal Tanning Extract's core plantations in 1992 and formed what was later known to be its Mkhondo business unit. Prior to 1998, the workers were directly employed by the company and received fixed wages. In 1999, Mondi decided to outsource forestry operations. The aforementioned sub-units were given contractor status. Former supervisors became the managers of these newly established firms, which were now in charge of their own logging operations. Retirement packages of ZAR 15,000 (EUR 1,650) were given to the workers and they were requested to choose whether they wanted to work for the new contractors under their conditions or seek new jobs elsewhere. The contractors paid their workers on an output-related, per-pole-basis. From a short-term, cost-related point of view, these measures achieved their objectives: Prior to 1998 the unit's harvesting costs stood at an average of ZAR 75 (EUR 8.25) per tonne of harvested wood; the new operational system led to an average saving of ZAR 49 (EUR 5.39) per tonne. From a long-term perspective these measures unfolded to become a hindrance for sustainable business operations as local community infrastructure deteriorated in an outsourced model.

Redefining Mondi's SD activities

In March 2004, when McMenamin started her new job as the Mondi group's SD director, she frequently met with Mondi executives in order to evaluate how to best drive SD across a consolidated company. Apart from gathering information on ongoing SD activities, she focused especially on reviewing the SD risks and opportunities that the group was facing in order to then define SD priorities. By September 2004, she was able to bullet-point the risks, opportunities and SD objectives, which were then published in the group's 2004 SD report. The risks and opportunities perceived by Mondi were:

In 2004, Mondi evaluated how to drive sustainable development across a consolidated company

- Good SD practices in Europe
- Growing group exposure in transnational economies
- Increasing contracting
- Stakeholder expectations that Mondi assumed increased responsibility for forestry
- The opportunity to profile the group around environmental excellence and innovation
- The successful integration of new acquisitions

The SD objectives that were thus defined were as follows:

- The implementation of good governance
- The development of economic development guidelines
- The pursuit of environmental excellence
- The improvement of the group's social performance, especially in transitional economies

Measures were then short-listed to achieve these objectives. These ranged from the establishment of a SD committee to coordinate SD issues throughout the group (governance), the development of local economic development guidelines (economic), the creation of a group energy strategy (environment) and the increased understanding of the communities in which Mondi operated through further SEAT assessments (social).

Shifting focus from the outcome of SD activities ...

More fully engaging with and listening to stakeholders to improve the group's social performance was of specific importance in South Africa, McMenamin quickly understood. Why? Because the various, respective SD activities Mondi implemented in the country on divisional, regional or local level did not seem to adequately respond to the socio-economic context of its business operations. They might be outcome-oriented in the sense that they achieved their project objectives, McMenamin often said when talking to executives in South Africa, but they lacked an impact from a corporate and a societal perspective. This became very clear to McMenamin during a briefing with regard to the Mkhondo business unit.

Roughly estimated 10,000 people were living in 56 villages on Mondi's property in Mkhondo. Average unemployment rates stood at 40 percent. The majority of the people were subsistence farmers, living off raising cattle.

Low levels of education were predominant, as was a lack of basic water and energy supply, sanitation and health services. Many villages only had one or two water pumps, which very often were located as far as 200 metres from the nearest dwelling and frequently needed repair. None of the 56 villages had a sewage system, only one had electricity supply. Stable housing hardly existed. Rates of HIV/AIDS infections were estimated to be around 35 percent.⁵

... to business operations' socio-economic impact ...

In order to cope with these pressing facts, Mondi had engaged in a number of SD activities in Mkhondo during the late 1990s and early 2000s, encompassing education and health services that were coordinated by the community engagement facilitator CEF, a member of Mondi's full-time staff. The CEF was chiefly responsible for the management of social issues associated with the operation and the establishment of working plan units WPU forums, which allowed for local stakeholder complaints and issues to be raised and addressed.

More fully engaging with stakeholders was important for Mondi in South Africa

The Nodal System project had to be stalled without any tangible results

One of the SD concepts in the Mkhondo business unit had been the proposed idea of village consolidation (called the *Nodal System*): Mondi planned to solve the aforementioned acute need for basic infrastructure provisions by regrouping the majority of the residents of the 56 poorly planned and equipped villages into five consolidated nodal villages, which could then be more efficiently supplied with basic infrastructure, provisions and services. But the project had to be stalled in late 2003 without any tangible results because of the lack of capacity to deliver at a local level.

... in order to cope with pressing social needs in South Africa

Generally speaking, Mondi's historical socially-focused SD efforts had not made a difference to the overall socio-economic picture in Mkhondo. In early 2004, forest fires were still a common way for the local inhabitants not only to rob wild beehives on Mondi property, but also to express their sentiment of general discontent. Therefore, in order to more fully understand stakeholders' needs, McMenamin decided to focus on and evaluate the immediate socio-economic impact of Mondi's business operations (rather than the company's individual SD projects). Business operations (not separate SD activities) were the company's main interface with society. Evaluating Mondi's socio-economic impact from that perspective would thus lead to a deeper understanding of stakeholders and improve the group's social performance in South Africa. Shifting from outcome to impact was a question of efficiency.

Shifting focus from outcome to impact was a question of efficiency

Socio-economic assessment toolbox: The SEAT process

In the early 2000s it became clear that other companies within the Anglo American group in South Africa were confronting similar challenges. Executives were trying to professionally evaluate the socio-economic impact of business operations in order to more fully understand stakeholders and to improve their individual company's social performance. Within this framework SEAT emerged in 2002 and when McMenamin joined Mondi in 2004, she was pleased to have a seemingly effective tool at hand to assess the impact of Mondi's South African business operations from a socio-economic perspective.

"The SEAT process can be broken down into five distinct stages", said McMenamin when explaining SEAT to executives in South Africa, "Stage one", she said, "refers to the definition of the specific objectives of the SEAT process. Stage two", she continued, "profiles the local Mondi business unit and its neighbouring communities apart from identifying key issues at stake. Stage three aims at evaluating Mondi's economic and social impact. Stage four provides guidance on management responses to key issues, while stage five consists of reporting back to stakeholders" (see *Exhibit 1* for a bullet-point overview of the key steps in the SEAT process).

Although the SEAT process in Mkhondo had the highest priority for reputational reasons, McMenamin also wanted SEAT to be implemented in SiyaQhubeka forestry operation in Zululand, the Richards Bay pulp operation in Richard Bay, the Merebank paper operation in Durban and in the Peak Timbers operation in Swaziland. To her the number one objective for an implementation of SEAT in all the five business units would be to identify and assess the (positive and negative) socio-economic impacts that Mondi's operations had on local communities and other relevant stakeholders within the company's zone of influence.

The SEAT process in Mkhondo had the highest priority for reputational reasons

Would they succeed? She was positive they would due to a number of reasons:

- The SEAT process contained group-wide best practice experience and encouraged third-party involvement throughout the entire process, all of which would build trust and credibility.
- The process was designed not only to consult with directly affected stakeholder groups, but to also consult with interested parties (such as neighbouring farmers and church leaders) as well as local authorities. This broad perspective, she believed, would help to construct a wide picture of reality.
- Finally, she thought the interactive quality of SEAT would foster true dialogue and build confidence.

The SEAT processes were set up by Mondi together with two local consultants, KSE-Ukhozi Environmentalists and Environment Resources Management ERM in 2004. They were then carried out from November 2004 to February 2005. Quantitative data, such as exact population figures, were drawn from municipal documents. Qualitative data, such as perceptions and attitudes, were collected through open-end one-to-one interviews as well as moderated open-end group discussions. In Mkhondo, a total of 1,800 individuals, representing 21 stakeholder groups, were consulted in that time. They ranged from Mondi employees to private medical services (see *Exhibit 2* for an overview of the 21 consulted stakeholder groups).

The insights SEAT provided

The stakeholders mentioned a number of (positive and negative) socio-economic impacts they linked to Mondi's business operations in Mkhondo. They were pleased to see Mondi initiating a large-scale stakeholder dialogue. They also endorsed the company's ongoing contribution to the local economy.

But they were less satisfied with the weak flow of information from the company to the communities. Poor communication between Mondi's management and the local communities was perceived to be a factor significantly contributing to community discontentment.

Stakeholders also mentioned that Mondi did not always deliver on its commitments and they raised numerous other concerns regarding the working conditions under contractors (such as working hours, remuneration and safety).

Furthermore, overgrown plantations were perceived to create unsafe conditions for women and children (such as crime and rape) and tensions had arisen between Mondi and village inhabitants over the grazing of cattle and the collection of firewood on company property.

Finally, concerns were raised that Mondi stood to lose a large proportion of their work-force due to the high percentage of labourers reportedly being HIV positive.⁶

Lack of social perspective: Using the insights of SEAT process to re-align SD efforts
Did this feedback relate to the results found in the other business units' SEAT reports? By February 2005, McMenamin knew it did: Poor communication was mentioned on numerous occasions, as were problems relating to subcontractors. The reduction of

Stakeholders gave positive and negative feed-back

local employment opportunities in forestry operations due to the use of mechanical harvesters – which was perceived as a negative socio-economic impact in the other four business units – suggested that large proportions of employees in South Africa feared the loss of employment.

Large numbers of employees feared loss of employment

When analysing the feedback, McMenamin understood that a lack of social perspective was the key problem in those communities with which Mondi had engaged via SEAT. In Zululand, Richards Bay, Durban and Swaziland, people said they were afraid of losing their jobs. In Mkhondo, the problems and tensions with regard to the collection of firewood and grazing cattle conveyed the same fear, but from a different angle: People were trying to make a living (e.g., by cattle farming) within their own socio-economic perspective and this perspective did not relate to Mondi. In fact, their perception was that Mondi and its policies were hindering people's means of survival.

In general terms this meant that people did not experience Mondi as a socio-economic enabler. McMenamin realised that one way in which Mondi could improve its social performance in South Africa was to focus on substantially contributing to human capacity building; in other words contributing toward the alleviation of the country's "chronic skill deficiencies"⁷.

Stakeholders did not experience Mondi as a socio-economic enabler

McMenamin knew that this had one main implication with regard to the ongoing socially-focused SD projects in South Africa: They would have to concentrate on developing and enabling specific skills of people.

Management responses and evaluation

In February 2005, the findings of the five SEAT processes carried out in South Africa were summarised. The respective reports were distributed to Mondi's stakeholders, Mondi's management in South Africa and Europe and to Anglo American's top-level management in London. Additionally, the reports were published on the company's corporate website. Reactions were very positive from all sides. Adequate management responses focusing on improvements in communication and human capacity building soon followed.

What did these responses look like in concrete terms? In Mkhondo, Mondi's management decided to centre its efforts on three main ideas:

Cattle and firewood

Subsistence cattle farming could possibly be used as a lever to enable community inhabitants to make a living and thus open socio-economic opportunities. Therefore, in areas with a low density of seedlings, setting aside grazing areas for the winter months would be granted to livestock owners. But it would be even more important to build human capacity (possibly together with local NGOs) to turn these subsistence farmers into market suppliers. In addition, Mondi would address current sensitivities with its existing firewood policy. As many village inhabitants stole wood due to a lack of housing material, a complementary housing-programme would be installed.

Nodal System

During the SEAT process, it was discovered that many stakeholder groups had never heard about the Nodal System and key stakeholders remained sceptical. Management

would thus expand its consultations with key stakeholder, as well as widen its general communications on the topic, thereby shedding light on the specific socio-economic benefits implied by the Nodal System. Didn't entrepreneurial village inhabitants lack the basic infrastructure to start their own microbusinesses? Somebody who wanted to open and run a bar or a barbershop, for example, would need a steady supply of water and electricity – and that's what the Nodal System was aiming to establish.

HIV/AIDS

Mondi would embark on a number of initiatives aimed at addressing the impact of HIV/AIDS

Many former employees not only lacked perspective due to the socio-economic setting in which they lived, but were further limited by their poor physical condition. Therefore, Mondi would also embark on a number of initiatives aimed at addressing the impact of HIV/AIDS. Helping to increase the role of peer education, and access to testing, treatment and counselling appeared to be a feasible way forward in this respect.

In addition, company management considered attending meetings which formally did not relate to Mondi, but which informally shaped the company's image (e.g., meetings of farmer associations, etc.). The company hired a human resources and labour specialist to check its contractors' compliance with the Basic Conditions of Employment Act of 1997, and considered a number of additional measures to address specific concerns raised in the SEAT processes.

Looking forward

Individual projects were combined into a single Mondi Mkhondo project

All of these individual projects combined into a single Mondi Mkhondo project which was launched at the beginning of 2007. The project (which involved a public-private partnership PPP to drive an integrated rural development strategy for the Mkhondo municipal area and which was facilitated by a substantial contribution from Mondi) aimed at enhancing the professional planning capacity in the region to ensure that poor residents on Mondi land received assistance in order to access basic government services – and therefore to improve their socio-economic welfare. ♦

Notes

¹ See Michael Novak and Luca Antonio Ricci (eds.), *Post-Apartheid South Africa: The first ten years*, International Monetary Fund, New York, 2005, p. 34.

² Given an EUR/ZAR exchange rate of 1/0.11

³ See Novak and Ricci, *Post-Apartheid South Africa: The first ten years*, pp. 1, 2 and 34.

⁴ See *SEAT Report Forestry Operation (Mkhondo)*, Mondi Business Paper South Africa, Melrose, Gauteng, 2005.

⁵ See *SEAT Report Forestry Operation (Mkhondo)*.

⁶ See *SEAT Report Forestry Operation (Mkhondo)*.

⁷ Novak and Ricci, *Post-Apartheid South Africa: The first ten years*, p. 34.

Exhibits

Exhibit 1: Bullet-point overview of SEAT's procedure

Key Steps in the SEAT Process

Step 1: Define objectives of the SEAT process

Step 2: Profile Mondri and neighbouring communities; identify key issues

Step 3: Evaluate social and economic impacts

Step 4: Provide guidance on management responses to key issues

Step 5: Reporting to stakeholders

Source: SEAT Report Forestry Operation (Mkhondo)

Exhibit 2: Overview of stakeholder groups contacted in Mkhondo during the SEAT process

Stakeholders Consulted

Affected parties

- 56 local communities/villages on Mondri SA's Mkhondo property
- Local schools and school governing bodies
- Mondri SA's Mkhondo personnel (junior, middle and senior management)
- Contractor employees
- Contractor management

Interested parties

- Neighbouring farmers
- Local Economic Forum
- Church leaders/pastors
- Training providers
- Political parties
- Taxi association
- Private medical services

Authorities

- Mkhondo Local Municipality
- Department of Labour
- Department of Transport
- Department of Social Services
- Local Department of Traffic Control
- Department of Agriculture
- Department of Education
- Department of Health
- Traditional leaders

Source: SEAT Report Forestry Operation (Mkhondo)

Credits

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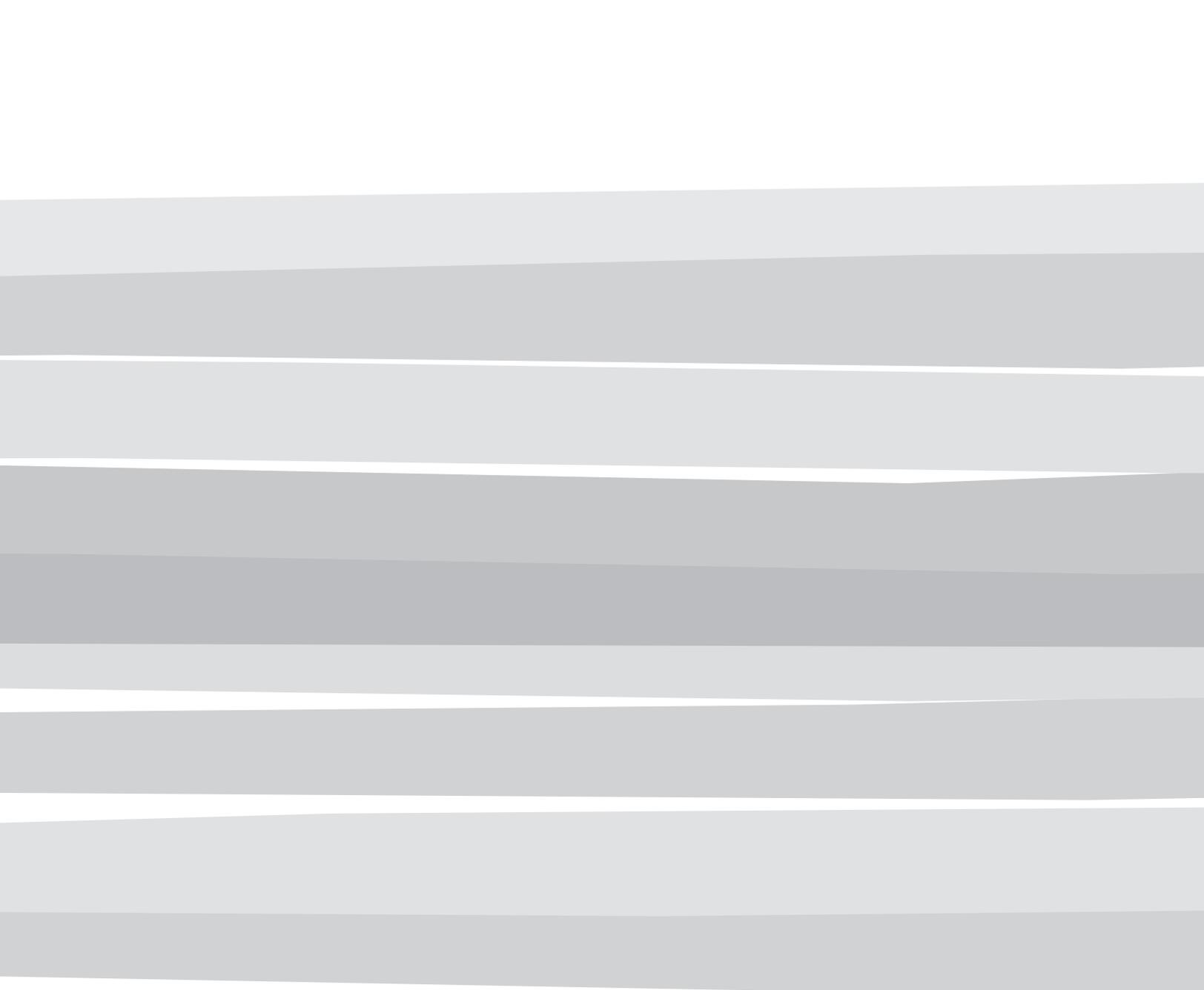
Content management and project supervision: Christoph Eder (ICEP)

Teaching Note: Mondi

Mondi: The importance of stakeholder dialogue presents Viv McMenamin in her role as Mondi's sustainable development SD director and indicates how she assessed Mondi's social performance in South Africa in 2004 and 2005: South Africa, Mondi's country of origin, was the group's "hot-spot" with regard to its socially focused SD activities. Why? In the early post-apartheid period the country experienced the outsourcing of labour in the country's entire industrial sector (also within Mondi) due to disproportionately employee-focused labour market regulations. This had positive, short-term economic effects for companies, but the socio-economic consequences such as high unemployment rates proved to be pressing. In order to address these consequences, Mondi regionally initiated various SD activities. These activities had positive effects on a local level, but unusually high occurrences of forest fires on Mondi's property (a costly problem for a company that grows wood and manufactures paper and packaging) suggested they did not transform the overall situation in the context of Mondi's business operations. So, instead of assessing the *outcome* of these ongoing SD activities, McMenamin decided to evaluate the immediate *impact* of Mondi's business operations via large stakeholder dialogues as a first step towards an improvement of Mondi's social performance in South Africa. The result? Stakeholders, especially Mondi employees, did not experience Mondi as a socio-economic enabler, but as a hindrance to their means of survival. In consequence, the company decided to realign its ongoing socially-focused SD projects and concentrate on contributing to human capacity building.

Measuring and sustaining the social performance of a company is strategically relevant for any corporation. But it is especially important for those operating in developing countries, as the borders between the economic world and society are permeable when compared to those of the developed world. But *how* can managers measure social performance? *Mondi: The importance of stakeholder dialogue* gives two (general) answers: First of all, companies ought to differentiate between a company's social impact and the outcome of CSR activities. The former, not the latter, so the case suggests, has to be brought into perception in order to measure a company's social impact. Why? Because business operations (not CSR activities) are a company's main interface with society. Secondly, corporations should consider the implementation of large stakeholder dialogues referring to their business operations. A company's social impact is seen through the eyes of stakeholders – not through those of the company's management. Corporations can understand their societal influence by giving stakeholders a forum to authentically express themselves and by receptively listening to them.

Seen from a wider perspective, the case also stresses the specific responsibility corporations have in developing countries. The business and the social world are closely interwoven in many African, Asian and Latin American countries. Subcontracting and outsourcing policies may have been considered to be "business as usual" by employees in a developed country; in South Africa, however, they were perceived as an existential threat. This also resulted in the fact that the profit, which was generated by outsourcing labour, was absorbed by its social side-costs. ♦



Business Case

Kjaer A/S: From inside the company out

Anyone entering the offices of Kjaer Group A/S in Svendborg, a small coastal town on the Danish island of Funen, instantly knew that the company broke clichés. The premises looked more like an art gallery than that of the headquarters of a car export company selling vehicles to developing countries. With its open spaces and relaxed atmosphere, the company generated a peaceful working environment accompanied by an instantaneous buzz and excitement. The employees' workstations were grouped together and there were no closed offices in sight, not even that of the CEO, who shared his office with the other members of the Board of Directors in a large auditorium.

At Kjaer A/S headquarters, visitors could feel that employees were considered the most important capital. Every morning employees were greeted with breakfast where they could catch up on work and personal issues. The company offered benefits ranging from home work stations to an in-house fitness room. And this pro-employee mentality was not limited to the head office in Northern Europe. After all, the majority of the 220 Kjaer employees were working at affiliates in Uganda, Mozambique, Sierra Leone and Vietnam.

The principal owner of Kjaer A/S, Mads Kjaer, had lived in Africa for years and felt an especially strong responsibility for his African and Asian employees. He considered it his duty and mission to support the UN 2015 MDGs. In 2004 he hired Palle Maschoreck as a Life Manager, a title equivalent to CSR Director. Both agreed that initiatives with a direct impact on employees and communities in developing countries were important catalysts for development and could contribute to the MDGs. One of Maschoreck's first tasks was to set up an employee satisfaction programme for the subsidiaries. With this many questions arose: How would such a programme look like? How would it meet the local employees' and communities' special life and circumstantial needs? How could it be executed in a cost-efficient way?

According to Maschoreck, the key of this challenge was how it was seen: "It is a question of looking at your employees as human beings, as family providers and as fathers and mothers."

This very way of thinking quickly characterized the atmosphere in Svendborg and how Kjaer A/S functioned.

The company

The Denmark based Kjaer A/S was the holding company to a number of international subsidiaries in 2006. Its business was to provide vehicles and transport services, addressing the special needs of the aid and development sector.

The private company was born when Christian Kjaer took over a car dealership in the Danish town of Svendborg in 1962. In its early days, the company only sold Renault cars to the domestic market. The establishment of aid and development offices by the Nordic countries in the late 1970s marked the beginning of the company's delivery of vehicles to Africa. In 1983, Christian's son Mads Kjaer started to work for the company, focusing on strengthening its international activities. A few years later, he became CEO and transformed the corporation into a 100 percent export-oriented trading house that focused on the supply of vehicles, motorcycles, spare parts and relief goods to development projects. In the 1990s, Kjaer A/S launched national distribution companies in developing countries, which also provided after-sales service and spare parts. The geographic expansion of the Danish SMEs in comparatively high-risk areas was financially supported by two partners who promoted economic activity in developing countries: Danida, the Danish International Development Agency, and the Industrialisation Fund IFU, a financial instrument established by the European Investment Bank EIB and the European Development Finance Institutions EDFI. The first subsidiary of the Motorcare Distribution Group was established in Mozambique in 1996, followed by Uganda, Sierra Leone and Vietnam. Other, smaller national distribution centers were also introduced to Laos, Cambodia, Liberia and Ethiopia.

With a large presence in Africa, the Middle East and Far East, Kjaer A/S was a leader in its field. About 60 percent of the company's customers were development agencies and NGOs such as FAO, UNICEF, CARE and the Catholic Relief Service. The vast majority of the remaining 40 percent consisted of commercial companies operating within aid and development programmes, while commercial clients in traditional businesses were of negligible importance to Kjaer A/S. Among its major competitors were another Danish company named Bukkehave Ltd., the UK-based Conrico International, Toyota Gibraltar Stockholdings and Global Fleet Sales of Thailand. Kjaer A/S distinguished itself by having its own workshops in developing countries and by giving after-sales services a high priority. Financing options tailored to its special clients gave it an extra competitive edge. For instance, in 2005, the group introduced a new approach to its business strategy in Africa. Customers that did not have the funds to buy their own vehicles or were not sure about the duration of their operations, could enter into time-flexible leasing contracts with low and gradually increasing monthly rates.

In 2006, Kjaer A/S generated revenues of DKK (Danish kroner) 788 million (EUR 105.7 million), an EBIT of DKK 26.7 million (EUR 3.6 million) and a dividend payout of DKK 27.4 million (EUR 3.7 million). The private company's shareholding was structured into 78 percent of shares held by Kjaer, and 22 percent were owned by all employees. Altogether, Kjaer A/S had 220 employees worldwide; 40 worked at the headquarters in Svendborg and about 165 were based in developing countries. The rest were scattered around the world, working as representatives in the United Arab Emirates, United Kingdom, Switzerland, Germany and the United States. From 2004 to 2006 the company

Mads Kjaer took over the business and made it 100 percent export

Kjaer was present in Africa, the Middle East and Far East and was a leader in its field

delivered and serviced around 20,000 vehicles in 133 countries. About 95 percent of its profits were generated in Africa and the Middle East. However, the development of new markets, especially in Vietnam, Laos and Cambodia, was regarded as an important step for ensuring the company's future.

In August 2006, Kjaer resigned as CEO and started to work full-time for C4, a start-up that had been partly funded by Kjaer A/S. This initiative aimed at eradicating poverty through business by setting up a global investment platform that allowed individuals to invest directly in African businesses. Kjaer decided to take up the seat as a Chairman of Kjaer A/S, while his successor, Per S. Lundgren, led the group from the headquarters where subsidiaries could access administrative, managerial and financial support.

CSR at Kjaer A/S

Kjaer A/S was a mid-size family business. Its management was inextricably linked with the personality of Kjaer, principal owner and CEO of the company until 2006. Having been exposed to Africa and its people since his childhood days, Kjaer was acutely aware of the fact that a large portion of the world's population was living in very poor conditions. When he started to work for his father in the 1980s, he decided to run the company with a higher purpose than just making profit: "We call it profit for a purpose." According to Kjaer, this purpose was *to make the world a greater place to live in*. Kjaer said: "We are incredibly lucky that our market is huge and with an unexploited potential. Kjaer A/S wishes to contribute towards cultivation of these markets through new initiatives within the use of vehicles and transportation overall in Africa and other developing areas in the world such as Vietnam, Cambodia and Laos. The growth in these countries can result in eradication of poverty and start a cycle towards welfare, growth, economic, human and social considerations."

According to Kjaer, every company that made business in poor countries could actively contribute to development simply by acting "with awareness of being part of a larger thing." Thus, a responsible company had to integrate financial, social and environmental sustainability along its entire value chain and to take all stakeholders into account: businesses, customers, partners, suppliers, employees, their families and local communities. Kjaer A/S promoted a company-wide business philosophy that encompassed the three dimensions of *Love Cars*, *Love People* and *Love Life*. *Love Cars* meant the company's care for customers and products; *Love Life* was concerned with the environment and society; and *Love People* stood for taking responsibility for employees.

In October 2003, Kjaer A/S joined the UN Global Compact GC. As its business reflected the ten GC principles, the membership did not bring changes in business conduct, employee or customer treatment. It simply reinforced the way Kjaer A/S did business, and actually gave more weight to its importance. For example, all Kjaer A/S employees had to sign an agreement stating that they would act according to the ten principles. An important strategic change was that after joining efforts with GC companies, Kjaer A/S started encouraging suppliers and other business relations to join the GC, too, and gave preference to suppliers who were already part of the initiative. These efforts resulted in car maker Nissan's membership of GC in March 2004, for instance.

New philosophy: profit for a purpose, making the world a better place to live

Kjaer joined the UN Global Compact but business conduct was already in accord

In addition to that, Kjaer A/S also tried to raise awareness for the UN Millennium Development Goals. A survey to determine Danish awareness of the MDGs disclosed that only 9 percent had ever heard of them. And although Kjaer A/S's core business was based in Africa, a company questionnaire showed that the awareness within Kjaer A/S employees in Svendborg was at the same low level. These results were appalling to Kjaer. He decided to take action.

The CEO raced in an African rally to raise awareness of UN goals

In response, he decided to race in the East African Safari Rally in 2005 with the support of the Danish Ministry of Development. He purchased a 1971 Porsche 911 and together with his brother Soren, raced 4,500 kilometers for 10 days. The car was bare except for one line that read: *2015 Make Poverty History: www.rallywithpurpose.com*. With this race, the Kjaer brothers wanted to spread awareness of the UN's goals all around Denmark. Kjaer spent EUR 470,000 of his own money while Danida helped fund the press communications related to the event. A subsequent survey showed that the population's awareness had risen from 9 to 26 percent.

Concerning his own company, the former CEO wanted to actively support the ideas of the MDGs by setting up activities for employees as well as entering into partnerships with different non-profit organisations. However, incorporating these initiatives took a lot of time and it was sometimes difficult to balance with Kjaer's working schedule. At first, he was not sure how to handle the time problem. The solution came by chance: an unsolicited application submitted by Palle Maschoreck. Maschoreck had initially worked in Svendborg for another company and discovered how Kjaer and his employees conducted business and was eager to work for the company. He approached Kjaer and asked for a job. Kjaer mentioned all the projects he would like to launch and offered Maschoreck a chance to work for Kjaer A/S for two months. If Kjaer was happy with the direction things were taking, he would hire him indefinitely. Maschoreck jumped at the opportunity and became the first Life Manager of the group in May 2004, a title equivalent to CSR Director at any other company.

CSR at Kjaer A/S was not separated into its own department

In spite of his newly created position, Maschoreck explained that CSR had never been and would never be a separate department within Kjaer A/S. Both management and employees believed that CSR was not something that needed a specific department. They also did not have specific CSR initiatives or a specific CSR budget. The company did not even collect statistical data for most projects conducted. And even the use of the expression CSR was avoided inside Kjaer A/S walls. Maschoreck explained: "Firstly, the term corporate in CSR refers just to businesses and thus neglects the important work done by NGOs or public services. Secondly, in Denmark there seems to be a misconception of social responsibility. Companies that donate money to an NGO or engage in child sponsorships in Africa believe to act responsible – but it's far more comprehensive than that."

For Kjaer and Maschoreck, acting in a sustainable matter within the entire value chain and showing commitment towards society, was a question of common sense: "Growing a business in the emerging countries is a responsibility. The more a company operates with regard to the collective interest, the more it does something to improve people's lives and to solve society's challenges, the more indispensable and sustainable it ultimately becomes."

Thus, the way Kjaer A/S conducted its business was also regarded as a kind of long-term investment. Maschoreck said: “Poor countries are our market – so any initiative that supports development will eventually support our markets.”

Love people: Motivating employees

Kjaer was convinced that his company’s economic success was dependent upon the employees’ professionalism, flexibility, motivation and cooperation. According to him “the most precious asset in a company was, still is and will always be the employees.” After taking over his father’s company in 1998, he decided to change the company from the inside out by making employees shareholders. He was sure that employee ownership had a direct impact on motivation. Said Kjaer: “Employee ownership creates a feeling of pride as there is a mentality that they are working for themselves to improve their lives, not just the company’s performance.”

Kjaer’s first priority: his employees, the most important capital

Kjaer offered employees the first opportunity to purchase shares in 2000. However, to ensure that all employees would eventually become shareholders, the company later introduced a year-end goal, and if it was achieved, each employee received shares as a bonus. As of 2006, employees together owned 22 percent of the company.

Kjaer also concentrated his efforts on a positive working environment. Despite his heavy workload and numerous business trips, he took time to be part of the office at Svendborg and participated in leisure activities with his employees. One example of the unique relationship he cultivated with his employees was a trip where he took six new global sales training executives to climb Mount Kilimanjaro. He also launched several activities to strengthen team commitment. For instance, he introduced the daily coffee break at the headquarters in Svendborg, where all employees met to catch the company’s news, talk and drink coffee. Furthermore, it was Kjaer’s idea to establish a *Life Club*: an employee-run platform that organised parties and sport activities such as tennis, football or squash. The Life Club, which was mainly financed by the company, had a state of the art work out and fitness room with instructors available for group activities and masseurs offering therapy. Employees were also coached on how to handle stress.

The CEO initiated several activities to boost team spirit at the headquarters

Since Kjaer defined his company as a learning organisation, emphasis was put on the development of the individual employee. In 2000, Kjaer A/S implemented the Investors in People Standard, a framework (developed by the same-named UK-based company) that helped organisations improve performance and realise objectives through the effective management and development of their employees.

Kjaer A/S employees were offered quite extraordinary chances to develop their skills and increase motivation. Maschoreck said: “For instance, we encourage our employees to work with humanitarian organisations. This way, they are more knowledgeable and can contribute to our core business. To keep qualified employees you need to offer both challenges and opportunities. That boosts our position as an interesting employer.”

The company also partnered with numerous NGOs and non-profit organisations. For example they launched a partnership with the Danish Red Cross in May 2006. The emergency unit of the Red Cross relocated its stock from Copenhagen to the Kjaer

A/S premises in Svendborg. As Kjaer A/S offered the storage space free of charge, the organisation was able to save money for more relief items. Kjaer A/S also invested in human resources. Kjaer realised that the organisation often encountered problems during an international emergency to find qualified staff on short notice. So Kjaer involved the Red Cross to train Kjaer A/S staff members for emergency assignments. In times of crisis, Kjaer A/S staff were readily available to help.

Besides these activities, Kjaer A/S annually invited employees from all over the world to Svendborg to participate in Leadership, Innovation, Fun and Energy LIFE seminars. These seminars lasted several days and included discussions on issues such as anti-corruption, gender equality, HIV/AIDS or the Global Compact principles.

**Kjaer A/S was
acknowledged as
best place to work
in Denmark**

Because of its proactive employee-oriented initiatives, Kjaer A/S was acknowledged as the *Best Place To Work in Denmark* in 2003 and 2004 by the Oxford Group, and among the *Top 100 Best Workplaces in Europe in 2004* by the Great Places to Work Institute. Kjaer was honoured by these recognitions. Nonetheless, he decided that Kjaer A/S should not participate in 2005's competition of Denmark's best workplace. He felt that in the years to come Kjaer A/S needed to focus its efforts on aligning the entire organisation – no matter where in the world employees worked. After all, three-quarters of all employees were engaged in developing countries; 150 were based in Africa and about 15 in Asia. Except for a small number of expatriates, the vast majority were local people. Kjaer felt responsible for their well-being and sought ways to improve his local employees' living conditions. Kjaer said: "We can and must be better in taking care of our local employees in the emerging countries we operate in. This applies to information, motivation and joy at work; it applies to education, health, living conditions and schools for their children. In Uganda and Mozambique, where we have operations, one of eight inhabitants is infected with HIV. This involves quite different challenges and all foreign companies operating in Africa need to realize that the big basic problems like food, water, electricity, health, etc., need to be solved regionally before one can establish a company."

Thus, the challenge Kjaer and Maschoreck faced was to set up initiatives which addressed the special needs of the company's employees and, moreover, which supported the local community.

Providing adequate salaries

In 2004, Kjaer A/S discovered a fraud scheme in its Motorcare Uganda subsidiary. Independent investigators identified five employees that had stolen money from the company. Because of this Kjaer rethought the company's salary distribution. He asked Maschoreck to investigate the matter. As Life Manager for Kjaer A/S, Maschoreck knew that simply taking the average salary in Uganda and adding a fixed percentage was not an adequate solution, because it did not reflect the real needs. Thus, he compiled statistics on financial conditions of local employees. For instance, they found that the average employee had to support 20 family members. Further statistics revealed that the families needed higher income for their children's education and for medical treatment. The two executives decided to raise salaries with the new *affordability policy*. Maschoreck explained: "Salaries are considered a long-term investment. They stimulate growth, secure political stability, increase living standards, reduce staff

**Uganda fraud made
Kjaer question if
salaries were
high enough**

turnover, reduce absenteeism, improve our employees' skills, get healthier, happier employees who are more productive and turn them into considerate consumers and active citizens.”

Ensuring that local employees could afford a safe and healthy lifestyle was also a question of health insurance. Medical expenses for an employee or a family member posed a severe threat to a family's financial situation. So, in addition to the affordability policy, Kjaer A/S covered employees and their families' insurance. Insurance programmes did not work in every country. For example, in Mozambique, the company had troubles partnering with an insurance company. So they entered into a private agreement with a nearby hospital: All of Kjaer A/S employees and families could go there and receive medical treatment with Kjaer A/S covering the bills.

The ownership programme that was implemented in the Love People initiative was also a means of improving the financial situation of employees. While it was, according to Maschoreck, “a nice thing to have for Danish employees”, for locals in Africa and Asia it was “quite a significant contribution to private economy.” As it was difficult for most people in developing countries to access credit, the dividend payouts or the eventual selling of a Kjaer A/S share presented a source of extra income that employees could access.

In some situations, extra financial resources for Kjaer A/S' employees led to the creation of new businesses. This had a pleasing snowball effect. John Okaba, a technician in the Uganda workshop, along with his wife and their eight children, was a man with strong entrepreneurial spirit. Through dividend payments he was able to invest to drill a borehole in his village. The well provided the entire village and its population of 200 people with the purest drinking water in the vicinity. After building and maintaining the well in good condition and free of charge to the village, Okaba decided to expand. He built a bar in which he charged the local brewer EUR 1.75 a day in order to brew their beer. Proceeds from brewing and selling beer were given to a woman who operated the bar and also ran an orphanage. Okaba's ideas did not stop there. He hoped some day to buy a pick-up truck so that he could start a business transporting fishermen. From that money, he planned on eventually buying cattle, land and growing maize and nuts.

Setting up Life Clubs in Africa

The Life Club in Svendborg was highly popular with employees and Kjaer saw it was a great way to boost employee motivation, increase satisfaction and lower staff turnover. This, in turn, enabled Kjaer A/S to invest more in its employees and led to greater efficiency. For these reasons, Kjaer wanted to replicate a club in the company's major subsidiaries in developing countries. However, a few questions arose: Should – and could – the original Life Club be copied one-to-one? How would it meet the local employees' and communities' special life and circumstantial needs? And how could it be executed in a cost-efficient way?

It was one of the first projects of which the newly hired Maschoreck took charge. He visited subsidiaries in Uganda and Mozambique where he talked to local managers and employees. Maschoreck discovered that the people held high expectations of the company, in that the headquarters would provide a Life Club with no employee contribution. This input led Maschoreck to rethink the concept of the original Life Club. He intended it to be far more than just a party and sports organisation. Instead,

Regional differences had to be considered while implementing employee initiatives

Life Clubs helped to boost esteem, motivation and increase staff retention

he wanted to introduce a vehicle that would enhance the local employees living conditions and at the same time encourage their personal development. Maschoreck explained: “If you want to develop people you have to give them possibilities and opportunities. They have to take initiative, responsibility and ownership. Through this, and only with this, people will grow.”

First three Life Clubs were quickly set up in Mozambique, Uganda and Sierra Leone

Maschoreck’s brainchild won the support of Kjaer and the Human Resource Manager. He was free to start the Life Clubs according to his ideas and set up the first three in the Motorcare subsidiaries in Mozambique, Uganda and Sierra Leone within a few months in 2004. Each of these branches employed around 40 to 50 people. Later, another Life Club in Vietnam followed.

The Life Club’s basic concept was to build a local governing body consisting of a group of five employees that was elected by employees every other year. These five people organized Life Club activities during working hours. Maschoreck aimed for solely employee-driven and run Life Clubs, so he insisted that no managerial representative could be part of the club’s committee. Maschoreck said: “Whether in Denmark or elsewhere in the world, we don’t keep track of how much time employees spend on these kind of activities. We also do not have any stringent guidelines, and the management does not interfere.”

But despite granting the committee a lot of freedom, he also wanted to make sure that activities were not too one-sided. Therefore Maschoreck determined the clubs to cover three lines of action: They must offer social activities, address health issues and include some education or training. To assure that funds were being used in a productive way, he additionally required the governing body to report regularly on its work.

The new Life Clubs became places where employees and their families could socialize outside office hours, creating a community within their community. For example, the Uganda Life Club set up a football team and completely renovated a building where employees and their families could play darts, pool, ping pong and host barbecues. The committee chose to purchase a television so that employees and their families could use their money elsewhere and on more important items. The Life Club also provided HIV training and bought medicines for HIV patients, neither of which were covered by insurance.

Setting up the Life Clubs, according to Maschoreck, was “a quite easy thing” to do. The biggest challenge he faced concerned funding. Maschoreck insisted on integrating the philosophy of ownership into the financial dimension of the programme, which meant that employees had to contribute some of their own money. He explained: “Ownership encourages employees to think of how to effectively use the money and how to plan long term. It is a mentality, a willingness to invest something today and later get something back from it.”

His idea was to jointly fund the Life Club by employees and Kjaer A/S. Employees were asked to provide a small monthly fee, and in turn, the local Motorcare subsidiary would triple the sum. Every employee was intended to give one dollar of his or her monthly salary to the funds. Motorcare would then give two dollars to match that sum accordingly. Furthermore, additional fundraising was taking place in Denmark for contributions. However, this financing model met one obstacle. Maschoreck said:

One challenge was: Who was going to fund the Life Clubs and how?

“Despite of the fact that our salaries were above national standards, most employees were not willing to abandon a part of their salaries.”

Apparently, it was not possible to convince employees of something that did not yet exist. Although it was not a money issue for the company, Maschoreck did not want to give up the idea of employee ownership. He sought for a compromise: He decided to raise salaries by one dollar, but instead of paying out the extra money in cash, it was directly allocated to the Life Club funds. That way, each employee would give 12 dollars a year. Employees agreed to this, as they no longer felt they were losing money. Together with the money from Motorcare and the fundraising, an average Life Club generated between USD 6,000 and 8,000 annually. Danish employees were not involved in the Life Clubs except for fundraising activities, which were, however, not institutionalized at Kjaer A/S. Maschoreck stressed: “Employees should not engage in such things because the company expects them to do so, but because each individual wants to contribute.”

A one dollar raise of salary was directly donated to the Life Club fund

Aside from fundraising, whenever Kjaer A/S members were invited as speakers at seminars around the world, the amount raised was put toward the Life Clubs. In 2006 all of these activities generated a total of USD 20,000.

Establishing an in-house microcredit bank

Maschoreck was very fond of a Life Club activity called the *Self Help Group* introduced in Mozambique. This initiative allowed employees to borrow money from the company. The idea initially came from the manager of the local branch who had visited the headquarters in Denmark. Maschoreck remembered: “We discussed that there were several employees who wanted to establish decent homes with electricity and running water or spend money for educational purposes, but they were unable to access loans at local banks.”

He initiated a company analysis of the Mozambique banking structure. It turned out that the payback terms and interest rates – the lowest rate available was set at 29 percent – made it very difficult for any employee to become a banking customer. “Besides the unfavourable interest rates, I also got the feeling that some employees felt ashamed to ask for a loan in a bank,” said Maschoreck.

The company established a microcredit bank in Mozambique

Soon after, Maschoreck decided together with the local manager, to establish a microcredit bank within the Life Club of Motorcare Mozambique. As a starting point, the company allocated USD 10,000 for the credit bank. Outsourcing or partnering with a microfinance institution was never considered. For the Life Manager, such an in-house facility was “another good mechanism to develop employees.” Thus, the Life Club launched a Self Help group to administer funds and set regulations. For instance, the employee government board decided to set aside a part of the initial “donation” to be used for emergencies such as hospital stays and funerals.

The board was also free to determine the rules of the credits. For example, employees needed to have worked at Motorcare for at least one year in order to be eligible for a microcredit; the monthly repayment could not exceed more than one-third of an employee’s salary; and the interest rate was set at 15 percent. Maschoreck thought that the interest rate was “absurdly high” and suggested to lower it. However, the group members told him that the rate was not only very low compared to existing credit schemes, but also made it possible to generate more money into the funds – so that eventually more employees would benefit from it.

The credits covered activities such as building and home reparations, installation of water and electricity, and the purchasing of furniture and household goods. Maschoreck realised that it was important not just to lend money but also to teach employees how to invest that money in a sustainable way. Therefore, the Life Club institutionalized seminars on household budgeting and financing, conducted by employees who worked in the accounting department. Similar classes were also integrated in Life Club activities in other countries, even though they had not yet established a microcredit programme.

HIV/AIDS in the workplace

A HIV/AIDS programme was institutionalised within Kjaer A/S

Before 2004 there was no official programme addressing HIV/AIDS for Kjaer A/S employees. The company provided financial support to employees in need of medical treatment, and subsidiary companies in Africa held seminars to spread information about the disease, protection, and treatment. Said Maschoreck: “The virus was not a major issue for Kjaer A/S in terms of staff absenteeism. Still, we were always aware that we have employees whose daily lives are somehow affected by HIV/AIDS.”

Maschoreck personally institutionalised the HIV/AIDS in the Workplace programme. The starting point was when the Danish Aids Foundation approached Kjaer A/S for a money donation. Maschoreck disliked the idea of just passively handing out money. He was sure that there were alternatives and more efficient ways to approach the problem. After all, the vast majority of people infected with the virus belonged to the active workforce in African countries – HIV/AIDS was becoming an increasingly important workplace issue. Maschoreck sought for a way to handle this problem adequately. For this purpose, Kjaer A/S and the Danish Aids Foundation established a partnership. Danida (the main source of funds for the new programme), the Confederation of Danish Industries and the UNDP also came on board. Maschoreck said: “When we started working together, we did not know exactly where we were headed, but we knew that together we could find a way to involve more stakeholders and hence have a much broader reach.”

Their common objective was to offer support and advice to companies operating in high-risk areas. The partnership entailed consultants visiting Kjaer A/S Motorcare subsidiaries in Africa and conducting trainings and evaluations. The outcome led to the creation of a booklet and movie titled *Handling of HIV/AIDS in Workplace*. The Life Clubs incorporated the results in its health programmes and modified its education and training classes. The booklet and video became part of a toolkit that was provided to private companies for their use.

Effects trickle down the ladder

Not only Kjaer A/S employees benefited from the Life Clubs

It was not only Kjaer A/S employees and their relatives who benefited from the various Life Clubs. The opportunities that they were given led to a new community spirit and ambition to start additional activities. Maschoreck said: “Even though employees were not wealthy, and many of them were taking out loans just to build their houses, when they saw a group of people in more need than themselves, they always did something to help.”

The Life Club and its initiatives led to a trickle-down-effect, meaning it had an impact on disadvantaged people outside the company. For instance, Motorcare Mozambique worked with religious institutions and during one of their visits to the

Missionary of Sao Carlo Sisters to sell vehicles, they were exposed to the problems the sisters and orphans dealt with everyday. Thus, the Life Club collected money to buy food and toys for the orphanage. Another example was in Motorcare Uganda, where the Life Club donated clothes, mosquito nets and shoes to the Internally Displaced People IDP camp in northern Uganda.

Evaluation

Kjaer A/S was a private for-profit company. At the same time, their gut-feeling was always actively considered: “Does what we are doing feel right? If it does, then good. If it doesn’t, then let’s change it.”

Maschoreck believed that if Kjaer A/S had been a public company, many restrictions would have been in place and the pace would have been slower because of the very formal nature of the sector. However, since it was a private company and headed by someone like Kjaer, employees were able to act fast and on instinct, while building their business concept around this position and still remaining a profitable company.

Private company allowed for quick, informal and instinctive decisions

Rethinking existing structures and initiating changes was at the company’s core. Not only did Kjaer quit his job as CEO to work fulltime for the development in Africa, Maschoreck’s position of a Life Manager was also dissolved in 2006. Instead, he became the strategic relations specialist of Kjaer A/S and dealt – among other things – with the creation of cross-sector partnerships. After initiatives like the Life Clubs and projects like the HIV/Aids programme were successfully launched, his old position at the headquarters became redundant. Maschoreck said: “Remaining tasks like support or supervising had switched to the Human Resources team, and we try to run all initiatives in such a way that they can be sustainable without every day management.”

The overall investment in employees was by no means going to be downscaled. However, since that investment was sustainable, up-scaling was not necessary either, regardless of the company’s growth. All programmes could be run without having to train more people and without having to invest more time in them. Things that had been done in Mozambique, Uganda and Sierra Leone, could easily be copied and adapted to new subsidiaries. Maschoreck was also quite satisfied with the Life Club’s concept and saw no need for major alterations. The only room he saw for change concerned the financial basis. He said: “I would not raise salaries again in order to finance the Life Clubs but insist on deducting the fee. It’s a fairly low amount of money compared to what employees get out of it.”

Investment in employees was not going to be downscaled

Furthermore, he hoped that local managers would also implement the Self Help Group that had turned out to be a successful and popular scheme in the Mozambique Life Club.

How the company benefited from its engagement was hard to measure in actual numbers, but at Kjaer A/S nobody doubted that it paid off in numerous ways. Kjaer stated: “Employees are your resources. Anything you can do to change employees’ lives, and make their lives better will, without a doubt, improve the company’s productivity.”

The incorporation of social responsibility assumed to result in a competitive advantage

For instance, commitment toward employees and communities resulted in higher motivation and led to a higher employee retention rate. In turn, this enabled Kjaer A/S to invest in its people, having more efficient employees.

The way Kjaer A/S conducted its business also aided its reputation, which eventually opened more doors. According to Maschoreck, corporate ethics were an issue that more customers were aware of than ever before. When Kjaer A/S had to qualify to bid for a tender, it often needed to state how they practised its business. Having incorporated responsibility along the entire value chain and living its commitment in a genuine way gave Kjaer A/S a competitive advantage. However, Maschoreck also noted: “How high corporate ethics are on the evaluation criteria of customers is still a blur. But I can confirm that it is a trend, especially within commercial companies.”

With the introduction of a new CEO in August 2006, Per S. Lundgren, an organisational adjustment was made in order to ensure that the tremendous growth could be maintained in the years to come. To this end, the sales force was strengthened and administrative jobs in Svendborg were reorganised. Nonetheless, Maschoreck was convinced that these changes would not weaken Kjaer A/S’s commitment to its stakeholders. He said: “Our philosophy is a strong and important pillar of Kjaer A/S – and that will never change.” ♦

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In *Kjaer A/S: From inside the company out* the reader is made familiar to Mads Kjaer, the principal owner of Kjaer A/S. This family run SME is a Denmark based holding company that provides vehicles and transport services to customers mainly from the aid and development sector. Established in 1962, the company started to deliver vehicles to Africa in the late 1970s, transformed into a 100 percent export-oriented trading house in the 1980s and established its first subsidiary in Mozambique in 1996, which was followed by subsidiaries in Uganda, Sierra Leone, Vietnam, Laos, Cambodia, Liberia and Ethiopia. By 2006, 165 of the company's 220 employees were based in developing countries.

This case focuses on the implementation of measures to enhance staff members' professionalism, flexibility, motivation and cooperation and the adaptation of this initiative to the work environment of countries in the developing world: In 2000, Kjaer offered employees at the company headquarters in Svendborg the opportunity to purchase shares, introduced a so-called *Life Club* (a staff-run platform for recreational activities) apart from encouraging employees to work with humanitarian organisations; the latter being a measure that boosted motivation and increased employee know-how with regard to the context of the company's core business. By 2004, Kjaer wanted to introduce the Life Clubs to the company's subsidiaries in the developing world. But would the concept be importable?

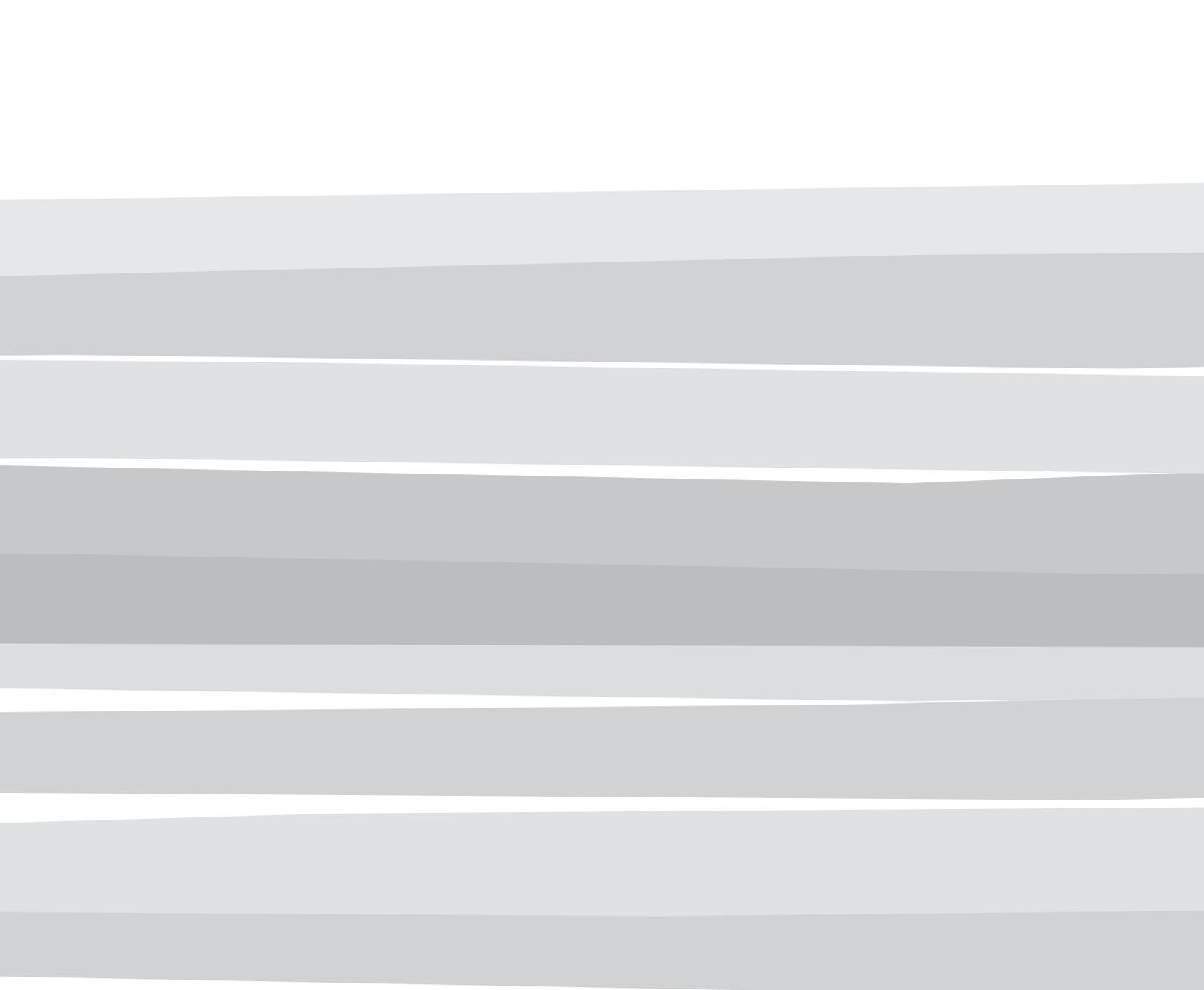
One-to-one interviews with local managers and staff members showed that the company had to walk on new grounds: Instead of only promoting leisure time activities to relieve stress, Kjaer and his team found a way to also improve living conditions. In 2004 the company installed slightly altered Life Clubs in Mozambique, Uganda, Sierra Leone and Vietnam. Each had a yearly budget between USD 6,000 and 8,000 and represented a welcomed opportunity for employees and their families to socialise after working hours. The difference to the Danish Life Club? Besides investing in football jerseys, ping pong tables and barbecue grills, staff members also set up an in-house microcredit bank and an awareness raising program with regard to HIV/AIDS.

In dealing with employees a holistic perception is a major challenge for employers all over the world. Employees' motivation and commitment increase when their socio-economic and personal setting is taken into account, when they are encouraged to unfold personally and as labourers as well as when they are given the chance to relate their daily work to a meaningful cause. This is especially true for SMEs: As these companies tend to produce niche goods and services, their employees – who are expected to act in a highly customised, innovative and flexible manner – ask for more recognition.

While employers' efforts to treat all staff members equally may be value driven, *Kjaer A/S: From inside the company out* shows that some of the methods of gratification and remuneration that have evolved in the developed countries (and were designed to articulate appreciation of employee work and commitment) can fall short of reaching their objectives in the developing world due to the different socio-economic context. The case highlights local employee involvement in the development of motivation measures in order to more fully understand staff needs and to design suitable programmes accordingly. Two examples – the microcredit bank and the HIV/AIDS

awareness raising efforts – give the reader a feeling for what a suitable programme in a developing country might look like.

By 2006 Kjaer A/S management was content to be able to track higher employee retention rates – a fact that was linked to the emergence of the Life Clubs – as well as spill-over effects that positively affected the company’s social context: Using the given structure of their Life Clubs, employees in Africa pro-actively set up funds and donations for charity. ♦



Business Case

Repsol YPF: Employees' ideas help cushion crisis

It was December 2001. Argentina was in the midst of a sweeping economic crisis. For nearly a decade, the country had been trying to recover from substantial national debt and interest accrued from the 1980s. By the 1990s, inflation was insurmountable. The country was at its economic nadir.

Social unrest quickly ensued and people were desperately seeking funds for social projects. One prospect was Fundación YPF, a foundation established in 1996 by the Argentine oil giant, YPF. Fundación YPF was created to support the education of younger Argentineans and was capable of responding to immediate social necessities because of its decentralised structure. Three years later, in 1999, the Spanish oil company, Repsol S.A. acquired YPF, bringing with it CSR mandates.

On December 15, 2001, Silvio José Schlosser, CEO of Fundación YPF, was on his way to meet the organisation's president and the director of education. Numerous friends and family members of Repsol YPF employees were knocking on the foundation's door, imploring it to help. Just before the meeting started, Schlosser asked himself: "We have a flood of requests pouring in. Who should we choose to help? And how?"

The three executives had brainstormed and generated countless ideas in the last few weeks. Now Schlosser was eager to reach a decision and move forward. Good intentions did not suffice in Argentina in 2001. The situation was alarming. Fundación YPF had to act.

Repsol YPF: A profile

As an international integrated oil and gas company, Repsol YPF operated in over 30 countries as of 2006. It was the leader in Spain and Argentina, one of the ten largest private oil companies in the world and the largest private energy company in Latin America in terms of assets. Its four main business activities were: exploration and production of oil and gas; petroleum refining and oil product marketing; production of petrochemicals; and the distribution of natural gas.

History and competitive environment

Repsol YPF was the largest private energy company in Latin America in 2006

In 1981, the Spanish government created the Instituto Nacional de Hidrocarburos (INH – National Institute for Hydrocarbons) as a state-owned institution holding all of Spain’s shares in oil companies. From the INH, Repsol S.A. was created in 1986. In 1989, the Spanish government embarked on a privatisation process that was completed in 1997. Two years later, Repsol took its first international step when it acquired YPF in Argentina. Doing so the company significantly expanded its exploration, production and refining capacity. The acquisition laid the groundwork for further internationalisation in Latin America, North Africa and the Gulf of Mexico.

By 2006 Antonio Brufau Niubó had led Repsol YPF to become an international oil and gas company with a diversified portfolio of both downstream and upstream activities (meaning the refinement and commercialisation, as well as the production and the supply, of oil and gas). According to the company’s 2006 annual report, Repsol YPF generated revenues of USD 80.62¹ billion and was recognised by Fortune Global 500 as the world’s 15th largest petroleum refining company. By comparison, the three largest refining companies in terms of revenues were ExxonMobil (revenues of USD 365.46 billion in 2006), Royal Dutch Shell (USD 318.84 billion) and BP (USD 274.31 billion).

20 of the world’s 30 largest oil and gas companies were state-owned in 2006

While Exxon, Shell and BP posted the highest revenues in the oil and gas industry, they were not the largest in terms of oil and gas production and reserves. By 2006, 20 of the world’s 30 largest oil and gas companies were overwhelmingly state-owned. Examples included: Saudi Aramco (which did not publish its annual financial statement), CNPC of China (with revenues of USD 110.52 billion in 2006), Venezuela’s PDVSA (USD 85.61 billion), Russia’s Gazprom (USD 81.11 billion), Brazil’s Petrobras (USD 72.34 billion), NIOC of Iran (USD 51 billion) and Petronas of Malaysia (USD 50.98 billion). State-owned companies controlled almost one-third of the world’s oil and gas production and more than one-third of the total oil and gas reserves.

According to a March 2007 article in the Financial Times, the private oil giants formerly known as the *Seven Sisters* who dominated the mid-20th century oil business – BP, Exxon, Mobil, Chevron, Texaco, Gulf and Shell (shrinking to four after the industry consolidation of the 1990s) – were left producing merely 10 percent of the world’s oil and gas and held no more than three percent of reserves in 2006. So what made them push their revenues notably higher than those of the newcomers? Observers credited their *integrated status*: The companies not only sold oil and gas, but also gasoline, diesel and petrochemicals.

Looking toward the future of the industry, Total S.A. CEO Christophe de Margerie and Royal Dutch Shell Plc CEO Jeroen van der Veer, declared, “the days of so-called easy oil are over.”² The International Energy Agency, an adviser to energy importing nations, estimated oil supply would have to rise 39 percent to 116 million barrels of oil per day by 2030 from about 86 million barrels per day now to meet world demand. How was the industry supposed to cope with this situation? Apart from improving oil exploration methods and techniques to satisfy demands (especially the increasing demand of the rapidly growing Chinese and Indian economies), the disappearance of easy oil challenged the industry to find and develop alternatives to the fossil fuels.

Disappearance of easy oil challenged the industry and energy companies

An impossible task? “No”, said Thomas Straubhaar of the Hamburger Weltwirtschaftsinstitut (HWWI – the Hamburg World Economic Institute) in an article

published on Spiegel Online in November 2007. The creative potential was given in the industry, he said. And according to him, the expected USD 100 per barrel price indicated that the right moment had come for the oil industry to make big investments and decrease oil and gas dependence.

Within this market environment, finding alternative sources of energy as well as technically outperforming competitors (especially in downstream activities) was key for a private company like Repsol YPF.

Repsol YPF in detail

Repsol YPF's 36,994 employees generated revenues of USD 80.62 billion in 2006, EBIT of USD 8.64 billion and EBITDA of USD 13.24 billion. In the course of the Argentine crisis, Repsol YPF's share price was worth USD 12.15 on May 5, 2002. It had climbed to a high of USD 36.71 on December 12, 2006 and as of January 1, 2007, it stood at USD 34.50. In 2006, shareholders' equity was USD 25.50 billion, EPS were USD 3.37 and USD 1.28 billion of dividends were distributed to the shareholders.

Repsol YPF's 36,994 employees generated revenues of USD 80.62 billion in 2006

Ownership of Repsol YPF in percent of total stock, October 31, 2006			
Sacyr-Vallehermoso	9.2	PMI Holdings	4.8
La Caixa	9.1		
Repinves	5.0	Free Float	71.8

In contrast, ExxonMobil had revenues of USD 365.46 billion, EBIT of USD 39.50 billion, EBITDA of USD 79.86 billion and 106,100 employees. With an industry-leading 32.2 percent ROCE in 2006, ExxonMobil outperformed Repsol YPF, which registered an ROCE of 14.3 percent.

Repsol YPF's 35,000 employees were distributed throughout more than 30 countries in Europe, Latin America, North Africa and the Middle East. Each of Repsol YPF's three main regions – Spain, ABB (Argentina, Bolivia and Brazil) and what was called the *rest of the world* – accounted for roughly a third of the company's overall operating income. Seventy percent of the daily net production of oil, 55 percent of the daily net production of natural gas and 27 percent of the refining activities were done in Argentina. Given that the first two business activities accounted for almost 90 percent of the Repsol YPF operating income, it was clear that Argentina was a key region for the company.

CSR at Repsol YPF

As an energy company Repsol YPF had some specific concerns that influenced its approach towards CSR and sustainable development. Most notably, many of the company's employees and their families lived close to Repsol YPF business activities. During 2005, the company consequently formulated a CSR strategy that gave priority to two main activities:

- fostering the economic progress of the regions in which Repsol YPF operated and
- protecting and conserving the environment and biodiversity.

CSR focused on socio-economic development and protection of the environment

These CSR objectives were rooted in the company's ethical values of integrity, transparency, responsibility and safety. These values were part of Repsol YPF's continuous aim to strengthen an environment of mutual trust with the company's stakeholders. A code of ethics and conduct for Repsol YPF employees was written to ensure these values were implemented throughout all company levels across the world.

Apart from ethical principles, Repsol YPF established four professional values: leadership, result orientation, innovation and customer orientation. These were seen to be a fundamental part of the company's vision to be an international integrated oil and gas company, focused on customer service and value creation, and were perceived with admiration.

Combining ethical and professional values were regarded as the best possible response to relevant issues raised by the stakeholders. Issues ranged from value creation and better products to the reduction of the company's environmental impact and employee career development (see *Exhibit 1* for CSR model). In 2005, a total of USD 48.31 million was invested in education, training, health, social integration and community development, as well as professional development.

Foundations of Repsol YPF

The company created foundations to implement CSR

Repsol YPF had three foundations: Fundación Repsol YPF (in Spain), Fundación YPF (in Argentina) and Fundación Repsol YPF (in Ecuador). Financed by the company, these organisations mainly focused on scientific research and were regarded to be integral tools for the implementation of Repsol YPF CSR activities. The foundations could perceive regional demands quickly and thereby initiate activities, which were beneficial to their regions and the Repsol YPF stakeholders.

Between 2000 and 2005, Repsol YPF Argentina invested up to an annual maximum of 0.5 percent of its average profits over the previous three accounting periods. Annually, USD 5.5 million was invested in education and scholarships via Fundación YPF, as well as cultural and social projects. Compared to the first years of the foundation's existence, the focus on social and cultural projects had been broadened after 2000. About 57 percent of the capital was invested in numerous cultural and social projects annually and 40 percent went into education and scholarships. Salaries and administration accounted for the remaining 3 percent.

Argentina and the 2001 crisis

Argentina's economic crisis changed the setting of the company's regional foundation

In 1999, when Repsol S.A. started acquiring YPF, Argentina was tumbling into a major economic crisis. By the end of 2001, the situation was alarming. Panic spread. People started to withdraw their savings from banks opting to hide the money under their mattresses or to exchange it for foreign currencies, especially US dollars. The run on the banks culminated in central reserves falling by USD 1.8 billion on a single day: November 30, 2001. In December, President Fernando de la Rúa imposed the so-called

corralito (little fence): No one could withdraw more than ARS (Argentine peso) 250 per week from their bank accounts. This radical measure practically froze the entire personal banking sector and led to dramatic social tensions throughout the whole country. Argentines took to the streets demonstrating. Riots, violent street fights and destruction of property became part of daily life.

A few months later, the financial situation worsened. Inflation reached more than 10 percent, the unemployment rate climbed to unprecedented heights and the peso fell by 75 percent. Entrepreneurial activities slowed dramatically as access to credit was almost impossible. The worst aspect of the crisis was the significant rise in poverty. In May 2001, 36 percent of the country's population was considered to be living under the poverty line. This statistical indicator shot to 57.5 percent toward the end of 2002.

How to cope with an overwhelming amount of requests

The Argentine crisis changed Fundación YPF's setting overnight. The foundation was confronted with an unseen number of requests coming in on a daily basis. In addition, stakeholders observed Repsol YPF and its foundation very closely: Was the company's new management and owners willing to prove its social responsibility in the midst of an economic crisis? Fundación YPF quickly acknowledged two things:

- They were in precedent-setting times. The way they acted towards stakeholders during the Argentine crisis would determine Repsol YPF's image for the years to come.
- They knew that a business-as-usual approach would not be sufficient to cope with the enormous task.

Fundación YPF's CEO, Schlosser said: "It was clear that we needed more capacity. The question was: How do we build it?" Three options were discussed.

Option 1

Increasing the number of staff members working for the foundation by four. This option had good supporting arguments. It would have been very easy to employ experienced managers, give them a set of working guidelines and supervise them. This approach seemed convincing, especially because the usual 3 percent ratio of salaries and administration costs to capital would have only been exceeded by one percentage point. But the public might not have perceived this measure favourably. No matter how convincing the arguments were, people would remember that Fundación YPF increased its salary expenditure during the country's financial crisis instead of directly using that money to help elsewhere.

Option 2

Seeing the numerous requests being brought in from Repsol YPF employees' families, friends and communities as an opportunity. Schlosser said: "We have thousands of Repsol YPF people all over Argentina. They know the needs of their families, friends and communities best. Is there a more effective way for us to get in contact with the population?"

How was Fundación YPF going to cope with this new challenge?

Various options were thought through and considered

At first, this option seemed to be self-evident. Fundación YPF thus considered establishing an intranet-platform where all employees could formulate their requests in writing. This idea would have been extremely cost effective. However, the problem was that staff initiative and staff responsibility would become unbalanced. Employees would have been asked to take initiative but, at the same time, they would have been excluded from the decision-making process. The result was easily foreseeable: Participation rates would have been extremely low.

Option 3

Allowing Repsol YPF employees to present their requests orally and collectively and to decide which projects Fundación YPF would actually finance. This option meant treading upon new ground, but its basic idea seemed intriguing: It would have been cost effective and close to what was happening already. Also, the public would favour it. Newspaper headlines were easy to imagine: “Repsol YPF employees contributing to Argentina’s re-building!”

But was there a feasible way to bring the idea to life? Schlosser and the Fundación YPF team started searching. They focused on the following thoughts:

- It was impossible to centrally organise all the requests coming in if they were to be presented orally. A regional structure was therefore necessary.
- Numerous Repsol YPF staff members, especially blue-collar employees, had never presented an idea professionally. Therefore, some kind of presentation format had to be created.
- Repsol YPF staff members would choose which projects Fundación YPF should finance, but in this they lacked experience. Decision-making guidelines had to be established.
- Who was going to implement the projects financed by the foundation? The employees who were advocating various social needs were surely important, but they usually lacked the required expertise. They therefore had to be trained.
- Only Repsol YPF could fund the implementation of the projects created by their staff members. That meant that the final projects would have to be convincing in their objectives and measures.
- Fundación YPF had positive experiences with various NGOs. Mutual projects, involving experienced NGOs and Repsol YPF staff members, were most probably sustainable.
- Obviously, not every proposal was going to be selected. In relative terms Fundación YPF would only invest in a few projects. The foundation feared a fast spread of frustration. If staff members knew that they were part of a competition, this problem may have been cushioned, because of common knowledge that competitions produced winners and losers.

**Walking on new ground:
employees advocating
social projects**

The idea of an internal contest unfolded and took shape. Schlosser explained: “After having brainstormed numerous ideas we came up with a very simple one. We created an internal contest. We asked our employees to make presentations and decide which projects Fundación YPF would actually finance. That meant that they had to formally propose projects to a jury made up of Repsol YPF staff members.”

The idea of an internal contest unfolded and took shape

Energía Solidaria (Solidary Energy) was born. To kick-off the initiative, Repsol YPF informed all its employees. Everyone was invited to participate: secretaries and service men at gas stations, engineers, managers and members of the board. Presentation guidelines were placed on the company's intranet. In order to make sure that everybody actually had the same chances to present a project, Fundación YPF divided the country into eight regions, each one roughly comprising the same number of employees.

Energía Solidaria's goal was to involve as many employees as possible to thus initiate a dialogue with a large number of the company's stakeholders. Doing so, the foundation hoped to find a method to determine which projects should be granted funds.

Energía Solidaria

Soon employees started to identify and propose potential projects. They varied in nature and type, but by 2005 general tendencies could be perceived: Of all proposed projects, an average of 23 percent dealt with education between 2002 and 2005. 19 percent referred to micro-business activities, 16 percent to social assistance and 11 percent to nutrition (see *Exhibit 2* for an overview of all categories). Juries made up of Repsol YPF staff members chose the winning projects according to the following criteria:

- *Sustainability*: A project had to have enough momentum to continue operating once implemented.
- *Impact*: A project had to generate a visible benefit to the community in which it was implemented.
- *Consistency*: A project had to be consistent with regard to its own environment.
- *Replicability*: A project had to be replicable in other regions.

Fundación YPF initiated a dialogue with stakeholders in order to fund social projects

As soon as decisions were made, Repsol YPF's Human Resource department, which had been engaged in the development of *Energía Solidaria* from the very beginning along with the External Relations department, communicated the winning projects to the company. Then it designed and carried out workshops with Fundación YPF, External Relations and external specialists for those employees who would voluntarily put their projects into practice. Once they were technically prepared, Fundación YPF provided the money to launch the initiative.

As a result, employees not only proposed projects, they also implemented and administered them. As soon as the projects could operate independently (normally no earlier than in six months and no later than in 18 months), Repsol YPF employees withdrew from *Energía Solidaria*.

Often enough volunteers and NGOs would join the projects as they moved ahead. Academic and technical institutions frequently supported Energía Solidaria by providing advice. Additionally, Fundación YPF, Human Resource and External Relations were actively monitoring, evaluating and communicating the initiatives both internally and externally.

Mejorando el Presente: One of Energía Solidaria's implemented projects

Matías Sánchez was one of the 2,800 employees that participated in the Energía Solidaria contest. He worked in the greater Buenos Aires area as a service employee at a Repsol YPF gas station. In 2004, he presented his project *Mejorando el Presente* (Improving the Present). Sánchez was one of the 663 employees who contributed to an Energía Solidaria project.

Employees did not only propose projects, they also implemented them

Sánchez had heard about an NGO called Centro Educativo Complementario (CEC – Complementary Centre of Education) that gave educational support to children in Monte Chingolo, a town of 85,000 in Lanús, which is part of the Buenos Aires province. He was impressed by CEC's work and wanted to help.

At the time, one of CEC's projects was designed to help eleven mothers, whose children were at CEC, find a job. As most of these women had not received any kind of formal education, the idea of creating a sewing workshop appeared to be a feasible way to pave the path toward employment. The problem was the lack of money. CEC did not have enough funds to buy sewing machines, equipment and raw materials, nor did it have enough to pay teaching staff.

Sánchez was convinced that a sewing workshop could make a big difference to many mothers. He was in his early twenties and had never presented a project idea professionally; he was cautious and insecure. Things changed when he saw the presentation guidelines. Looking back Sánchez said: "Many proposed projects were not taken. A lot of my colleagues were frustrated. But the guidelines really made things look easy. So I just gave it a try."

The overall objective of Mejorando el Presente was job generation for unemployed mothers

The overall objective of *Mejorando el Presente* was to give a decent job to the unemployed mothers of the children attending CEC by teaching them how to use a sewing machine. Learning by doing was taken very seriously: Right from the start, the women began sewing clothes. During the first weeks, the women were tasked with providing clothes to all of the children attending the centre. The project had a broader impact than anticipated. Not only did the participants feel self-assured due to the fact that the children liked their new clothes; absenteeism from class dropped considerably. Martha Gonzalez, a mother who was part of *Mejorando el Presente*, explains: "I think when we gave our kids these new clothes they were so proud that they had to go to school to show off." This positive experience was the cornerstone of what happened later on: The participants of *Mejorando el Presente* started a small enterprise that sold textile products.

Looking back at Mejorando el Presente

Fundación YPF had invested a total of about USD 4,400 in sewing machines, raw material and staff and wanted to have the project operating independently after 10 to 12 months. During the first three months Sánchez spent three hours per week managing the budget, coordinating meetings and constantly communicating the objectives of *Mejorando el Presente* to all involved. While the project was a learning experience for

Sánchez, it was not always easy to manage. Meetings were not easy to coordinate due to the fact that they could only take place during a certain three hours per week. Trust had to be established because initially, neither the mothers nor CEC believed that a gas station service employee could generate an idea like *Mejorando el Presente*, let alone help implement it. Finally, Fundación YPF and Human Resource's monitoring was perceived as problematic. Sánchez commented: "I think it was in week two. We had just broken the ice when somebody from HR just walked in and started taking pictures of everything. He should have talked to me first. Don't we work for the same company?"

Nevertheless, the project was a success. In the summer of 2006, the sewing workshop celebrated its second anniversary. During a small party, one of the mothers gave a short speech thanking Sánchez for making a dream come true.

Mejorando el Presente was one example of a successful employee's project proposal and implementation

More than USD 1 million invested

By 2005, *Energía Solidaria* had had an enormous impact. Between 2002 and 2005, roughly 2,800 Repsol YPF employees presented 816 projects. Among them, 159 were chosen under the voluntary guidance of 663 Repsol YPF employees. Some 200 NGOs helped professionally to put selected social initiatives into practice. Fundación YPF invested a total of USD 1.08 million, an average USD 6,820 per project. Repsol YPF employees turned out to be the driving force and the decision makers of *Energía Solidaria*, with Fundación YPF operating as their platform.

CSR reinforcing professional skills

For employees of Repsol YPF, *Energía Solidaria* meant a unique opportunity to play an important role in the company's CSR. At the same time, they had a chance to help. The reinforcement of their solidarity led to unexpected personal satisfaction and to an increase of self-esteem. Apart from that, leading a social project helped staff members to develop their leadership skills, their capability to work in teams, their creativity and their problem-solving capacities. Generally speaking, using managerial skills in a low-pressure environment reinforced professional skills. Schlosser said: "It might sound funny, but the lesson we learned was that taking social responsibility helped increase leadership skills and innovation within the company. That means ethical values can really strengthen professional values. Actually, this social programme really helped to reinforce professional skills."

Using managerial skills in low-pressure environment reinforced professional skills

40,000 beneficiaries throughout Argentina

Sánchez's story is one of the many successful *Energía Solidaria* projects. By the end of 2005 staff members volunteered during their work time for more than 25,000 hours in total. Repsol YPF did not deduct volunteer hours from salaries or holidays. The company also contributed to various projects by donating cars, gas and construction material. Additionally, technical and human support was given. Several accountants, engineers and salespeople were able to pass on their technical expertise to specific projects. Asked on the outcome of *Energía Solidaria*, Schlosser said: "We know that proposing the projects was not easy for everybody and that work occasionally overlapped, which caused friction among our employees. But overall, we believe we have helped about 40,000 people by 2005, either directly or indirectly. Doing the contest turned out to be

Energía Social benefited about 40,000 people and surpassed expectations

a good idea. Looking back, I am especially proud that Energía Solidaria's benefit for Repsol YPF was larger than we would have expected in 2002."

Comparing results to expectations

After three years of operation, Energía Solidaria had surpassed expectations. The initiative had permitted Repsol YPF to initiate a dialogue with its stakeholders in the midst of an economic crisis. One of the problems Fundación YPF had to tackle was the way they were perceived by some NGOs and communities. Although positive feedback from society remained strong, helping to keep management-level acceptance of Energía Solidaria high, beneficiaries occasionally took a more passive role due to their perception of the foundation as a provider of unlimited resources. This image had to be modified quickly so that third parties understood that the projects were common initiatives.

The biggest challenge was to keep staff interest high

But the biggest challenge was keeping staff interested. The number of presented projects dropped from 319 in 2002 to 135 in 2004 (see *Exhibit 3* for the scope and magnitude of Energía Solidaria). One year later, this indicator moved up to 215 project presentations. But real enthusiasm had only been felt in 2002. Fundación YPF was well aware of this problem. Schlosser said: "It is Energía Solidaria's key challenge. Staff members are the driving force of this project. If their spirits are low, the whole thing will not work. On the other hand you have to keep in mind that the employees are the ones who decide. And they seem to have a very good eye in terms of sustainable projects. Still, staff interest is an acute problem."

As of 2005, the Fundación YPF team was at crossroads. Fundación YPF continued to increase investments per year following 2002. Total investments grew from USD 95,056 in 2002 to USD 418,149 in 2005 (see *Exhibit 4* for resources invested in Energía Solidaria) and the number of selected projects climbed from 24 to 64 in the same period. Still, most employees seemed to have lost interest. Was there a need for action or was it better to wait and see? Were opportunities missed? Was it an option to allow Energía Solidaria come to an end? If not, how was the project going to be continued? Had the moment come to professionalise the project by working directly with NGOs – and without staff members? If so, how would Repsol YPF's employees and the public react?

Similar to late 2001, the Fundación YPF team met frequently, brainstorming numerous ideas and thoughts. Schlosser said: "We came up with a very creative solution in 2001. We will come up with another one."

And so it was: In 2007, Energía Solidaria became *Energía Productiva*. In addition to staff members, NGOs and SMEs were invited to present projects that aimed at ensuring the creation of genuine labour sources. Already in 2007, 317 projects were presented to Repsol YPF and to external experts (nearly the same amount of projects as Energía Solidaria's first year). ♦

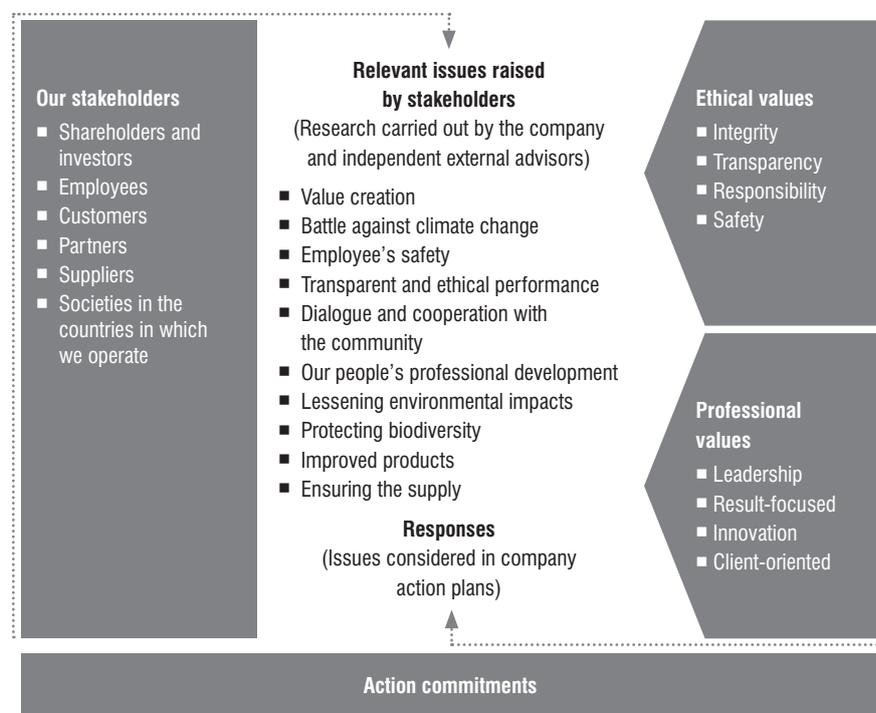
Notes

¹ Repsol YPF's annual report is in EUR and according to the company's 2006 report, its revenues stood at EUR 55.08 billion. In this document, 1 EUR is calculated at 1.4636 USD.

² Stephen Voss and Tara Patel, *Total, Shell Chief Executives Say "Easy Oil Is Gone"*, www.bloomberg.com, April 5, 2007.

Exhibits

Exhibit 1: Repsol YPF's CSR model



Source: Repsol YPF Corporate Responsibility Report 2005

Exhibit 2: Categories of projects presented during Energía Solidaria (in percent)

	2002	2003	2004	2005	Average
Education	21	25	22	23	22.75
Microbusinesses	12	20	31	15	19.50
Social Assistance/ Workshops	19	13	19	13	16.00
Alimentation/Nutrition	18	12	10	4	11.00
Disability/Elderly	6	7	7	20	10.00
Health	8	8	4	7	6.75
Recreation/Sports	2	4	-	10	4.00
Environment	1	1	3	2	1.75
Art	1	1	-	3	1.25
Research	1	1	-	1	0.75
Others	11	8	4	2	6.25
Total	100	100	100	100	100

Source: Repsol YPF

Exhibit 3: Scope and magnitude of Energía Solidaria

Scope	2002	2003	2004	2005	TOTAL
Employees presenting proposals	900	584	540	810	2,834
Employees involved in the implementation (volunteers)	107	151	136	269	663
Proposals presented	319	147	135	215	816
Projects selected	24	30	41	64	159
NGOs implicated	29	46	66	76	217
Direct and indirect beneficiaries	9,000	9,285	9,517	12,300	40,102

Source: Repsol YPF

Exhibit 4: Resources invested in Energía Solidaria

	2002	2003	2004	2005	TOTAL
USD Funded	95,056	185,715	380,223	418,149	1,079,143
Volunteering hours	4,920	9,120	6,528	4,500	25,068

Source: Repsol YPF

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Teaching Note: Repsol YPF

Repsol YPF: Employees' ideas help cushion crisis presents Silvio José Schlosser, CEO of Fundación YPF, Repsol YPF's foundation in Argentina, during the country's 2001/2002 economic crisis. Being flocked by people who were seeking funds was nothing new to him. After all, Repsol YPF was one of the biggest petroleum refining companies in the world. But in late 2001, just two years after the Spain-based Repsol S.A. had acquired YPF, Schlosser was confronted with an unprecedented amount of enquiries, many of which were brought forward by Repsol YPF employees. They were advocating for ways to finance social projects on behalf of friends and neighbours.

How did Schlosser cope with the situation? He set up an internal contest that sparked a project called *Energía Solidaria*. Employees were asked to formally present what they thought to be fundable social projects. And many did. Between 2002 and 2005, 2,800 Repsol YPF staff members presented 816 projects. Employee-juries selected 159, which received an average funding of USD 6,820. Two hundred NGOs helped 663 employee-volunteers to professionally implement the chosen projects.

The outcome? By 2005 *Energía Solidaria* had benefited about 40,000 people directly or indirectly, and had also produced two major positive effects for Repsol YPF:

- The 663 volunteers were able to reinforce professional skills in a low-pressure environment and increase their personal motivation to work for the company since it gave them a chance to serve a worthy cause;
- The company was able to live up to public expectations in terms of corporate citizenship, which can be particularly high after a large-scale merger or a take-over.

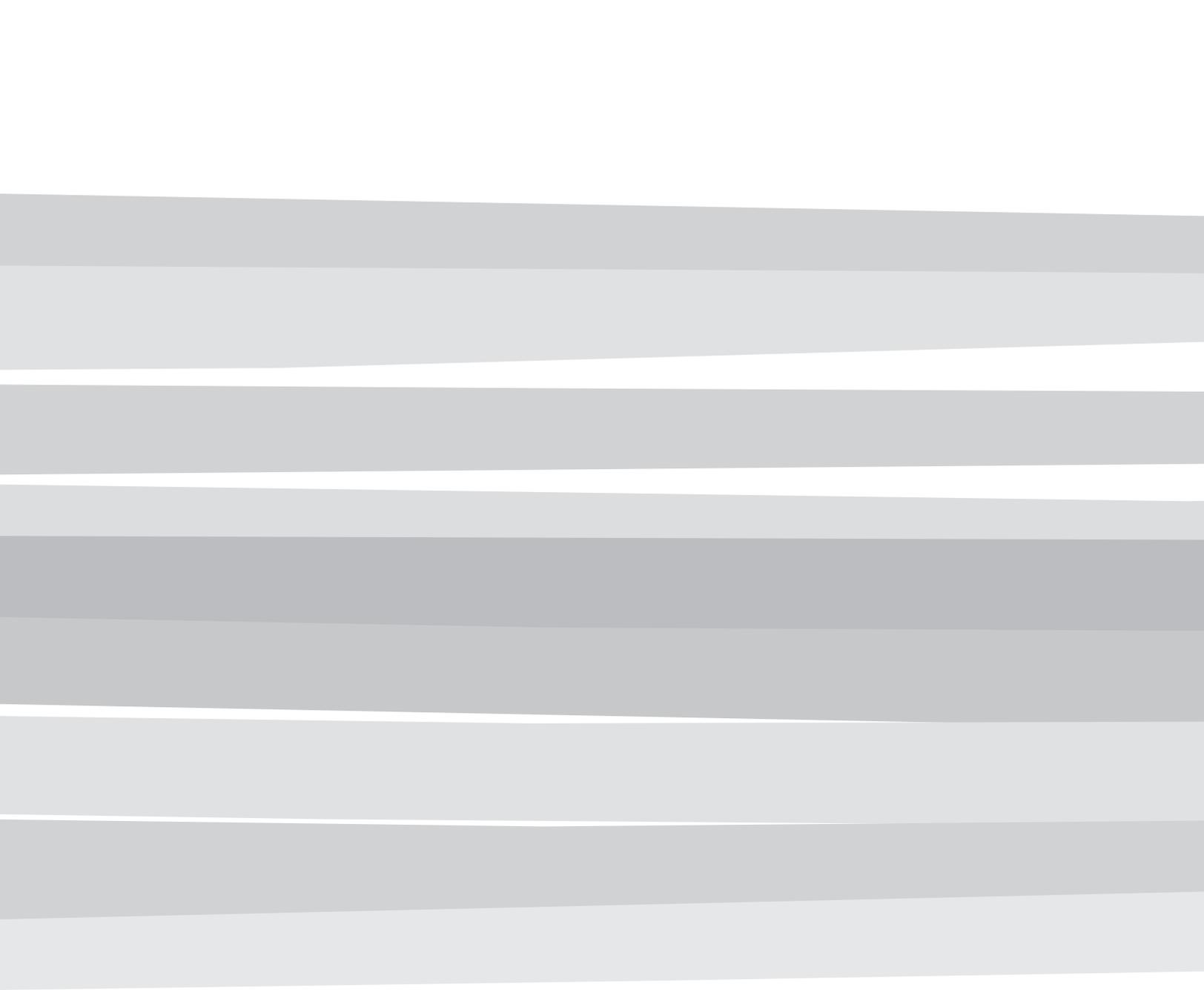
Argentina's 2001/2002 economic crisis occurred in the sway of world-wide financial market turbulences following the deregulation of the international financial markets of the early 1990s. It is a typical example of the socio-economic volatility of emerging markets. While this instability can have different causes, such as political inconsistency or one-sided market dependencies, the social effects are generally alike: high inflation and unemployment rates as well as an increase of poverty and social tension.

Companies in emerging markets should be aware of these facts and also be prepared to react to them adequately in the social context of their business operations. Doing so they assure what is called to be their *social licence to operate*. This is especially true for multinational companies MNCs who diversify economic risk by operating in various countries. Simply turning one's back on an emerging market and concentrating on others as soon as socio-economic volatility surfaces may be to the short-term advantage of an MNC. But a long-term perspective suggests that MNCs should build their global reputation and legitimacy by confronting social problems country-by-country.

The intriguing point about *Repsol YPF: Employees' ideas help cushion crisis* is that it doesn't only lead to the aforementioned general considerations, but it also sheds light on how MNCs can handle the social effects of economic instability in emerging markets –

namely, by showing its social commitment as if it were a national company and by using its very own know-how and resources. By means of a large-scale stakeholder dialogue (in essence, the internal contest was exactly that), Repsol YPF was able to install creative social projects throughout the country, benefiting communities and the company itself – a stunning performance in the midst of an economic crisis.

In 2007, after the crisis had melted away and the amount of incoming enquiries had dropped back to normal, Fundación YPF “built a new container” by allowing NGOs and SMEs to participate in what used to be an internal Repsol YPF contest. By doing so, the foundation professionalized Energía Solidaria and transformed the project into an on-going CSR measure, ensuring the creation of genuine labour sources. ♦



Chapter 4

Supply Chain and Development

CSR and the Supply Chain: How can CSR policies be implemented effectively in global supply chains?

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Abstract

This essay is about the implementation of CSR policies in inter-organisational relationships. More specifically, this essay examines how a number of safeguarding mechanisms can promote responsible business practises throughout the supply chain. It is argued that safeguards are an essential part of CSR that help to both stimulate commitment among the supply chain partners and reduce the risk of non-compliance with social and environmental requirements.

Meeting the needs
of shareholders
and stakeholders

Introduction: CSR in global supply chains

Business is said to be about more than just making profit. Social and environmental responsibility is moving up the corporate agenda and companies are evaluated on their ability to meet the needs of both the shareholders *and* the stakeholders (customers, communities, suppliers, government, distributors, etc.).¹ Companies are increasingly adopting management standards, reporting systems and labelling schemes that help them regulate the social and environmental impacts of their business activities.

Realising that CSR goes well beyond the perimeter of one particular company, a growing number of very large companies are introducing CSR policies and/or codes of conduct that cover the supply chain.² A code of conduct can be defined as a set of written principles, guidelines or standards that are intended to improve a company's social and environmental performance.³

Despite its current popularity, managing and controlling CSR in supply chains is far from being a trivial task. First, companies in the supply chain are often separated geographically, economically, legally, culturally and politically – something which increases the risk of diverging CSR standards while at the same time making it more difficult to monitor behaviour. Second, if the costs and benefits from social and environmental improvements are unevenly distributed among the companies in the supply chain, there is no guarantee that all companies share the same view on the importance of CSR. Third, lack of time, money and competencies may block the implementation of improvements necessary to comply with the CSR policies. Fourth, overlaps and inconsistencies between various CSR policies may cause confusion, frustration and inefficiencies in the supply chain.⁴

How does a company make sure that the supply chain partners comply with the social and environmental requirements stated in its CSR policy? We will try to answer this question by examining some of the safeguarding mechanisms that can be applied when planning and implementing CSR in the supply chain. Without such mechanisms, non-compliance becomes nearly inevitable (which, in turn, may have severe consequences for a corporation's image and reputation). This essay is based on previous work on CSR in supply chains.⁵

Safeguarding mechanisms and CSR implementation

A close look at
safeguarding
mechanisms

We distinguish between five types of safeguards: direct sanctions, goal congruence, third-party intervention, trust and reputation effects (see *Figure 1*). Each safeguarding mechanism helps to ensure that an agent complies with an agreement. In the following sections, we will discuss each safeguard in turn.

Direct sanctions may take a number of forms. The quickest and most immediate sanction is to break off the relationship with a supply-chain partner in the case of non-compliance. However, this strategy has certain limitations. The ability to terminate an agreement depends on the bargaining power of each party in the relationship. Breaking off a relationship is not a credible threat if the company is dependent on the transactions with the supply-chain partner. For instance, a recent case from Harvard Business School illustrated that even a large multinational like McDonald's can have difficulties terminating agreements because only few suppliers have enough capacity to serve its needs.⁶ In practice, therefore, companies will often go to great lengths to maintain the relationships with suppliers that do not comply with certain CSR policies as long as the suppliers show a willingness to improve their conditions. For example,

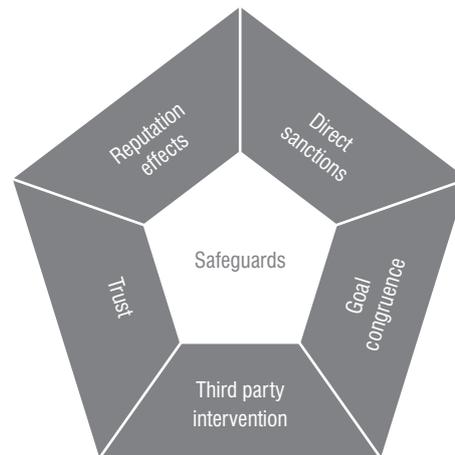


Figure 1:

Safeguarding mechanisms help to ensure that an agent complies with an agreement. All five safeguards are discussed in the following sections. Source: Pedersen & Andersen, 2006

the company might request an action plan from the supplier detailing how the non-compliance issues will be rectified. The suppliers are then usually given a time frame for carrying out the corrective actions. During the course of carrying out the corrective actions, the company may undertake follow-up visits as well as assist their suppliers in making improvements. In cases of continuous lack of ability or unwillingness to correct non-compliance issues, some companies choose to discontinue a business relationship.

Goal congruence prevents opportunism, stimulates cooperation and heightens commitment to CSR policies in the supply chain. It is not enough that the initiating company is dedicated to social and environmental issues; it must also encourage other supply-chain partners to act socially and environmentally responsible. In other words, the company needs to establish an element of goal congruence to make the suppliers act in accordance with the terms of the CSR policies. Goal congruence can be acquired in numerous ways: for example, by rewarding compliance or compensating the costs of social and environmental improvements. Evidence indicates that such decisions have to be made up front. A study of code of conduct implementation among 22 multinational corporations MNCs and their suppliers concluded that the questions of who should bear the costs of necessary changes and training need to be addressed at the very beginning.⁷ Another way to stimulate goal congruence is to convince suppliers that the costs of complying with the CSR policies are negligible. A recent survey of 1,071 Danish SMEs concluded that only 4 percent of the respondents believed CSR to have negative economic effects.⁸ Finally, a company can involve the suppliers in the development and implementation of its CSR policies. If CSR policies are implemented top-down, it may be difficult to ensure commitment throughout the chain. A study conducted by Business for Social Responsibility⁹ (a NGO that promotes CSR) concluded that suppliers saw communication and dialogue through workshops, partnerships and meetings as important for the successful *greening* of the supply chain. In conclusion, a collaborative approach to CSR which includes the involvement of the supply-chain partners may foster a higher level of goal congruence.

Third-party intervention can be used to monitor the supply-chain partners and thus safeguard the company from non-compliance. Examples of third-party monitors are industry organisations, certification auditors, external consultants, NGOs, etc. From a contractual point of view, it is of little relevance whether the company itself or a third party carries out the monitoring of the suppliers. However, in practice

Direct sanctions are a last resort in the case of non-compliance

Goal congruence prevents opportunism and heightens commitment to CSR

Third-party intervention
is often perceived as
reliable and credible

many companies choose to rely on third parties because they might have special competencies in evaluating compliance. In addition, customers and other stakeholders might perceive third-party monitoring as more reliable and credible. However, it is worth noting that third-party monitoring is not a silver bullet that automatically guarantees supplier compliance with CSR policies. For instance, an assessment of PricewaterhouseCoopers' labour monitoring in China and Korea found a number of important flaws in the system that significantly limited the additional value of these activities.¹⁰ However, independent third-party monitoring can still be seen as an important means to ensure credibility of – and compliance with – the CSR policies.

Trust can be an efficient safeguard, especially in long-term relationships where the business partners have accumulated a thorough knowledge about each other. Many companies have realised that the implementation of CSR policies is easier to obtain if the relationships in the supply chain are based on trust rather than control. Some degree of control – typically in the form of on-site monitoring of suppliers – may be necessary in order to maintain the credibility toward stakeholders. But if it is not supplemented by some degree of trust, implementation of CSR policies may be very difficult to carry out. In general, new business relationships are expected to be characterised by low levels of trust. As a relationship evolves, the two parties will become more acquainted with each other, which in turn may lead to higher levels of trust. In the planning and implementation of CSR policies, a company can thus use experiences from past transactions to target the monitoring in the supply chain. For instance, it will be a waste of resources to monitor suppliers, which traditionally have been proactive in the implementation of social and environmental standards.

Reputation effects
are highly relevant
safeguards

Reputation effects are also important when discussing the governance of CSR in global supply chains. Currently, concern for corporate image and reputation is one of the main reasons for setting up and complying with CSR policies.¹¹ With regard to CSR policies in the supply chain, companies want to show customers and other stakeholders that their products and services are produced in a socially and environmentally responsible way. However, supply chain partners may not have the ambition to be seen as good corporate citizens. Compliance with CSR policies will therefore depend on whether these actors will see an interest in keeping their reputation as reliable supply-chain partners. Reputation effects are expected to be a highly relevant safeguard in situations where a supplier can benefit from future cooperation with the initiator of the CSR policy (for example, by being assured more orders) and/or when the initiator can harm a supplier by communicating its non-compliance to other influential actors. A concrete example is the case of IKEA, which is known for having quite a strict code of conduct. The company has experienced that its suppliers sometimes use compliance with its code of conduct to signal to other potential customers that they, too, are responsible partners.¹²

Conclusion: The enforcement of CSR in global supply chains

Today, it is generally acknowledged that CSR covers the whole supply chain – from the extraction of raw materials to the final disposal or recycling of the products. However, it is also generally acknowledged that the management of CSR in the whole supply chain is a complex and difficult task. In global supply chains – where more and more parts of the production process are outsourced to companies in different geographic, cultural and institutional settings – CSR policies cannot be implemented without the

active commitment of all actors involved. However, CSR policies are often vague and poorly monitored, which leaves room for different types of non-compliance.

Realising that the successful implementation of CSR policies depends on the actions of all involved parties, the governance of CSR in global supply chains is of utmost importance. By discussing how companies can ensure compliance with CSR in global supply chains we argue that a number of safeguarding mechanisms can help a company to align supply-chain activities with its CSR policy. Without such safeguarding mechanisms, companies will have little influence on the environmental and social conditions in the chain, which in turn may damage the credibility of the CSR policy and the ultimately the reputation of the company. ♦

**Implementation needs
the active commitment
of all actors**

Notes

- ¹ See Pedersen & Andersen, *Safeguarding Corporate Social Responsibility (CSR) in Global Supply Chains: How codes of conduct are managed in buyer-supplier relationships*, Journal of Public Affairs, Vol. 6, No. 3/4, 2006, pp. 228-240. Also: Neergaard & Pedersen, *Expanding the Concept of Quality Management to Global Supply Chains*, The Asian Journal on Quality, Vol. 6, No. 1, 2005, pp. 98-108.
- ² See Jenkins, *Globalization, Corporate Social Responsibility and Poverty*, International Affairs, Vol. 81, No. 3, 2005, pp. 525-540. Also: Roberts, *Supply Chain Specific? Understanding the patchy success of ethical sourcing initiatives*, Journal of Business Ethics, Vol. 44, No. 2-3, 2003, pp. 159-170.
- ³ See Pedersen & Andersen, *Safeguarding Corporate Social Responsibility (CSR) in Global Supply Chains*, pp. 228-240.
- ⁴ See Jørgensen et al., *Strengthening Implementation of Corporate Social Responsibility in Global Supply Chains*, The World Bank Group, Washington, 2003.
- ⁵ See Pedersen & Andersen, *Safeguarding Corporate Social Responsibility (CSR) in Global Supply Chains*, pp. 228-240.
- ⁶ See Goldberg & Yagan, *McDonald's Corporation: Managing a sustainable supply chain*, Harvard Business School Case 9-907-414, Boston, 2007.
- ⁷ Mamic, *Managing Global Supply Chain: The sports footwear, apparel and retail sectors*, Journal of Business Ethics, Vol. 59, No. 1/2, 2005, pp. 81-100.
- ⁸ See *Kortlægning af CSR-aktiviteter blandt små og mellemstore virksomheder*, TNS Gallup, Copenhagen, 2005.
- ⁹ *Suppliers' Perspectives on Greening the Supply Chain*, Business for Social Responsibility BSR Education Fund, San Francisco, 2001.
- ¹⁰ O'Rourke, *Monitoring the Monitors: A critique of corporate third-party labour monitoring*, in: Jenkins, Pearson & Seyfang (eds.), *Corporate Responsibility & Labour Rights. Codes of conduct in the global economy*, Earthscan Publications, London, 2002, pp. 196-208.
- ¹¹ See Poksinska, Dahlgaard & Eklund, *Implementing ISO 14000 in Sweden: Motives, benefits and comparisons with ISO 9000*, International Journal of Quality and Reliability Management, Vol. 20, No. 5, 2003, pp. 585-606. Also: Pedersen, *Perceptions of Performance: How European organisations experience EMAS registration*, Corporate Social Responsibility and Environmental Management, Vol. 14, No. 2, 2006, pp. 61-73; *Kortlægning af CSR-aktiviteter blandt små og mellemstore virksomheder*, TNS Gallup, Copenhagen, 2005.
- ¹² Pedersen & Andersen, *Safeguarding Corporate Social Responsibility (CSR) in Global Supply Chains*, Journal of Public Affairs, Vol. 6, No. 3/4, 2006, pp. 228-240.

Global Supply Chains: The importance of traceability and transparency

Bart Slob is a senior researcher at the Centre for Research on Multinational Corporations SOMO in Amsterdam, the Netherlands. He has undertaken research on sustainability issues in several industrial sectors, such as coffee, electronics, garments and the travel industry.

Abstract

Around the globe, businesses are faced with increasing consumer demands to act in a responsible manner. Expectations rest not only in the hands of the corporate managers, but also throughout the supply chains of companies. Consumers who trust that a company complies with CSR standards must be able to know where and how the products they buy are made. For this to happen, a company has to track and trace its products through the entire supply chain. This essay distinguishes between different product attributes and defines two supply avenues to be traced. Furthermore, it explains the importance and benefits of transparency and traceability in supply chains and how this can be accomplished by setting and using CSR standards. Finally, the essay provides an example of a voluntary standard that was developed to improve working conditions at manufacturers and suppliers, and concludes that even state-of-the-art standards have flaws in their implementation mechanisms.

“You know so much more of a country when you haven’t seen it.”¹
Mark Twain, Sydney, Australia, 1895

Introduction

Child labour, sweatshops, global warming, deforestation: Many European governments believe that consumers will eventually reward companies that do what is in their power to solve these issues. If consumers purchased products and services exclusively from companies that comply with renowned and widely accepted CSR standards, unsustainable or irresponsible enterprises would cease to exist. However, at present, even those consumers who wish to make *a difference* are often unable to exercise critical choice because they do not have sufficient access to information on the conditions under which products are made. This issue was made clear by the European Commission in 2006: “Consumers play an important role in providing incentives for responsible production and responsible business behaviour. They are expected to exercise critical choice and encourage good products and good companies. At the moment consumers lack clear information on the social and environmental performance of goods and services, including information on the supply chain.”²

EU communication
addresses transparency
but offers no solution

The European Commission depicts the problem quite accurately but does not propose any solutions. The only thing the Commission plans to do, according to its *Communication on CSR*, is to “examine, in consultation with all relevant stakeholders, the need for further voluntary actions to achieve the objectives of transparency and information for consumers including on issues of public health.”³

Transparency is apparently a key element in the EU policy regarding CSR. But would more transparency actually enable consumers to “exercise critical choice and encourage good products and good companies?” Moreover, can we expect consumers to choose *good products* from *good companies*, or should governments make a pre-selection by defining through legislation what *good products* and *good companies* are?

Can we expect
consumers to choose
good products from good
companies?

Let us first go back to Mark Twain’s quote at the beginning of this essay. When Twain first arrived in Sydney in 1895, he announced that he intended to begin writing a book about Australia at once. “You know so much more of a country when you haven’t seen it,” he declared.

Notwithstanding his supreme sense of humour, his comment bears some truth. Travellers usually know a lot about a country before they actually visit it. They acquire knowledge by reading travel guides, books and websites, and by talking to people who have visited the country before. As soon as a traveller arrives in a country for the first time, the thin line between knowledge and experience is blurred. Very often, actual experiences leave impressions that differ significantly from the impressions we have based on our prior knowledge about a country. This is why vacations can sometimes be utterly disappointing.

Now, how is this relevant to the debate about transparency and selecting *good products* from *good companies*?

Content and process attributes: Can they be traced?

Consumers think they know about the products they buy and the companies from which they buy them. They identify or recognise products through a range of aspects that can be associated with a specific product – such as the level of technology,

design, taste, reliability or trendiness. Many of these aspects are intangible and refer to characteristics that consumers cannot discern even after consuming the products. Consumers cannot, for example, taste or otherwise distinguish between oil made from genetically engineered corn and conventional corn oil. In CSR terminology, these invisible characteristics are frequently called *credence attributes*.

Credence attributes can be divided into two categories: *content* and *process*. *Content attributes* affect the physical properties of a product, although they can be difficult for consumers to detect. For example, consumers are unable to determine the amount of isoflavones in a glass of soy milk or the amount of calcium in a glass of enriched orange juice. *Process attributes* do not affect final product content, but refer to characteristics of the production process. *Process attributes* include the certification of products and production processes. In general, neither consumers nor specialised testing equipment can ascertain process attributes. In some industrial sectors, systems have been developed to trace process attributes and to inform consumers about these aspects. In the food sector, for example, there are many schemes such as country-of-origin, free-range, dolphin-safe, shade-grown, earth-friendly and fair trade.

When you buy a product, especially a brand-name product, you might think you know a lot about it. Most companies do all they can to inform consumers about the positive content and process attributes related to their products. They can only inform consumers adequately if they can provide clear evidence to lend credibility to the attributes. The only way to actually verify the existence of these attributes is through a book-keeping system that establishes their creation and preservation. Therefore, products need to be traceable.

Content attributes affect physical properties; process attributes are intangible

Companies have to know where their products come from, who makes them and how the products are made. Moreover, they must be transparent about their processes and provide their stakeholders with useful and timely information. By definition, transparency is about openness and communication on issues that are regarded as important to those affected.⁴ Transparency is good for business. Managing a company in a transparent manner tends to improve the flow of information within the business and thus strengthens internal controls. Transparency also enhances market trust and credibility with key stakeholders because the perceptions of a company's stakeholders are vital to the reputation of that company. Perception is a factor of the quantity and quality of information received by the stakeholders and the extent of its validity and whether it satisfies the need of the stakeholder.⁵

Transparency enhances market trust and credibility with stakeholders

The most important argument for transparency, however, might not be the business case. Societies as a whole benefit from companies being more transparent about the way they produce and conduct their businesses. Some scholars and market analysts have called this the *Enron Factor*. The transparency agenda gained momentum with the collapse of Enron. The Enron saga exposed not only the evils of greed but also the dangers of secrecy and misreporting. Disclosure and corporate governance became buzzwords.⁶

Raising the bar through standards

One effective way for companies to communicate credence attributes is to use standards. The proliferation of standards in many industrial sectors is a result of the need for measuring and qualifying content and process attributes. Stefano Ponte

classifies standards in three broad categories: mandatory, voluntary and private:

“Standards are mandatory when they are set by governments in the form of regulation. These may affect trade flows by placing technical requirements, testing, certification and labelling procedures on imported goods. Governments can rely on standard enforcement through ex post liability rules that allow punitive damages to be awarded to the buyer in case of non-compliance, or they can adopt ex ante measures – such as requiring information or banning a product not matching technical standards from being imported. In the US, ex post liability is more common, while in Europe ex ante measures are the backbone of regulation. Voluntary standards arise from a formal coordinated process in which key participants in a market or sector seek consensus. The International Standardization Organisation ISO has established over 7,000 voluntary standards. Some of these are also introduced as a response to consumer request (such as eco-labels) or as a result of NGO initiatives (such as Fair Trade labelling). Sectorial organisations can also establish voluntary standards that apply to their members. Voluntary standards are usually verified through third-party auditing. Private standards are developed and monitored internally by individual enterprises. What often distinguishes them from mandatory and voluntary standards is their lack of third party verification, and a lower degree of transparency and participation by the affected stakeholders.”⁷

Ex ante measures to prevent non-compliance, ex post liability to punish non-compliance

Whereas a lot of people are distrustful of companies and their products, most people trust standards. One important driver of distrust is lack of knowledge or rather the reluctance of most companies to be transparent about their activities.⁸ Companies tend to communicate mainly about the things they do well. They often are reluctant to provide information about the negative effects of their business activities. Standards are needed to ensure that consumers, particularly in high-income countries, can obtain complete information on products in order to make individual choices based on their personal beliefs and preferences.

Moreover, consumers need to have confidence in the value of a particular standard to be able to choose a certified or labelled product. For example, when you buy fair trade products, you must be convinced of the value of fair trade, the value of fair trade standards, and you need to trust the organisations involved in the certification of fair trade products. Likewise, if a person is considering buying timber certified by the Forest Stewardship Council FSC, he or she needs to trust the traceability system developed by the FSC.

Standards provide information about the social and environmental performance of goods and services, including information about the supply chain. When consumers purchase labelled or certified products, they are sufficiently convinced that they are buying sustainable, environmentally friendly, safe or high-quality products. They trust the standards rather than the product or the companies that make the product. The problem is that the systems to implement standards are never perfect. All standards have flaws.

Standards provide information with regard to social and environmental performance

The SA8000 standard

An example of a rather comprehensive standard is SA8000, short for Social Accountability 8000. SA8000 is a voluntary multi-sectorial standard for auditing and certifying corporate responsibility developed by US-based Social Accountability

International SAI (formerly the Council on Economic Priorities Accreditation Agency) in 1997. The standard is primarily intended for use by manufacturers and suppliers. The standard and its verification system draw from established business strategies for ensuring quality (such as those used for the ISO 9000 standard) and include several elements that international human rights experts have identified as essential to social auditing. SA8000 is based on the principles of international human rights norms as delineated in International Labour Organisation ILO conventions, the UN Convention on the Rights of the Child and the Universal Declaration of Human Rights.⁹ SAI trains and accredits social auditing firms and individual auditors who then are hired by companies to certify their own or their supplier's compliance with SA8000 standards. The SA8000 standard includes stipulations on child labour, forced labour, health and safety, freedom of association and collective bargaining, discrimination, workplace discipline, working hours, compensation and management systems.¹⁰

SA8000 is a standard for auditing and certifying responsibility

After reading this, socially-aware consumers might think: "If a brand-name company states that it sources from SA8000-certified suppliers, it must be a socially responsible company."

Unfortunately, the SA8000 system is not perfect. Research undertaken in 2005 by the Clean Clothes Campaign CCC demonstrated many weaknesses in the social auditing systems used to verify compliance with voluntary CSR standards.¹¹ Workers at an SA8000-accredited factory in China producing for, among others, fashion labels DKNY and Michael Kors said the following to the researchers: "The auditors never told the workers [...] their identity. [...] Nor did the auditors inform the interviewed workers about how the information they conveyed would be protected and how the workers could complain in case of retaliation or reporting of code violation."

In one SA8000-accredited factory in North India, workers stated that no improvements had been made in the health and safety situation in the factory since they joined the factory. In Tirupur, India, a consultant, who provided factories with advice on how to obtain SA8000 accreditation, specifically advised clients to set up welfare committees as an alternative to unions.¹²

Labour issues in SA8000-accredited factories in India

In an unprecedented legal move, Fibres & Fabrics International FFI and its subsidiary Jeans Knit Pvt. Ltd. JKPL in Bangalore accused the CCC of "cyber-crime, acts of racist and xenophobic nature, and criminal defamation." FFI was one of the companies included in the research on social auditing systems. Brands sourcing from the company include Guess, RaRe, Armani, Mexx, Gap, Ann Taylor and G-Star. In June 2006, FFI and JKPL petitioned and received a court order to prevent labour organisations and trade unions from speaking out about labour violations in the company's factories. The organisations named in the order included Munnade, CIVIDEP and the trade unions GATWU and NTUI. The court issued a temporary restraining order in July 2006, which was prolonged in February 2007. The order effectively silenced local stakeholders from speaking out about what they believed was the real labour situation and providing support to workers in improving the labour conditions at FFI and JKPL.

Restraining order silenced stakeholders from revealing labour conditions

At the same time, a fact-finding mission (formed by local legal, academic and human rights practitioners) interviewed workers and met with management. The

subsequent report was published on the CCC website in August 2006.¹³ The following allegations were in the report:

- Beatings occur for even minor faults in work and when workers cannot meet production targets that are unreasonably high.
- Supervisors themselves are beaten.
- In October 2005, a boy was stripped and beaten in front of all the workers in the shift.
- Musclemen are paid to beat up the workers outside the factory.

Four out of five FFI production facilities had been accredited with the SA8000 certification as of December 2006. A month earlier, the CCC filed a formal complaint with SAI, challenging the ongoing certification process of the FFI/JKPL production units. On the basis of an evaluation, SAI formally informed FFI and JKPL in writing that it would advise its certification bodies to suspend the certification of FFI and JKPL facilities unless FFI and JKPL engaged with the local labour organisations to normalise the strained labour relations. This could also include taking steps towards the lifting of the restraining order. In April 2007, SAI posted a public statement on its website which declared legal proceedings against local stakeholders to be fundamentally incompatible with SA8000 certification of companies.¹⁴

SAI wants to see certification of production facilities suspended

Voluntary or mandatory?

A voluntary CSR standard may be quite comprehensive, but the systems designed to ensure compliance with the standard are seldom satisfactory. Implementing policies has proven to be far more difficult than policy-making.

If even CSR standards, labels and certifications have flaws, what is a consumer to do? Companies that apply CSR standards and use these standards to communicate the credence attributes of their products are probably, but not certainly, doing better than companies that do not worry about CSR at all. We could say, paraphrasing Twain, that you know so much more of a product when all you have seen is its label. Although there are many labels and certifications, fears of confusion in the marketplace due to the proliferation of different standards seem unfounded.¹⁵ Perhaps, in the next five years, many labels, certification schemes and other sorts of voluntary standards will start converging.

A prelude to this trend is the work of the ISO Working Group on social responsibility. For the past three years, the International Standards Organisation ISO has been developing an international standard that will give guidance to organisations on social responsibility – the ISO 26000 standard. In order to avoid inconsistencies with and duplication of other voluntary standards and international regulations in the field of social responsibility, the ISO has signed a memorandum of understanding with the UN Global Compact and the International Labour Organisation. Other standard-setting organisations in the field of CSR, such as the Global Reporting Initiative GRI and Social Accountability International, have not signed memorandums of understanding with the ISO, but have actively participated in the process.¹⁶

Are voluntary approaches to transparency on CSR-related issues all we need?

Transparency through the use of voluntary CSR standards should be encouraged. But are voluntary approaches to transparency on CSR-related issues all we need? On the one hand, the European Commission states in its 2006 communication that it will examine the need for further voluntary actions to achieve the objective of transparency and information for consumers. On the other hand, the commission says that, in spite of all the voluntary standards that have already been created, “consumers lack clear information on the social and environmental performance of goods and services, including information on the supply chain.”¹⁷

Does this mean that there are limits to voluntary transparency? Many NGOs and trade unions think there is a need to move beyond voluntary compliance. They believe that regulatory measures are necessary to complement the many voluntary CSR initiatives and have called on the EU to take the lead in the development of an effective European CSR framework. Such a framework would have to be based on internationally agreed standards and principles, such as the OECD guidelines and the conventions of the ILO, and should involve all stakeholders from the early stages of development and include credible provisions for monitoring and verification.¹⁸ The European Coalition on Corporate Justice ECCJ, a network of civil society organisations from across Europe, recommends the following measures to improve transparency:

- Mandatory social and environmental reporting;
- Disclosure of payments and lobbying vis-à-vis public authorities;
- A right for consumers and other stakeholders to know about social and environmental conditions in production processes, products and services.¹⁹

Not only NGOs and trade unions have emphasised the need for governmental regulation in relation to transparency. Achim Steiner, UN under-secretary-general and executive director of the UN Environment Programme UNEP, recently stated that it is the *right time* for governments to introduce mandatory CSR reporting: “We need to liberate business by providing it with the regulation that it needs to do something differently. To set regulatory frameworks is exactly what is needed now.”²⁰

Voluntary CSR standards should thus be complemented by mandatory standards. A balanced mix of both is likely to benefit transparency and increase the possibilities for consumers to exercise critical choice. Governments need to take up the responsibility to regulate corporate social responsibility. Although it is clear that regulation by itself cannot provide all the answers, governments, the EU government in particular, could help lead the way to good products and good companies. It may be an arduous task to create mandatory standards but consumers will benefit greatly. ♦

Voluntary and mandatory CSR standards likely to increase transparency

Notes

- ¹ Quote attributed to Mark Twain, in: Flannery (ed.), *The Birth of Sydney: The story of Britain's arrival in the antipodes*, London, 2003, p. 319.
- ² *Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee – Implementing the partnership for growth and jobs: Making Europe a pole of excellence on corporate social responsibility*, Commission of the European Communities, Brussels, March 22, 2006, p. 7. URL: <<http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52006DC0136:EN:NOT>>.
- ³ *Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee – Implementing the partnership for growth and jobs: Making Europe a pole of excellence on corporate social responsibility*, Commission of the European Communities, Brussels, March 22, 2006, p. 7. URL: <<http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52006DC0136:EN:NOT>>.
- ⁴ Hohnen, *Transparency: The path to 'clearly better' sustainability and performance*, paper for the 9th International Energy Forum, Amsterdam, 2004, p. 3.
- ⁵ Comment by Chinyere Almona during an e-discussion organised by the International Finance Corporation, May 10, 2004.
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- ¹³ Devraj et al., *Fact Finding Report of Violation of the Rights of Workers at Washing Unit of Fibre & Fabrics International Pvt. Ltd. (FFI), Peenya Industrial Area, Bangalore*, 2006.
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- ¹⁶ Slob & Oonk, *The ISO Working Group on Social Responsibility: Developing the future ISO SR 26000 standard*, briefing paper, SOMO, Amsterdam, 2007.
- ¹⁷ *Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee – Implementing the partnership for growth and jobs: Making Europe a pole of excellence on corporate social responsibility*, Commission of the European Communities, Brussels, March 22, 2006, p. 7. URL: <<http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52006DC0136:EN:NOT>>.
- ¹⁸ Oldenziel, *European Commission Abandons Multi-stakeholder Approach in CSR*, Ethical Corporation, April, 2006, p. 15.
- ¹⁹ Oldenziel (ed.), *Corporate Social Responsibility at the EU level: Proposals and recommendations to the European Commission and the European Parliament*, ECCJ, Brussels, 2006.
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Is This Brand a Friend?

The emergence of citizen brands as a missing link between social responsibility, growth and value

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Abstract

As consumer markets are increasingly characterized by abundance, the intangible aspects of brands become more important. Consumers are increasingly basing buying decisions on personal attitudes and values that correlate with those which a brand seems to convey. While CSR is gaining strategic relevance in the corporate world, and corporate identity is shifting from local to global, companies need to act on the basis of the value of their socially responsible brands – their citizen brands – in order to create integration, identity and economic value.

Citizen brands increasingly derive their meaning from ethical and moral value

Buy good, do good, feel good

“The official drink of a better world.” This was the slogan with which Bionade – a very successful German soft drink company – welcomed visitors to its website, www.stille-taten.de. There, people could do something good without it being made public. People could send a present to someone, or decide to hide a poem between the pages of a library book. All of this was done in complete anonymity, except for a card on which the site’s URL was printed. Upon visiting the website, the recipients of the good deed found out who treated them to the pleasant surprise and, of course, saw the Bionade logo.

Smart thinking? Clever branding? Looks like it was. Bionade created an aura of positivism for its own brand, inspiring and helping others to do something good. But there was more to it: The campaign was built on the simple yet powerful assertion that doing something good makes you feel good. And Bionade became associated with this positive feeling. In this virtuous circle, everyone was a winner: Bionade sold its drinks, its consumers received a sense of self-fulfillment and the receiver of the gift got an unexpected treat. This goes a long way to demonstrate how new win-win branding strategies align the desire for individual involvement with the increasing interest in ethics shared by those who sit around the “campfire” of a brand and its products.

The brands, which actively enter this dialog and new relationship, are moral or better. They are “citizen brands” which increasingly derive their meaning and value from an incorporation of ethical and moral values dear to their consumers in their activities, their messages and, finally, their attributes.

How consumer capitalism and Web 2.0 redefine branding

With the shift of consumer markets in developed countries from scarcity to affluence, and the enormous increase of product and brand choices, the intangible aspects of the product and the brand become more important in guiding a buyer’s decisions. In the era of so-called *consumer capitalism*, the question changes from, “Does it work?” to “Does it suit me?” Consumer choices tend to integrate more and more dimensions of the individual: Does it fit my body, my needs, my friends, my environment, my aspirations – and my values?

As the necessity of meeting one’s basic needs becomes less relevant, buying and consuming becomes a (major) instrument of building and expressing identity, affiliation and social status. Consumption will therefore reflect more sophisticated preferences. The choices between products and brands of the new “moral consumer” do not only include personal predilections but also his or her socio-political preferences. The Web provides an excellent support platform for this behaviour. It fosters the rise of the “smart” consumer. This sophisticated consumer does not depend on the information given by producers and is therefore less “seduced” by advertising; rather, the consumer finds out the relevant information based on the experiences of his or her peers and shops around.

Web 2.0 empowers consumers to a more active dialogue with industries

With the next generation of Web 2.0, stronger connection platforms for communities, as well as improved active participation and production tools for consumers, emerge. This allows more fundamental ways of self-expression and exchange – from goods (eBay) to music (KaZaA), from video (YouTube) to friends (Facebook) and attention (MySpace). By adding interactivity to information, Web 2.0 empowers the single consumer and multiplies her or his collective power. Less rapidly

than technology itself, experiences and expectations change fundamentally while deeply challenging the relationship between consumers and companies.

Rising expectations to responsible (corporate) citizens

“The social responsibility of business is to increase its profits”, declared Milton Friedman in 1970. This was at the beginning of a decade when traditional values – including way of life and the belief in never-ending growth and production – were questioned by many, especially young people who shared “green” worries about the future (as pronounced by the Club of Rome’s report, *The Limits of Growth*). Companies active in pharmaceuticals, energy, chemicals and agriculture were primarily in the focus of young people’s concerns. The pervasive “success” of pesticides, chemical accidents like Bhopal and the oil crisis – all of a sudden the “dark side” of all the comforts enabled by mass production were brought to light and the interdependence between industrial, political and social issues was shown.

**In the 1970s,
traditional values
were questioned
by many**

Since those days, some companies have started to change their attitude of a business is business perspective. Corporate social responsibility CSR has added to the inheritance of corporate philanthropy. With accelerating globalization, privatization and liberalization, a greater demand for CSR has emerged, especially concerning the new “masters of the universe” – the global, multinational companies. Not only have consumers, products and markets grown beyond their former limits, the concept of CSR has evolved, too. Reacting to (accidental) causes and donating were not enough anymore. The concept of good citizenship, of being part of the community, of giving and sharing, was applied to global companies whose obligation it was not only to be aware of their ecological, environmental and social impacts, but also to provide the right solutions to people’s concerns.

Giants like Nestlé and Danone, Shell and BP, Nike and Adidas – favorite targets of the anti-globalization movement – have learned the hard way how direct and short the link is between workers’ conditions at a coffee plantation in Columbia and the coffee consumer in Berlin, or from a small oil platform to a big boycott, or from a “cool” winner’s logo to a leading (bad-guy) position in a strong “no logo!” movement. The lessons have been learned quickly and they have changed many companies profoundly. By November 2007, more than 4,700 companies had joined the UN Global Compact, a voluntary platform to raise and (uphold) certain standards of ecological, human and social rights. Adidas and Nike, both focusing on the brand and “orchestrating” a global, fast-moving value chain of different partners in low-cost countries, have evolved as industry leaders in transparency and monitoring processes to ensure that their partners’ working environments match their standards. AstraZeneca, the British/Swedish pharmaceutical giant, decided to cope with the pharma industry’s diminishing social license to operate by funding large-scale research programmes to develop effective drugs that could help combat tuberculosis in the developing world.

**4,700 companies joined
UN Global Compact to
enhance ethical standards**

CSR on the move: From a marketing issue to the center of strategy

In one way or another, the idea of CSR has reached a level of acceptance that is comparable to the idea that a company should have good labour relations or a Web presence. However, the concept is anything but clear and actions hardly follow strategic logic. If someone has a good idea, and someone else has the ambition to support it

CSR has reached an enormous level of acceptance, even though the concept is unclear

with resources, another pro-bono project or charity is born. If the recipients are lucky enough, the corporate donor stands out in terms of stability and (personal) continuity from other benefactors. Over time, many companies have collected an impressive number of pro-bono activities and have spent a considerable amount of financial and personal resources on pro-bono issues. This is good – but not good enough. Private companies may continue the tradition of the Vanderbilts and Carnegies, following their modern versions of great maecenas like Gates, Soros and Branson, but public companies face the (silent or public) questions of their shareholders: “What is in it for me?” and “In whose name is this being done?” Their challenge is to respond to their responsibilities with a win-win solution: How can we make a difference? What do we stand for? Why should we do that? How do we get our people involved? Will our involvement support our competitive position and make us stronger?

Meanwhile, many examples (as explained in detail in this book) can tell the (CSR) story of mutual gain by corporations and societies. Companies as different in focus, culture and industry as Repsol YPF, one of the world’s ten largest oil enterprises, and Caixa Catalunya of Spain share the ambition and experience of a win-win CSR case. During the economic crisis in Argentina (2001-2002), Repsol YPF answered the growing need for help by asking its own employees for ideas which could help surpass the crisis. Investing in social work and sustainable jobs throughout Argentina, Repsol YPF not only strengthened its own reputation but also built social and economic capacity for the country. Caixa Catalunya’s efforts to help to establish micro-credit structures in developing countries point in the same direction: They are a means to help people, and a way to establish markets and develop sustainable relationships in emerging markets.

Developing and deepening relationships is a core ability – and a key success factor – in management consulting. The Boston Consulting Group BCG, pioneer in strategy consulting and one of the world’s leading top-management consulting firms, has a history of social-impact work that is directly linked to its core business of strategy consulting. BCG’s social impact is closely linked to the company’s core competences, which are also defined in its brand’s claims – looking beyond the obvious, looking ahead to building sustainable competitive advantage, embracing diversity. They help shape BCG’s social benefit work on a global, regional and local level. On a global level, BCG worked with the UN World Food Programme to optimize its processes; on a regional level, BCG Germany started the educational initiative *business@school* in 1998 to close the gap between the increasing relevance of business understanding and the entrepreneurial spirit, and the minor role that economic and business know-how played in public-school curricula. Today, more than 1,000 students have participated in this initiative, developed business ideas and learned from first-hand experience how economy works. Every year, more than 100 BCG consultants team up with representatives of major client firms to coach students and to guide them through the course and integrated competition of the “best student team’s business idea of the year”. Investing in people, bringing people together, helping them to shape their ideas, analyse and learn is a win-win situation for all who participate – with a clear benefit for the BCG brand.

In dealing with society and values, CSR strategies affect more than just the image of the company; they profoundly impact the identity and the “DNA” of a corporation as

Many examples can tell the CSR stories of mutual gain

such. Strategic CSR has to build a lasting link between the company, its strategy, its history, its people, partners and clients. This moves CSR from the borders to the core, and changes its role from a *nice-to-have* to a *must-have*, becoming one of the decisive future drivers of any brand.

In brands we trust

If anything goes, something has to stay. In a deconstructed world, stability is not a given but an increasingly precious good. That holds true for the individual as well as for institutions. Corporations in the 20th century had a defined, mostly local identity. They had a place where they created and offered their goods and services; they knew their industry, their consumers and competitors, and knew how to work with them most effectively.

The brand will be corporations' place of identity in the 21st century

Today, driven by information technology, globalisation and capital markets, corporations evolve as networks where the pressures of outsourcing and offshoring turn the given roots into a matter of strategic disposal. Capital as the fastest-moving asset sets the pace for mobility and flexibility of institutions in order to react to consumer demands as well as to explore new market opportunities. If a company aims at sustainability over time, it needs stability and identity. The “place” where they have to be created may be decided as a global option, depending on markets; value layers may be deconstructed and recombined; staff may be substituted by temporary projects and freelancers. And, in the most recent turn of investors' capitalism, it is leadership, management and ownership that is increasingly – and in shorter periods – subject to turnover.

The “place of identity” in the 21st century is a creation itself, an imagination, a belief: the brand. It derives its meaning from a history of experiences; it sums up qualities that are delivered, perceived and believed by the people. It is the focus of trust; in consequence of modern acceleration, disposability and postmodern claims (that there is no “one truth for all”), the brand evolves as the “place” to be: the place where identity is created, communicated, where it is discussed and where it evolves over time. It is the focusing magnet for the different pieces (aspects of the campaign) to fit together and it is the “campfire” around which the people, the stakeholders – consumers, staff, investors – can gather around.

Citizen brand or value creation by value integration

In modern markets, brands create value because they can carry and communicate values over time. Consequently, it is the brand that combines the two paths and merges them: the demand that companies and corporations should integrate into their impact, and their responsibilities for “more” than just business. This is based on the trust (from within and outside the institution) that can be communicated by the brand and can only be created by focusing on values. “It is the intensity and the global dimensions of the discussion that have changed. We do not talk about isolated action; we have to act responsibly along all dimensions and activities in our value chain instead. The consumers' choices prove whether our efforts are accepted and acknowledged”, explains Henkel's CEO, Ulrich Lehner, talking about the difference between the past and the present. Henkel itself is living proof of the convergence of long-term economic success and citizenship. The company's slogan, *A brand like a friend*, does not express a recent insight; instead, it sums up the long history of its social

Brands create value as they can carry and communicate values over time

**A good company does
good with a good
balance sheet and good
non-economic values**

and local involvements, many of them being rare or new in their time, like health care programmes for workers, support for working women or reports on sustainability. Due to the perfect match between brand, strategy and citizenship, Henkel ranks, year after year, among the very best companies in Europe. “Let’s combine the power of markets with the authority of universal values, and the creative power of the entrepreneur with the needs of the left-behind and future generations”, said Kofi Annan to sum up the idea of the UN Global Compact at the end of the last century. It is the denial of an either-or perspective that has fuelled the success of this initiative itself: A good company does good when it has a good balance sheet and good non-economic values.

Companies need to act on the value of their brands as the core of their strategies and organizations. As consumers of the 21st century integrate social values and their political individuality, brands will become platforms to express values. Brands should be friends. And friends, most of all, are the ones we can trust. ♦

CSR Performance Measurement: From proving to improving

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Abstract

Companies all too often provide their stakeholders with CSR reports that explain the results and successes their action has yielded. CSR reporting today could be generalised as a defence of corporate actions. We suggest that by adopting this approach, companies have lost sight of CSR's intent, which is not to defend their practices but to create value for themselves and society. Instead of attempting to prove value creation, companies should focus on improving it. This essay offers ways to clarify and achieve corporate and social objectives. While progress can be measured through the elimination of negatives, we encourage insight into why this progress was made. Similarly, for products addressing social problems and philanthropic investments, insights about why progress was or was not achieved and how these insights resulted in new resource allocation decisions should be made transparent to stakeholders where possible. A clear strategy, combined with performance measurement focused on increasing value creation, will benefit both stakeholders and companies.

Introduction

Companies do not only need results but insight into why they occurred

When creating value, just measuring the results is not enough. Companies may well know this. When they launch a product, it is not just the sales and returns on investment that count, but also understanding why consumers are (or are not) responding. The same is true, of course, in the social sector. When a major foundation evaluates the results of its investments in dozens of different school districts, reading proficiency scores or graduation rates certainly matter. However, it is only insight into these outcomes – for example, how they are linked to improving instructional leadership, community engagement, or the attention school boards give to measuring performance – that allows such programmes to be iterated, adapted and improved.

Increasingly, corporations are understanding that strategic CSR investments can be a source of value creation and competitive advantage. In July 2007 at the UN Global Compact gathering in Geneva, new evidence was presented correlating social and environmental leadership with superior market returns.¹ A few months earlier, our colleagues Porter and Kramer issued an important article linking internal changes to value chain activities and external social investments to both economic and social value creation, emphasising, as the CEOs in Geneva did, the need to embed CSR in corporate strategy.²

In order to truly create value through CSR, the same approach to performance and management information is required: Measurement should address not only how much progress has been made, but *why*. Yet, current practices too often fall short of this. Many companies collect information for a wide range of key performance indicators and success stories that provide too little sense of context, relevance or relative value, and make it difficult for companies to integrate CSR with their overall strategy.

Focus needs to shift from proving progress to improving value

Focus has been on providing evidence of progress to stakeholders, reflecting the responsive nature of CSR as commonly practiced today. Andrew Likierman's insightful article on the subject is telling in its title: *Acting ethically – and being able to prove it*.³ In the scramble to demonstrate attributable results on everything from trade union rights to carbon emissions, companies lose focus on their global impact and how they can improve. For companies that are serious about creating value for themselves and society, it is time to go beyond trying to prove progress in CSR to understanding where value is created and why.

The state and challenges of CSR measurement and reporting

In general, there are three areas of CSR on which measurement and reporting focuses:

- Mitigating the negative impacts of a company's value chain, often in response to external issues and pressures.
- Social innovations that are beneficial to society, such as energy-saving light bulbs or micro-insurance.
- Social investments or donations aimed at, for example, supporting the local community or addressing issues in a company's competitive context.

Negative impacts: So much to measure, so little time for insights

The concern to mitigate the negative impacts of the value chain has been the driving force behind much of the recent increasing interest in CSR. Not surprisingly, current measurement and reporting practices reflect this.

The responsive nature of this agenda means companies are asked to measure a myriad of different indicators, each advocated by a different interest group. In recent years, vast numbers of standards and indicators have emerged, many focused on *proving progress* and *improvements of the negatives*. Groups such as the Global Reporting Initiative GRI have made bold efforts to rationalise the barrage of potential topics into a more manageable form. However, even in its third evolution, the GRI recommends not less than 79 standard reporting parameters (of which 49 are considered *core*) on issues of economics, the environment, labour standards, human rights, society and product responsibility.

Effectively tracking performance on such a wide range of issues can be costly and difficult. As a result, measurement is frequently either avoided or focused on inputs and activity progress rather than results. Moreover, targets and associated results are rarely provided in the context of the issue. For example, is a 20 percent reduction in overall carbon emissions good performance? Likierman makes a number of helpful recommendations to improve the quality and credibility of measurement of these parameters. Among others, he suggests:

- defining objectives based both on external and internal perspectives;
- clarifying assumed costs and benefits, incl. presumed reputation risks or gains;
- focusing on outcomes;
- validating outcomes through credible data collection processes and comparison against best practice benchmarks.

Together, these measures would certainly offer companies and stakeholders far more reliable information. However, the question remains as to whether companies have the capability to invest the necessary resources to be truly rigorous across dozens of areas. In general, the ability to figure out what matters most – namely, the impact and how to further improve it – diminishes proportionally to the number of areas reported on, as scarce management resources are consumed by information collection and review processes.

Social innovations: Impact and transparency

Social innovations pose a different set of measurement and reporting issues. Since the social and business value is delivered through companies' products and services, measurement is naturally integrated in the way business is conducted. Wal-Mart knows exactly what value its low energy light bulbs deliver: Each bulb uses 75 percent less electricity, lasts ten times longer, produces 200 kg fewer greenhouse gases from power plants and saves consumers USD 30 over the life of each bulb. That is the impact message the company uses to convince consumers to pay eight times more for a product which some believe to give off a harsher light and possess a peculiar appearance.

The challenge for managers is to contextualise the extent to which social innovations are having an impact. In the case of Wal-Mart's light bulbs, this is fairly

Tracking performance on numerous issues is costly and ineffective

Impact measurement diminishes according to the number of areas reported on

Managers should contextualise the impact of social innovations

straightforward. However, the effect of reducing the calorie content of food products on the prevalence of obesity, say, is more difficult. The product profile, and how it was derived from a specific needs analysis, helps to explain the contribution it makes to solving a greater problem. How much it contributes, however, frequently needs further research: Do high-risk groups buy the products? How important are they to overall diet? Do they in fact have an inverse effect by encouraging people to eat more, or opt for other high-calorie foods? Such questions are important to validate the social value proposition of innovations, if the pitch to consumers is in fact to be based on such a message.

Disclosure of insights into how the value for society could be improved also hits a thorny landscape. Transparency about why these products succeed and how much impact they have is tricky because such information could affect a company's competitive advantage in that market. External stakeholders may want to know more about the share of such products within the company's overall portfolio or barriers the company is successfully addressing to stimulate uptake. Reporting, however, must balance the sharing of such insights to help increase social value (for example, by mobilising others to address barriers to uptake) with the need to protect competitive advantage. Investor relations departments can be helpful when considering how much information a company should provide its investors to keep them interested.

Social investments: The burden of proof

Along with mitigation of negative value chain impacts, companies' social investments – often referred to as philanthropy or corporate citizenship initiatives – are a regular feature of CSR reporting. Here, the best approach to such measurement and reporting is largely dependent on the motivation for investing.

When the motivation is primarily responsive – seeking a *license to operate*, or wishing to be seen as a *good neighbour* – companies, if they say much at all, tend to provide details on how much was invested with anecdotes intended to illustrate success. If these investments do not play a more strategic role, this may very well be enough.

Many companies, however, have higher ambitions for their social investments. Strategic investments, as Porter and Kramer describe, involve both what is targeted (e.g., changing social conditions that affect the long-term potential of the business) and how change is achieved (e.g., leveraging the unique assets of the company). In the best cases, focus is on *game-changing investments* that have profound and lasting impact.⁴

In this case, the anecdote-and-extrapolate formula is clearly unreliable. However, more rigorous attempts to prove the effectiveness of social investments are just as problematic. Such evaluation requires costly analysis, including extensive base lining of the social or environmental issue prior to social investments, or analysing data from control groups who face the same issue but have not benefited from the programmes. Few companies have the necessary experience and expertise to do this well. Furthermore, managers, partners and beneficiaries are unlikely to find these reports useful, as the information generated is retrospective, and reports are designed primarily for public relations purposes rather than to inform management or make resource allocation decisions.

Paradoxically, the urge to *prove* impact can actually be counterproductive. While one would expect most internal measurements of social investments to be equally useful to both internal and external parties, as *public domain issues* are addressed, reporting may in fact be quite sensitive. Some results, such as reduced corruption, may be best kept to a small set of stakeholders to sustain efforts and progress.

For strategic social investments anecdotal evidence is not enough

It is sometimes better to first proceed quietly and then to share results

Clear and focused objectives

As companies are well aware, superior performance is based on carefully crafted strategy (making choices about where or where not to compete, positioning activities to deliver more customer value at lower cost), and superb operations (tracking results and making adjustments based on real-time information from the market). Disclosure, in turn, is focused on providing enough information to stimulate shareholders' investment without undermining the value creation process.

Simply stated, companies need to apply the same rigour to CSR. First, in order to address *where to compete* they should carefully choose which value chain impact and external social conditions. Second, they must set clear objectives and measure performance against them in real time, learning and adjusting as they go. Meanwhile, they should disclose enough information to attract investors, without undermining their ability to progress or reveal their competitive advantage.

The race to track progress on negative value chain impacts in ever greater detail, and the difficulties of measuring the impact of social innovations and investments, often stem from a lack of clarity on what companies are trying to achieve. Faced with competing demands for limited resources, managers that do not have a rationale for prioritising initiatives and activities are left vulnerable, more apt to follow only the loudest voices and trends.

In our view, companies should take some time to identify a number of salient objectives that are relevant to their circumstances, on which they have a clear rationale to act and for which they have the capacity to make a difference. By focusing on strict measurement in these areas, and lightening the touch elsewhere, companies can gain valuable insight without overburdening managers. Moreover, they can disseminate lessons internally for replication and expansion, or even share practices externally if another's gains do not challenge their competitive advantage. A beverage company, for example, may form a concrete set of social objectives for its business:

- choose light-weight material for its bottles;
- support research on bio-plastics to integrate innovations within 10 years;
- support recycling efforts to bring the U.S. to similar levels as Europe;
- get to fully sustainable use of water through new water monitoring partnerships.

In reporting, the company may work hard to publicise recycling, but may not disclose all the environmental benefits of optimisations in its logistics and supply chain. By prioritising activities on few areas, which align with wider corporate strategy and areas of expertise, a greater return on investment for both company and society can be realised.

Not proving but improving

The emphasis on *proving* results in CSR also limits companies' potential to create economic and social value by robbing them of the opportunity to learn and improve their performance as they go. By moving from *proving* impact to *improving* impact,

Prioritise a few areas for analysis and lighten the touch on reporting elsewhere

**Proving CSR results
distracts attention from
improving performance**

companies can drive a process of insight generation on a few social impact areas where they can make extraordinary contributions to society.

The social sector is learning the same lesson. Traditionally, foundations have also conducted heavy, retrospective evaluations of grant programmes in an attempt to explicitly link investments to outcomes and impact, and thus scientifically *prove* the value of the grant. Increasingly, however, they are also learning to shed the need for attribution and focus on generating information that helps them to better plan the work, track results, draw insights from progress and re-allocate resources.⁵

Case examples

Leaders in CSR are already starting to recognise this. With focus on the effects of specific operational issues, new levels of impact can be achieved through more refined performance measurement. Take the example of Nestlé's focus on the water issue. It is one of the rare companies to release an issue-specific report, with the understanding of the critical links between global food production and the looming freshwater crisis.

The company already had a history of tracking its water consumption in over 500 factories worldwide. By focusing on the issue, we realised that a blind reporting of water savings was not very relevant. Water saved in Switzerland or South Africa is not worth the same: Water scarcity happens at the water basin level, unlike greenhouse gas emissions which impact the whole planet regardless of their origin. By linking water savings targets to the Water Stress Index, the company can focus attention on the sites where water conservation has the most impact. The company can also signal these communities to engage on the issue and encourage the industry to rethink their approach to water reporting.

**Lead companies focus
on real-time assessment
of progress**

Around social innovations, lead companies are also demonstrating how measurement can be focused on real-time assessment of progress toward impact. Since April 2005, one of Procter & Gamble's CSR initiatives has been marketing and selling water purification sachets in developing countries through its Children's Safe Drinking Water programme. Working with US-based NGO Population Services International PSI, the company does not make a profit on selling the sachets, but seeks to break even on its own costs and allow a small margin for local retailers.

P&G sets clear sales targets for each market into which the sachets are introduced and tracks progress on a monthly basis. As with their other brands, the company takes steps not only to make sure measurable targets are being met, but also to understand how and why this is happening. For example, the company was able to identify that higher take-up rates were achieved among emergency relief workers when they were already familiar with the product. This knowledge also allowed them to adapt their marketing techniques. For example, they established relationships with emergency relief organisations. As a result, the sachets were used more widely following the Pakistan earthquake in 2005 than following the Tsunami of December 2004.

With respect to philanthropic social investments, companies are also learning to go beyond communications of investments and anecdotal outcomes. The logistics company TNT, for example, recently evaluated its *Moving the World* partnership with the UN World Food Programme WFP. With EUR 35 million invested over five years, the company was clearly interested in the results. But the focus of performance tracking has gone much deeper with a new agreement. It was essential to understand which deployment of corporate assets was most important to improve WFP's own logistics and, thus, most contributed to

emergency food distribution events or school feeding programmes.

TNT could afford to drill down on these questions, in great part because it allocated its CSR capacities to this one flagship partnership only. Through their performance assessment process, several insights emerged. It became clear that fundraising programmes were in fact best designed for awareness building and social mobilisation. The company learnt that small, targeted and replicable projects that aimed to transform WFP operations achieved more tangible results than costly re-engineering efforts. It was also evident that support to emergencies was more successful when the appropriate staff were on stand-by, and that volunteers to school food programmes were more effective when they had the skills to address systemic issues such as transport of supplies rather than food provision at school level. With these insights at hand, the partners in Moving the World were able to redefine their portfolio to achieve even greater impact.

**For Nestlé, P&G, TNT,
deep performance
analysis opened
the road to success**

Building the basis for improving

The premise for all value creation is good strategy and execution. With a clear portfolio of priorities around value chain impacts, social innovation and philanthropic social investments, companies can focus their attention on collecting the performance information they need to make decisions that accelerate progress toward specific social objectives. This does not mean that managers should ignore external voices. Quite the contrary: Rather than seeing stakeholders as judges of progress, companies should aim to work in partnership with them to understand their impact, address both social and economic barriers in value creation, and replicate earlier successful attempts to accelerate social progress.

Companies can take action to redesign the performance measurement of CSR to support a value creation agenda. First, they need to identify where they can have the most impact and develop a clear portfolio of priorities and social progress objectives. Second, they should only measure what is needed to make decisions and re-allocate resources along the way to achieving goals. Resources now diluted on extensive reporting schemes and public relations campaigns could be better devoted to deeper and real-time analysis in a few critical areas of progress. Third, companies should focus reporting on knowledge dissemination to stakeholders who could help meet goals or use the information themselves to create change. This point anticipates a new direction for CSR reporting – from tedious reports of indicators and success stories to performance insight reports explaining new decisions which increase the social and economic value of the company. By changing from *proving* impact to *improving* it, companies can reach unprecedented heights in fostering social progress. ♦

**Future CSR reporting:
disclosing social insight
and consequential
investment decisions**

Notes

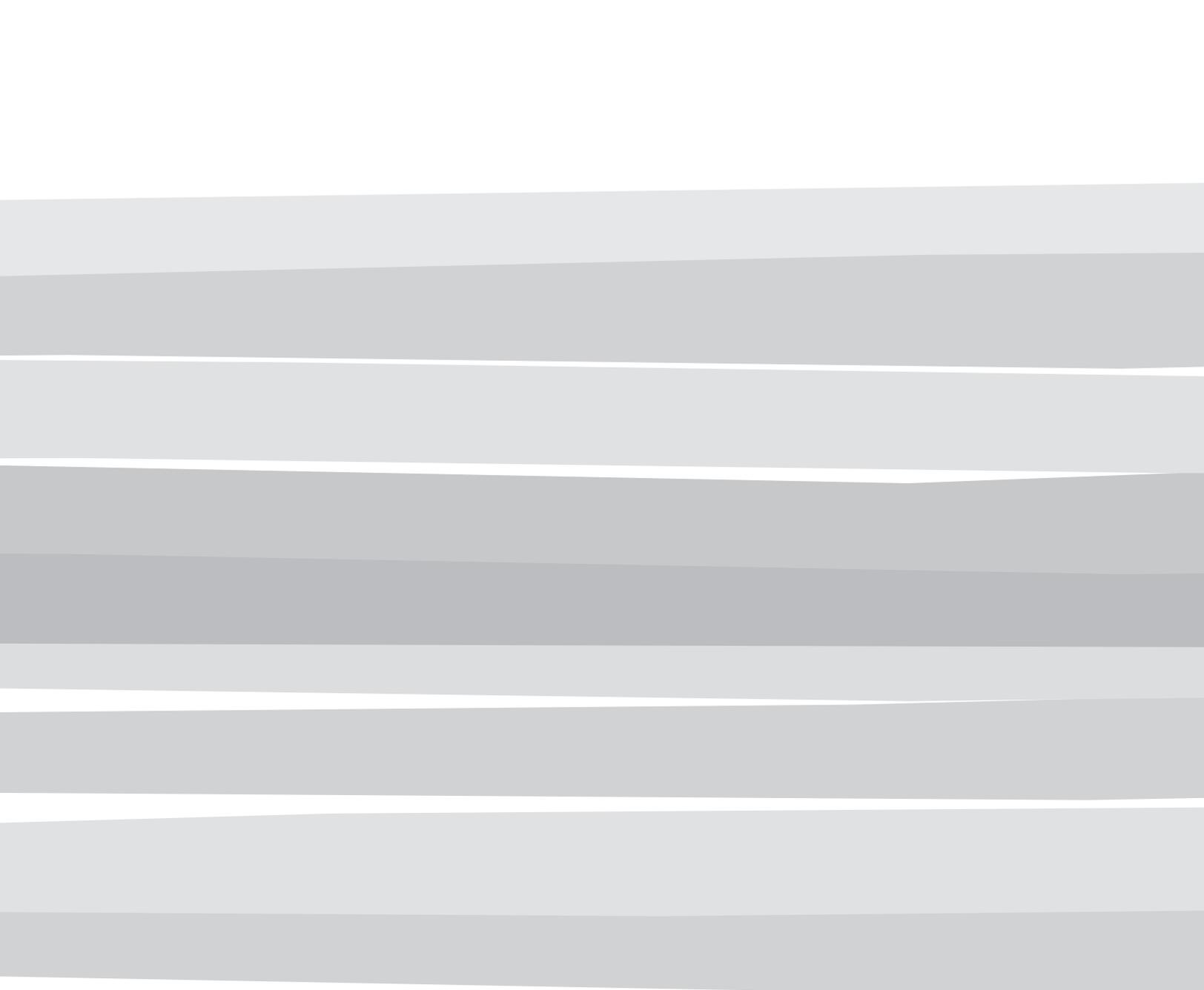
¹ See *GS Sustain Report*, Goldman Sachs, June 2007.

² See Porter & Kramer, *Strategy & Society: The link between competitive advantage and Corporate Social Responsibility*, Harvard Business Review, December 2006.

³ Likierman, *Acting Ethically – and Being Able to Prove It*, Ethical Corporation, December 2006.

⁴ See Kramer & Kania, *Changing the Game: Leading corporations switch from defense to offense in solving global problems*, Stanford Social Innovation Review, Spring 2006.

⁵ See *From Insight to Action: New direction in foundation evaluation*, FSG Social Impact Advisors, April 2007



Business Case

Carrefour: How to contribute to inclusive supply chains

June 18, 2003, was a sunny Monday in Madrid. Guillermo de Rueda, general manager of the Fundación Solidaridad de Carrefour (Fundación Solidaridad, hereafter), had just entered his office, when his assistant put through a telephone call. Javier Martín Cavanna, the director of Fundación Codespa (a Madrid-based NGO), was on the line and wanted to know whether de Rueda had read the letter he had sent two weeks earlier. In that letter, Cavanna had outlined Codespa's projects in Ecuador that helped to commercialise products from poor peasant farmers. He had also asked whether Fundación Solidaridad was interested in funding one of these projects.

De Rueda had been receiving similar enquiries every week – as word spread that Fundación Solidaridad had been established (in March 2001) by Centros Comerciales Carrefour S.A. (also known as Carrefour España), the Spanish subsidiary of the French retail giant Carrefour S.A. De Rueda had been appointed to lead Fundación Solidaridad after working as the institutional relations and communications manager for Carrefour.

The foundation was expected to bundle together the various social initiatives the company was implementing and to encourage activities that would effectively contribute to socio-economic development in the context of Carrefour España. De Rueda had to thereby thoroughly assess all incoming enquires, many of which he declined. But he thought this enquiry from Fundación Codespa sounded interesting. Why? As the second largest retail group in the world, Carrefour S.A. had supply chains which stretched around the globe. As institutional relations and communications manager, de Rueda had already expressed support for the inclusion of poor population groups from the developing world in these supply chains in order to spark their socio-economic development. Now, as director of the company's foundation, he could make these ideas come true. So instead of simply funding the activities of Fundación Codespa, he thought: Why not set up a pilot project aimed at including Ecuadorian farmers in Carrefour's supply chains?

“Yes, I read your letter. But I am not really interested in simply funding a project”, said de Rueda in response to Cavanna's question. “However, I would like to assess a strategic partnership that may include funding. Why don't we go for lunch, so I can tell you what I mean?”

Company profile of Europe's largest retailer

At a glance

In 2006, the Carrefour group was the largest retailer in Europe and the second largest in the world, selling to 25 million customers per day. Its 12,547 stores (which were either directly operated by the group or under franchising agreements) were located in 29 countries spanning four main grocery store formats – hypermarkets, supermarkets, hard discount stores and convenience stores – as well as cash-and-carry and e-commerce.

Carrefour: the largest retailer in Europe and the second largest retailer worldwide

Growing strongly while shoppers' behaviour becomes more complex

The history of Carrefour is probably best characterized by growth. On June 3, 1957, the Fournier and Defforey families opened the first Carrefour store in Annecy (France) near a "carrefour" (a crossroad). From this first outlet, the group grew into a chain. In the early 1960s, the Fourniers and Defforeys pioneered the idea of integrating supermarkets and department stores under the same roof, and opened the world's first so-called hypermarket in 1963 in Sainte-Geneviève-des-Bois near Paris, with 2,500 square meters floor area, 12 checkouts and 400 parking spaces.

Twelve years after it had been established, Carrefour began its internationalization by expanding into Belgium. Its strategy was based on building group market shares in each country by expanding the type of retailing best suited to the local market and by taking advantage of the way the group's formats complemented one another. Back home, Carrefour launched a highly popular private label line in 1976 (named *produits libres*) consisting of fifty foodstuffs, including oil, biscuits, milk and pasta. These were sold in unbranded white packages at substantially low prices. Company own-brand products were introduced in the mid-1980s, thus emphasising Carrefour's quest for in-store market shares. A series of acquisitions and takeovers in the 1990s culminated with Carrefour's 1999 friendly takeover of Promodès, the group's main competitor in France, thus creating Europe's largest food retailer.

According to Carrefour's 2006 annual report, the company, led by José Luis Duran, chairman of the management board, had revenues of EUR 77.90 billion. This made it Europe's top retailer, outranking the UK's market leader Tesco (EUR 53.72 billion revenues in 2006), and Germany's Metro (EUR 50.46 billion). Nevertheless, the world's largest retailer and company, Wal-Mart, was more than three times the size of Carrefour in terms of revenues in 2006 (USD 351.14 billion) and thus embodied a tremendously challenging industry benchmark.

In their 2004 survey *Deeper Customer Insight: Understanding today's complex shoppers*, Steve Ballou, Julian Chu and Gina Paglucia of the IBM Institute for Business Value stressed five mega-trends for 2010 that challenge retail businesses today:

Five mega-trends that challenged the retail business

- *Customer value drivers will fragment:* Substantial shifts in demographics, attitudes and patterns of behaviour will make customers trade up to premium brands and simultaneously trade down to low-cost providers.
- *Gatekeepers will become more guarded:* Empowered by new technology and regulation, customers will protect their identities and personal data more aggressively from me-too marketing tactics.

- *Information will continue to expose everything:* Customer choices are and will be shaped through unparalleled access to information – virtually wherever, whenever and however they want it.
- *Mega-retailers will continue to break boundaries:* The world’s top retailers will continue to expand across geographies, retailing formats and product and service categories, blurring market segments and devouring market shares.
- *Partnering will become pervasive:* Leading companies will continue to create so-called *value networks* based on strong integration and collaboration with partners (such as manufacturers, suppliers and sub-suppliers). Competitors will be challenged to match the responsiveness and agility of these connected market leaders.

These mega-trends, the authors predicted, will drive the retail industry into a world of extremes – in which customer diversity and individualism are omnipresent and traditional segmentation is rendered inadequate. In the near future, “customers will demand low prices for basic goods, but pay premiums for products that matter more to them personally.” The consequence is that “those best positioned to grow and succeed will be huge mega-retailers on one end of the spectrum and targeted retailers on the other, while undifferentiated companies, lost in the middle, risk fading into irrelevance.”

Experts said that retail industry will face a world of extremes

Europe’s number one retailer in detail

In 2006, Carrefour’s 456,295 employees generated revenues of EUR 77.90 billion, EBIT of EUR 3.26 billion and EBITDA of EUR 4.84 billion. Between 2003 and 2008, the group’s stock had the following notable highs and lows: It opened at EUR 37.36 on February 3, 2003, dropped to a low of EUR 29.20 on March 12, 2003, and then climbed to reach EUR 55.94 on March 23, 2007. On January 31, 2008, Carrefour’s stock closed at EUR 47.01.

In 2006, Carrefour’s 456,295 employees generated revenues of EUR 77.90 billion

On December 31, 2006, shareholders’ equity amounted to EUR 10.50 billion and market capitalisation stood at EUR 32.4 billion. EPS were EUR 2.64. A dividend of EUR 1.03 per share was paid out to shareholders.

Ownership of Carrefour S.A. in percent of total stock, Dec. 31, 2006

Halley family group	13.5		
Employee shareholdings	1.2	Free Float	85.3

In 2006, the industry’s peer was Wal-Mart, showing revenues of USD 344.99 billion, EBIT of USD 11.28 billion, EBITDA of USD 12.17 billion and 1.9 million employees. The US-based company’s EPS stood at USD 2.92 in 2006 – meaning that Carrefour’s stock was able to outperform Wal-Mart’s stock that year.¹

In 2006, Carrefour’s 1,040 hypermarkets worldwide contributed to 58.7 percent of the group’s sales. The 2,425 supermarkets generated 23.8 percent of sales, followed by the 5,798 hard discount stores (9.5 percent), and the 3,130 convenience stores and 154 cash-and-carries (whose joint sales equalled 8 percent of the group’s sales). In terms of breakdown of sales by geographic region, the company’s base country

France represented 47 percent. The rest of Europe (excluding France but including Algeria, Egypt and Saudi Arabia) had 39.8 percent. This was followed by the Americas with 7.3 percent and Asia with 5.8 percent.

Carrefour España: The nation's leader in the grocery retail business

Carrefour came to Spain in 1973 and was the nation's leading grocery retailer in 2006

Back in 1973, Carrefour entered the Spanish market by opening the country's first hypermarket in Barcelona. By the end of 2006, Carrefour had a total of 154 hypermarkets in Spain (with sales reaching EUR 9.01 billion that year). Only in France did Carrefour have more hypermarkets (namely 218 with sales totalling EUR 22.27 billion). The regional importance of the Southern European countries within the multinational group was also noticeable when looking at the amount of that year's total sales per country: France was ranked number one (with a total of EUR 41.67 billion), followed by Spain where Carrefour was able to sell goods valuing EUR 13.64 billion.

With its 67,903 employees working in 2,963 stores, Carrefour España was the ninth biggest employer in Spain in 2006 (the eighth biggest being Grupo Ferrovial with 88,902 staff members) and the nation's market leader in the grocery retail business. On average, almost one million customers shopped in one of Carrefour España's stores per day that year.

CSR at Carrefour

Carrefour focused on six major CSR issues

According to its 2006 CSR report, CSR at Carrefour primarily meant day-to-day commitments that were integral parts of their day-to-day business, namely: promoting economic and commercial progress for customers, partners, suppliers and shareholders; promoting social progress – especially for employees, but also for society – by being a committed corporate citizen; and, finally, promoting environmental progress. The various daily activities which manifested these commitments were a “chain of responsibility”, as one could read in the aforementioned CSR report, a chain that stretched from “the producer to the customer”.

In addition to these efforts, Carrefour decided to implement a large number of activities in 2006 that were meant to be responses to the following six issues, which were of particular interest to the company: nutrition; so-called *responsible products*; the promotion of diversity within the company; socially responsible manufacturing; climate change and the reduction of the environmental impact of the group's stores.

Of these, the group's response to the issue of *responsible products* was a good illustration of how one of the mega-trends identified by IBM's Institute for Business Value – that partnering will become pervasive – had actually become a trend: In 1992, Carrefour launched the first so-called *Quality Lines* for fresh food products (meat, vegetables, cheese, etc.), thus initiating a new type of partnership between retailers and farmers in France. By 2006, Carrefour already had 367 Quality Lines – meaning lasting partnerships all along the value chain – that spanned all over the world. They helped guarantee that products met certain levels of quality and also gave consumers the possibility to re-trace the origin of, for example, half a pound of beef.

Responsible products were an important aspect within the company's CSR strategy

To Carrefour, responding to the issue of *responsible products* was the next logical step after having established Quality Lines. Throughout 2006, the group not only increased partnerships all along the value chain to ensure product quality, but also

started to develop social initiatives meant to empower business partners in some of the Quality Lines.

Foundations to promote socio-economic development

In July 2000, Carrefour created the Fondation Internationale Carrefour, which was set up to focus the group's efforts in the areas of humanitarian aid and the fight against social exclusion. In March 2001, Carrefour España established Fundación Solidaridad. Although the Spanish foundation was aligned with the guidelines brought forward by the group's international foundation – especially those regarding quality and environmental issues – it had the autonomy to design its own activities. These revolved around the following guiding principles. The foundation wanted

- to enhance the socio-economic development in the company's social context;
- to increase the quality of people's lives and protect the environment;
- to promote a change of attitude and values so that commitment to society would grow in general.

Fundación Solidaridad was meant to be an integral part of Carrefour's business structure, a channel through which Carrefour España served society with its assets (such as capital, employees, know-how, infrastructure or relationships). Programmes and activities were supposed to be implemented in collaboration with company employees and were to be supported by products and services inherent to the company's business activities. By doing so, the foundation encouraged company identification among employees, and enhanced their social awareness.

De Rueda saw that companies were generally increasing the amount of importance they gave to social problems. This was a natural response, he often said, to the interests and demands of consumers, investors and employees. Was this trend only of temporary importance? "No", thought de Rueda. He believed that the market economy was evolving in this direction – which implied that corporate commitment towards society was not about image generation or marketing, but about long-term competitiveness.

Collaboration between companies and NGOs allowed the former to resolve the lack of knowledge and expertise in this new field of action. These partnerships, de Rueda acknowledged, impelled by the international wave of CSR, were increasingly seen as integral parts of business – rather than only as charitable activities conducted outside of the realm of a company's business activities.

Corporations perceived collaborations between NGOs and companies as part of business

Carrefour's inclusive supply chains

For a number of years, de Rueda's thoughts had been circling around the idea of integrating poor producers in the developing world into Carrefour's supply chains. When he thought of the possible effects of these inclusive supply chains, he pictured content farmers as well as happy families in remote rural areas of the developing world who would not even think of moving into slum-like suburbs due to the enhanced quality of life based on the fruit of their work. To de Rueda, commerce – locally,

Commerce was perceived to be key to social marginalisation

regionally, across national borders and global cultures – was the key to alleviating social marginalisation and to making that vision come true. Why?

As soon as people living in relative poverty were enabled to engage in value chains as real business-partners, not only would they be able to transcend their deprived context, but their self-esteem and the perception of their very own dignity would start to grow as their intrinsic capabilities would unfold due to their daily work.

But would it not be sufficient for Fundación Solidaridad to simply fund commercialisation projects that NGOs were already implementing? “No”, was de Rueda’s answer. There was too much potential lurking within MNCs like Carrefour. If poor producers in the developing world had the capacity to supply products at Carrefour’s quality levels (and only a few did at the time), they could substantially widen their access to markets. A company like Carrefour, de Rueda often said, is part of the solution for poor producers in the developing world.

Social Value Networks: Important to customers

Carrefour’s aforementioned “chain of responsibility from the producer to the customer” was a praiseworthy, ethical, day-to-day commitment. But it was also a strategic advantage – if one agrees with the aforementioned findings of IBM’s Institute for Business Value. Those companies that built up their *value networks* (meaning strong partnerships all along their supply chains) would have a competitive edge, according to the authors of the survey. Why? Because the traceability and the origin of products are of great importance to today’s and – even moreso – to tomorrow’s customers. By effectively constructing inclusive supply chains (via the foundation) and thus including relatively poor population groups, the company would not only empower producers in the developing world, but also magnify Carrefour España’s value network. And that would have an enormously positive impact on customers, many of whom were increasingly sensitive to the private sector’s social impact, as well as to where and how the products in their trolleys were made and shipped.

Turning small farmers in Ecuador into Carrefour suppliers

On July 2, 2003, about two weeks after their first telephone conversation, de Rueda, Cavanna and María Jesús Pérez, innovation and studies director of Codespa and the person in charge for the design of development projects in alliance with the private sector, met for lunch. They had a very open discussion on how business can contribute to development in emerging countries. The chemistry seemed to work: All three acknowledged the private sector’s enormous potential. But it was equally clear to them that companies could only leverage development effectively, and over a longer period of time, if community oriented activities implied real business opportunities. To de Rueda, who wanted to turn poor Ecuadorian producers into Carrefour suppliers, that meant two things:

- One had to find Ecuadorian producers who were willing (and able) to adapt their products and services to Carrefour’s standards of quality.
- One had to ensure large-scale demand for Ecuadorian products in Spain.

Real business opportunities perceived as motor of socio-economic development

Was that possible? De Rueda was interested in hearing the opinion of Codespa and asked Cavanna to present a concept to Fundación Solidaridad's board in mid-September. This job was delegated to Pérez.

On September 17, Pérez and her team presented a concept she called *Comercio Solidario* (Commerce in Solidarity) to de Rueda as well as to Carrefour's merchandising director, Ignacio González.

Matching supply and demand was an important aspect of the project

Economic crisis in Ecuador: The framework of an unfolding project

The presentation started with basic facts about Ecuador: In 1999, Ecuador's oil-driven economy witnessed a severe economic and financial crisis. The country, one of the world's biggest exporters of bananas and shrimps, had been struck by a number of external shocks – such as the El Niño weather phenomenon in 1997 (which had a negative impact on the fishing industry), a sharp drop in global oil prices in 1997 and 1998 (which recovered by 2002, allowing the country's oil exports to account for about one-third of public sector revenue and 40 percent of export earnings; see *Exhibit 1* for more details on Ecuador's exports), the general instability of emerging markets worldwide. These external factors went alongside with the federal government's unstable economic policy mix of large fiscal deficits and expansionary monetary policy. The overall result was a 7.3 percent contraction of the GDP, an annual year-on-year inflation rate of 52.2 percent and, in 1999, a 65 percent devaluation of the national currency.

Buoyed by high oil prices, the Ecuadorian economy experienced a modest recovery in 2000. Its GDP rose by 1.9 percent that year but in 2001, it was estimated that about 70 percent of Ecuadorians were still living below the poverty line, more than double the 1995 rate. One of the main consequences of this was that about two million Ecuadorians – from a total of about 12.2 million – left the countryside (and later the country) in search of better economic opportunities. These were mainly peasants whose scarce economic resources and difficult access to markets forced them to desert their villages and move to the cities – only to then move on to other countries. By the turn of the century, about 400,000 Ecuadorians were formally registered in Spain, not to mention the number of those not registered. This meant that although it was obviously necessary to thoroughly assess the market's demand for Ecuadorian products, the numerous Ecuadorians living in Spain very likely *were* that market.

Enormous capacity within NGOs in Ecuador

Pérez then continued by broaching the issue of the project's supply: In general, she said, farmers in Ecuador struggled with a limited negotiation capacity and little access to market information (such as prices and price fluctuations). They especially struggled with limited market access. Codespa's partner NGOs in Ecuador, Camari and Fundación Maquita Cushunchic Comercializando Como Hermanos MCCH were experts in helping farmers to overcome these pressing problems.

Generally, farmers struggled with limited negotiation capacity and market access

MCCH, Pérez pointed out, was established in 1985 and had one goal: to market the products of small peasant farmers. Based on 2001's numbers, she projected that the organisation would have 175 sub-organisations by 2005, which were believed to benefit about 6,000 people in 14 of the country's provinces. As early as 2006, she said, MCCH's sales would reach more than USD 17 million (cacao sales would account for about USD 14 million), of which around 85 percent will be exported to Europe.

Two NGOs in Ecuador with the joint aim to market the products of peasant farmers

Camari, Pérez continued, was established in 1981. It was a member-organisation of the Fondo Ecuatoriano Populorum Progressio (FEPP - the Ecuadorian Fund for the Development of People), which was a private social institution funded by Ecuador's Roman Catholic Episcopal Conference, and mainly aimed at supporting small-peasant producers with credit, instructional courses and technical assistance. Pérez pointed out that FEPP was the biggest NGO in the country with more than 70,000 families (or 400,000 people) as beneficiaries, while Camari was the organisation within FEPP that focused on helping poor peasant farmers access markets. In terms of numbers, she said, Camari would manage an estimated 1,500 different products by 2006 and have annual sales of about USD 2,420,000, of which circa 76 percent would be sold within Ecuador and 24 percent outside of the country.

After Pérez had conveyed these facts and projections, she explained the working methods of both Camari and MCCH: Both NGOs had a clear social mission to act as an intermediary between farmers and markets, and worked in similar ways. Both organizations encouraged farmers to group their efforts and create small associations. These were able to reach bigger volumes and receive advanced payments, since individual peasant farmers could not absorb the costs of distributors' deferment payments. Once the farmers set up their associations, Pérez explained, they jointly sold their products to Camari or MCCH, who then either retailed them directly to end-consumers in their own stores or to bigger national retailers, as well as to Fair Trade organisations in the US and Europe (see *Exhibit 2* for an illustration of the commercialization process). Codespa's role within the partnership, she said, was to build an international network and to open new distribution channels. "This is why we are here today", Pérez said. "For although Fair Trade has always been a reliable distribution channel", she continued, "Camari and MCCH know that it is limited in terms of volume, and they are open testing on new grounds to see if that benefits the farmers they represent." Finishing her presentation, Pérez bullet-pointed a way forward: The first step of a possible joint project was a thorough assessment of demand for Ecuadorian products in Spain. If demand is present, she continued, then Camari and MCCH products would have to match Carrefour's quality standards. How could that be made possible?

Carrefour employees could volunteer to help NGOs improve quality of products

She proposed a volunteer program she called *Profesionales para el Desarrollo* (professionals for development). Its basic idea? During their summer holidays, Carrefour employees could volunteer to help Camari and MCCH improve the quality of their products.

In the meantime, Pérez suggested that while demand was being assessed, de Rueda and a few other staff members could accompany her to Ecuador to jointly analyse the workflow and production quality of MCCH and Camari, in order to see how and where Carrefour employees were most likely to leverage quality standards.

The set-up of Comercio Solidario

At the end of the presentation, de Rueda and González thanked the Codespa representatives and promised to get back to them within a month. They felt they had just heard an in-depth analysis of the situation in Ecuador and were stunned by the capacity that seemed to lie within Camari and MCCH. At the same time, however, they knew they first had to contact Codespa's partner NGOs in Ecuador prior to assessing

Would NGOs partner with a company the size of Carrefour?

market demand in Spain. Camari and MCCH had experience in cooperation with European NGOs – but would they also partner with an MNC the size of Carrefour?

By mid-October, de Rueda told Pérez that Fundación Solidaridad was interested in setting up a strategic partnership with Codespa, but that he first wanted to meet with the representatives of Camari and MCCH in Ecuador. Not only did he want to jointly assess their workflow and the quality of their products, but he also wanted to understand first hand, whether they were actually willing to cooperate with Carrefour.

In January 2004, de Rueda accompanied Pérez to Ecuador and met María José Gil, Codespa's delegate in the region, as well as the representatives of MCCH and Camari. Both MCCH and Camari were delighted to take on the challenge of acting as a Carrefour España supplier, even though this would imply a number of changes with regard to packing and design, as well as to logistics and planning. Codespa was willing to coordinate the entire project and act as an intermediary between the Ecuadorian NGOs on one side, and Carrefour España and its foundation on the other. Codespa also confirmed the coordination of the volunteering program within Carrefour, once Codespa analysed how to improve workflow procedures and the quality of production given Camari's and MCCH's aforementioned shortcomings. Things seemed to fit together.

Back in Madrid, de Rueda discussed the project's objectives and outlined the way forward with the foundation's board. Comercio Solidario was aimed at

- commercialising products produced by MCCH and Camari that were to be sold via Carrefour in Spain at a competitive price;
- developing managerial skills within MCCH and Camari to increase their competitiveness;
- matching supply in Ecuador to demand in Spain;
- the project's replicability.

Steps to implement Comercio Solidario were defined

Way forward

The way forward to achieving these objectives, as defined by the board, was:

Step one entailed demand assessment. Fundación Solidaridad wanted to pay the expenses of the market demand assessment. If demand was present, Fundación Solidaridad was willing to initiate and fund Comercio Solidario.

Codespa was responsible for the project's second step, which involved analysing how to leverage production standards and build capacities within MCCH and Camari. Once this had been made clear, Codespa was to set up and coordinate a volunteer program for Carrefour employees who were interested in spending their summer holidays working as volunteers, working on and addressing the identified needs of MCCH and Camari. Apart from that, Codespa had to develop a monitoring system that allowed the retracing of noticeable quality increases and socio-economic impact quickly.

Could the guiding principles of Comercio Solidario become mainstream within Carrefour?

The project's third step focused on commercialisation, pricing and marketing. The products were meant to be shipped to Spain by Carrefour's usual contractors. The question which remained was: Which store format was Carrefour España going to use to distribute the products to end-consumers and at what price? Who was going to pay

for in-store marketing and shelf allocation? These questions were to be discussed and resolved by Fundación Solidaridad and Carrefour España.

Finally, the fourth step: If a reasonable sum of Ecuadorian products actually made it into the trolleys of Carrefour customers, Fundación Solidaridad would have to consider how to confer Comercio Solidario's guiding principles into the mainstream thinking within Carrefour.

Assessing demand in Spain and raising quality standards in Ecuador

In June 2004, Fundación Solidaridad and Codespa assessed the demand for Ecuadorian foods in collaboration with Accenture, one of the world's largest consulting firms. The results indicated that the immigrant population in Spain was increasing by an average of 34 percent per year, with one million Latin Americans as the predominant group (about 40 per cent of which were Ecuadorians). Their consumption habits? Most Latin Americans were considered to be so-called *nostalgic clients* – consumers who were willing to buy products from their home country. Due to predominantly low incomes, affordable prices were an important factor in the buying decision process.

Apart from Ecuadorians, a growing number of socially aware and eco-conscious Spaniards were also identified as potential customers. They were willing to pay higher prices for *responsible products*, as Carrefour's CSR report mentioned two years later in 2006.

Based on these numbers, Codespa and the foundation projected an initial annual consumption of 100,000 kg, or EUR 200,000 in yearly sales, for Camari and MCCH. Eleven Ecuadorian products were selected that seemed most suitable for the Spanish market: arroz de cebada (barley rice), avena (oats), frijol rojo (red kidney beans), frijol negro (black beans), maíz amarillo (yellow corn), maíz chulpi (yellow corn prepared for toasting), pinol (sugared and toasted corn), maíz mote (dried corn), panela grano fino bio (caramel based on bio sugar cane), quinoa (seeds of the chenopodium plant) and setas deshidratadas (dehydrated mushrooms).

"Fondo de Proveedores Sociales" and a volunteering programme

Codespa's next step was to help Camari and MCCH supply products at Carrefour's quality level. De Rueda and Pérez had already assessed the areas where help was needed. These were: packaging and design, as well as logistics and planning. In order to align packaging to Carrefour's standards, as well as to set up a monitoring system, Codespa proposed a EUR 60,000 investment, which was granted by Fundación Solidaridad as the foundation's Fondo de Proveedores Sociales (Fund for Social Suppliers).

Between 2004 and 2006, a total of 24 employee volunteers – especially from the areas of logistics and planning – spent their summer holidays in Ecuador, in order to help rationalise Camari and MCCH's production sequences. The costs of that program, which were paid for by Carrefour España, stood at EUR 30,000 per year. Carrefour España's volunteering programme was highly acknowledged. Santiago Gómez, responsible for MCCH's sales, said: "The support of the volunteers was very valuable as they brought us new techniques and ideas with a lot of interest and enthusiasm."

Choosing distribution channels and selling the products

Carrefour España and Fundación Solidaridad decided to sell the Comercio Solidario products in 50 of the country's 154 hypermarkets. In-store market research had

Ecuadorian NGOs
needed help with
packaging, design,
logistics and planning

shown that Ecuadorians frequented this store format more than others, as they appreciated the broadly spread variety of products for sale under one single roof. The Ecuadorian products were to be sold as *Quality Lines* products because consumers already associated Quality Lines to products from around the world.

Carrefour España agreed to increase the products' competitiveness by temporarily absorbing the in-store marketing and shelf allocation expenses, until products reached an adequate level of competitiveness.

After planning, assessing and setting up the project ever since June 2003, the first load of the eleven Comercio Solidario products (valued at USD 61,000) finally arrived in Spain in spring 2006 and were put on the shelves of fifty hypermarkets.

Comercio Solidario products were to be sold in 154 hypermarkets in Spain

New perspectives for all partners

As of 2006, sales increased the incomes of almost 2,000 peasant families in Ecuador. By October 2007, Carrefour sold EUR 146,000 of Comercio Solidario products and demand was increasing noticeably. Projections in Spain suggested that total sales for Camari and MCCH together would add up to USD 300,000 within the next few years (representing 27 percent of Camari's exports and 28 percent of those of MCCH). Subsequent yearly sales increases of 15 to 25 percent appeared to be possible. A long-term, win-win situation seemed to be surfacing which was especially encouraging for the MCCH and Camari farmers involved in the project. They had seen that the project was able to widen perspectives by unlocking a new distribution channel. Now that farmers felt more competitive through what they had learned during the project, they were full of realistic hope that sales would continue to increase.

A long term win-win situation seemed to be surfacing

Comercio Solidario positively affected Carrefour España as well. The 24 employee volunteers did not only contribute to the success of the project, but also experienced greater motivation to work for the company. This was recognised by staff in Spain and implicitly contributed to the emergence of social commitment as an essential aspect of corporate culture. In terms of external communication, the company was able to link its image with the support it was giving to poor producers in Latin America, while offering new quality products to clients in Europe.

To Fundación Codespa, Comercio Solidario highlighted the private sector's contribution to poverty alleviation. It was clear that public and non-governmental actors would not be able reach the Millennium Development Goals MDGs if they did not strategically engage socially committed companies. Apart from that, the Spanish NGO hoped to have witnessed the beginning of a long-term strategic alliance that would help to expand its network in the private sector.

Scaling up and replicating Comercio Solidario

By late 2007, de Rueda and Pérez were impressed by what had happened since 2003. Turning poor producers into Carrefour suppliers proved to be entirely possible. Now the inherent question was: What's next? During numerous brainstorming sessions, de Rueda and Pérez considered how to scale up the project. They understood that it would be important to continue to improve quality standards in Ecuador as the European market was very demanding. As quantities were expected to grow while prices for agricultural products remained volatile, they knew that MCCH and Camari, as well

The project's scalability and replicability was at the centre of concerns

as Carrefour España, would have to come up with larger investments in order to buy large quantities as long as prices were low. Payment periods thus became critical. They also wanted to diversify Comercio Solidario's range by commercialising other products – such as cacao, fruit and handicraft products. But would these products sell as well?

Apart from its scalability, the project's replicability was at the centre of Pérez's and de Rueda's concerns as they tried to develop a long-term strategy for Carrefour. In doing so, they contributed to the emergence of the group's worldwide efforts to establish inclusive supply chains as a response to the issue of responsible products – a prominent topic that had become group-wide mainstream, as one could see in the Carrefour's 2006 CSR report.

Looking back, Pérez and de Rueda were content with Comercio Solidario. They knew they had contributed to the evolution of Carrefour's business model and to the socio-economic development of the poor. ♦

Note

¹ Given an exchange rate of 1.4810 (on February, 4, 2008) EUR 2.64 equals USD 3.91, meaning that Wal-Mart's EPS rate would have had to reach USD 3.91 in order to compete with Carrefour's EPS rate in 2006.

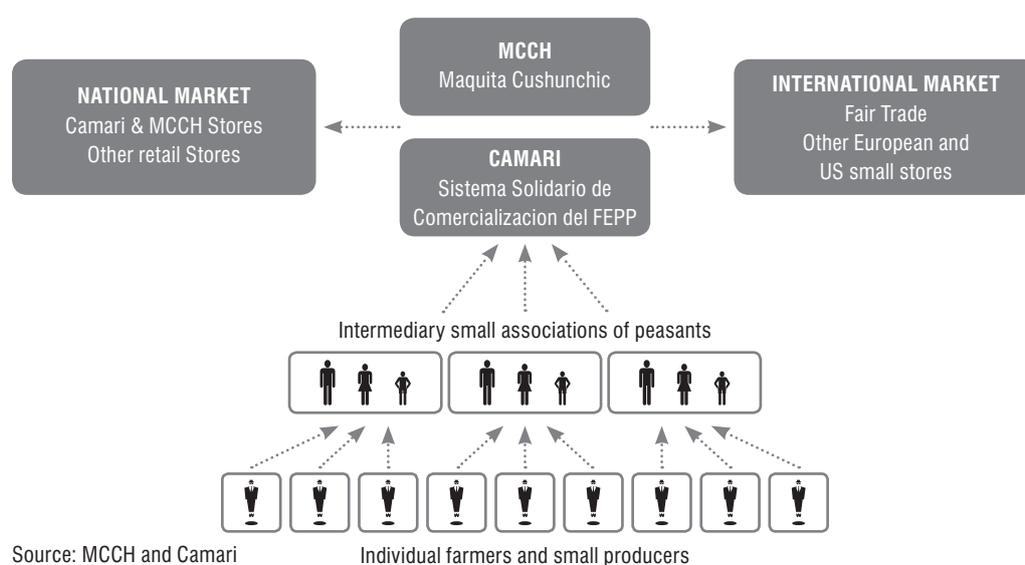
Exhibits

Exhibit 1: Trade statistics of Ecuador

TRADE (USD millions)	1984	1994	2003	2004
Total exports (fob)	2,622	3,843	6,038	7,655
Oil	1,835	1,185	2,372	3,899
Bananas	136	708	1,099	1,023
Manufactures	--	684	1,584	1,658
Total imports (cif)	1,529	3,622	6,534	7,861
Food	--	--	--	--
Fuel and energy	63	104	664	785
Capital goods	555	1,390	1,789	2,054
Export price index (2000 = 100)	101	75	105	118
Import price index (2000 = 100)	135	113	99	103
Terms of trade (2000 = 100)	75	67	107	115

Source: World Bank

Exhibit 2: Illustration of the commercialisation process set up by MCCH and Camari



Source: MCCH and Camari

Credits

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Teaching Note: Carrefour

Guillermo de Rueda, general director of Fundación Solidaridad de Carrefour (Fundación Solidaridad, hereafter), the foundation of Carrefour España (the Spanish subsidiary of the France-based retail giant Carrefour), is presented in *Carrefour: How to contribute to inclusive supply chains*. The case retraces how Fundación Solidaridad managed to effectively include poor peasant farmers from Ecuador within Carrefour España's supply chains between 2001 and 2007. Instead of arbitrarily funding various NGO projects aimed at commercialising agricultural products, de Rueda strategically cooperated with specific NGOs to set up an innovative joint project called Comercio Solidario: Its objective was to increase the socio-economic development of poor peasant farmers by turning them into Carrefour suppliers.

How did de Rueda and his partners proceed? They assessed demand for Ecuadorian products in Spain and increased the quality of eleven to-be-sold products (rice, corn and oat, among others) to Carrefour quality levels. The first load of goods (valued USD 61,000) arrived in Spain in Spring 2006 after market research had shown that sufficient demand existed, and after Carrefour España employees had volunteered to help optimise production procedures and lift the quality of product packing and design. The goods' competitiveness was increased as Carrefour España assumed both in-store marketing and shelf allocation expenses, so that products reached an adequate level of competitiveness.

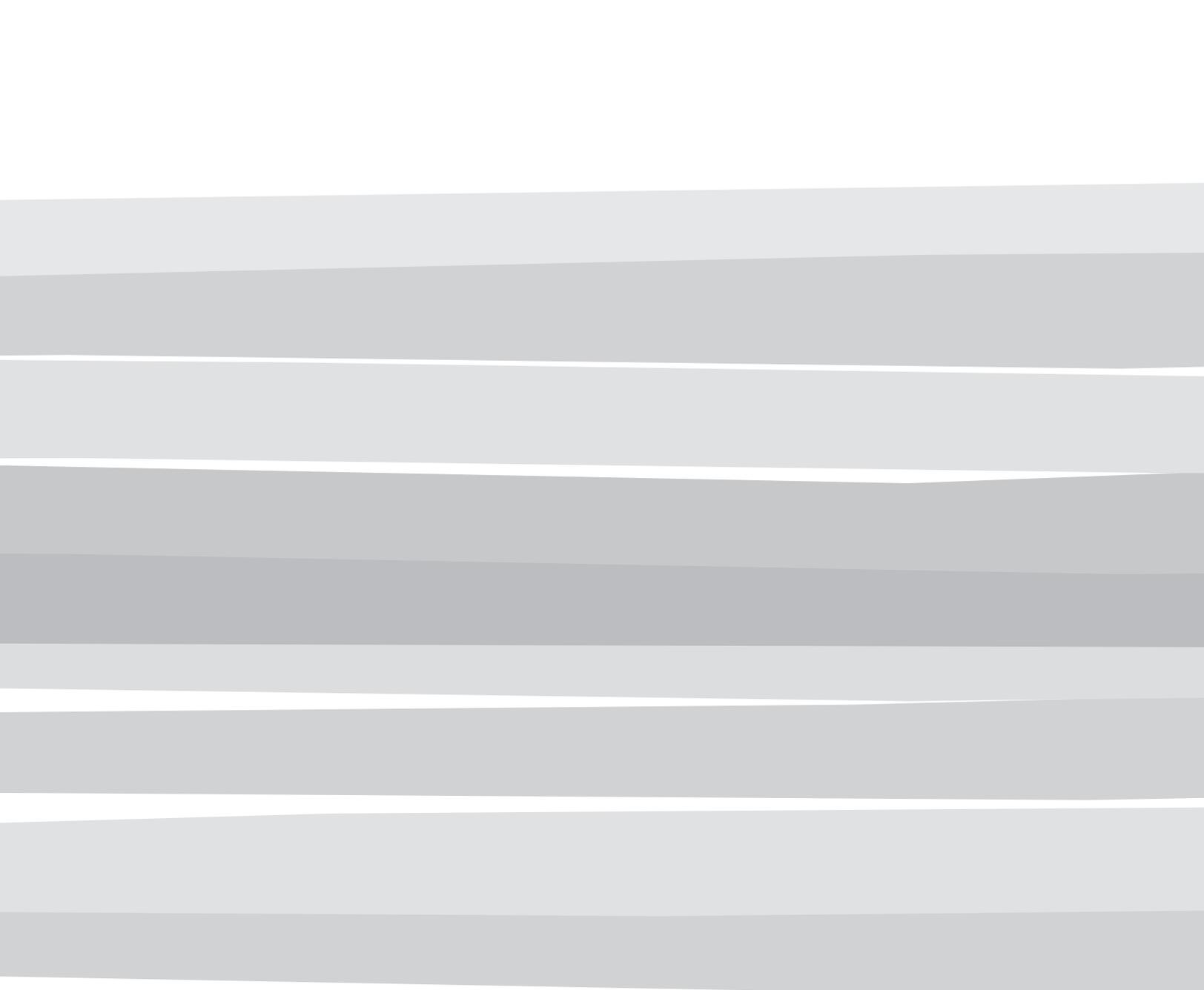
Did consumers actually buy the products? By autumn 2007, Carrefour had sold Comercio Solidario goods valuing EUR 146,000 and demand was noticeably increasing.

Tapping consumer markets in the developed world is a way for relatively poor producers in developing countries to surmount poverty. The problem is that these markets are nearly impossible for them to access. Why? One reason is that 70 percent of all the newly marketed fast moving consumer goods never find their way to the trolley, at least according to a 2006-survey conducted jointly by Germany's Markenverband (the country's brand association), the Gesellschaft für Konsumforschung (GfK – the national consumption research society) and Serviceplan, an advertising agency. For companies like Henkel or Unilever, this high quota of new product fall-outs (which is likely to slightly differ from country to country within the developed world) is part of daily business – for producers in the developing world, it is a question of survival as they can't afford to supply goods via method of trial and error. Is the Fair Trade movement the only sensible answer to this deadlock?

Carrefour: How to contribute to inclusive supply chains suggests that there is another way to exit the described dilemma. Provided that demand for products from developing countries exists, retailers can contribute to the socio-economic development of poor producers, if they are willing to invest in the quality and the marketing of these products.

But why should they? Because retailers can do well by doing good, as the case suggests. Not only did Comercio Solidario increase the incomes of 2,000 peasant families in Ecuador as of 2006, but by 2007 demand for Comercio Solidario products was growing noticeably in Spain. One reason for this success could be that these

products were truly new and market focused, instead of being simply copies of already existing products – one of the main reasons for innovation flops in marketing according to the aforementioned survey. ♦



Business Case

Coop NKL & Ethical Coffee Trading: Good for farmers and for retailers

It was January 2000. Like every morning, Bjorn Klovstad, the information director of the Norwegian retailer Coop Norges Kooperative Landforening BA (Coop NKL, hereafter), responsible for marketing, PR and the company's CSR policy, knew what to expect: a load of letters, faxes and emails. Norwegian consumers were advocating for coffee producers in the developing world by requesting the availability of fair trade coffee at the country's large retailers. Why? Prices for raw coffee had fallen drastically between 1994 and 2000 and farmers in developing countries were unable to respond to this decline by producing larger quantities. Companies the size of Coop NKL, the letters, faxes and emails said, simply *have* to help.

"I completely agree! It's important to do something about the coffee crisis!", Klovstad thought to himself. He considered how to introduce fair trade coffee in a way that would benefit both producers in the developing world *and* Coop NKL. As a company that focused on own-brands, he knew Coop NKL would only be able to participate in the fair trade movement over a prolonged period of time, if the company was able to develop and sell a product with a unique selling proposition USP. Was coffee traded on the basis of pre-determined minimum prices unique enough? Certainly not: The concept was originally introduced in Europe in 1998 by the Max Havelaar Foundation in the Netherlands.

One night in late January 2000, while watching TV, Klovstad saw politicians demanding the availability of fair trade coffee on the shelves of the country's supermarkets. Norway's retailers, the politicians declared, ought to boldly contribute to the fair trade movement. Klovstad shook his head. "Giving statements on TV is easy", he thought. "But we can't simply sell a me-too product. There has to be some kind of added value. Me-too products – no matter how ethical they are – will not survive market competition. And that will harm us, as well as the farmers. The question is: How can we add value to fair trade coffee?"

Coop NKL at a glance

Coop NKL was the second largest retailer in Norway

Coop NKL was the second largest retailer in Norway in terms of market share in 2005. The company – with the distinctive organisational statute of a consumer cooperative – mainly sold groceries. But it also offered various types of kitchenware and home products, sports and hardware articles as well as electrical goods. Every fourth bag of groceries sold in Norway was a Coop NKL bag.

100 years of Coop NKL

Oslo-based Coop NKL was founded in 1906 by 26 cooperative societies as the Norges Kooperative Landforening (NKL – the Norwegian Cooperative Union and Wholesale Society). It was one of many small and cooperatively organized grassroots organizations in Western Europe and North America that had developed within the setting of the industrial revolution. The Rochdale Pioneers are generally considered to have established the first modern-day cooperative back in 1844: The 28 artisans from Rochdale, England, entered the retailing business by pooling their resources in order to purchase and sell flour, oatmeal, sugar and butter at prices well below local market levels. Customers who bought these products became *user-owners* – which meant that they shared the profits generated by their purchases and democratically determined the management and alignment of the business.

Company history stretched back to 1906 and was a success story

NKL's long history read like a success story: Until the 1970s, it built up a large chain of grocery shops and grocery producing firms, and founded a bank and a life insurance company. During this time of steadily increasing revenues, the number of NKL's members climbed to 400,000. But in the 1970s and 1980s, as Norway's oil driven prosperity rose, accounts showed red figures for the first time and membership numbers dropped. Then, in 2000, after a phase of reorganisation, NKL was re-branded into Coop NKL. The company also defined a new business strategy and new target audience which would focus the company on more aggressive forms of business by reaching out for consumers who were primarily interested in purchasing good quality goods at affordable prices.

2002 - 2006: Coop Norden's merger and demerger

In 2002, Coop NKL, Kooperative Förbundet (KF - the Swedish Cooperative Union) and Fællesforeningen for Danmarks Brugsforeninger (FDB – the Danish Consumers Cooperative Society) jointly established Coop Norden. KF held 42 percent, followed by FDB (38 percent) and Coop NKL (20 percent). The national subsidiaries of this newly established company – Coop Norge, Coop Sverige and Coop Danmark – oversaw the operations of about 2,000 hypermarkets, supermarkets and discount stores throughout Scandinavia.

After four years, Coop Norden demerged and transformed into a purchasing company. Its former subsidiaries – now subsidiaries of Coop NKL, KF and FDB respectively – were meant to render services to cooperative super- and hypermarkets. Coop Norge, for example, led by CEO Svein Fanebust, was responsible for the logistics, marketing and purchasing activities of – as well as the supply of goods to – 1,300 Coop NKL stores. These were owned by 227 cooperative societies representing one million user-owners – or about one out of every five Norwegians as of 2008.

Coop NKL: Norway's second largest grocery retailer

According to a 2005 analysis written by Johan Sahlström for Nordea, a Stockholm-based financial services group, Coop NKL, led by CEO Nils A. Steigedal, was the second largest grocery retailer in Norway in terms of market shares (24 percent), followed by ICA Norge (23 percent) and Reitangruppen/Rema (18 percent). The country's largest retailer was Norgesgruppen with 35 percent.

Four companies dominated the Norwegian grocery market

The Norwegian grocery market

In addition to the fact that the four companies mentioned practically dominated the entire Norwegian grocery market, as Sahlström pointed out, this market had:

- relatively high entry barriers due to legal planning restrictions;
- a relatively low penetration of own-brand goods (except within Coop NKL stores);
- high distribution costs due to a low population density;
- high prices, strong purchasing power and good margins for retailers.

According to Sahlström, the entry of the low-cost German chain Lidl into Norway in 2004 (Lidl opened 24 shops that year) was expected to result in a downward pressure on pricing – a common trend with grocery markets across Europe. Between 2000 and 2005, said Sahlström, European food retailing experienced increased competition and stagnant demand, which helped low-price chains (such as Tesco) to gain ground but forced mid-priced chains (such as Ahold, Casino and Carrefour) to lower their price profile in order to reverse market share losses.

The essence of cooperative business

The International Co-operative Alliance ICA – a NGO founded in 1895 which aimed at representing, promoting and serving its 226 member organisations in 88 countries and representing 800 million people worldwide – has defined a cooperative as an autonomous association of persons united voluntarily for their common economic needs through a jointly-owned and democratically controlled enterprise. In a cooperative business, “the owners and the users are the same people; they are the members”, explained the United States Department of Agriculture briefly. The key characteristics were:

User-ownership, democratic control and service at cost are key to cooperatives

- *Service at cost*: The purpose of a cooperative was to provide profitable services and goods to its user-owners at the lowest costs possible, rather than generate the largest possible profits for shareholders.
- *Membership dividends*: Earnings, in excess of expenses, were paid out to the user-owners according to their use of services and goods, and not on the basis of their amount of investment. Purchase-based return of investment – often referred to as *membership dividend* or *patronage refund* – was usually calculated according to a percentage rate established by the user-owners or their representatives.

- *Profit-based (not profit-oriented) business:* A cooperative was a profit-based business, even if its objective was not identical to the shareholder business model. The operations of a cooperative had to have a sound financial basis as well as the flexibility to adjust to markets and changing business climates.
- *Democratic control:* Membership was open to all. The management of cooperatives was either controlled by a representative or through a direct voting system.
- *Continuing member education:* Membership information was of utmost importance, as was the external promotion of this relatively unusual business format.
- *Cooperation among cooperatives:* In order to meet the requirements of members and provide profitable goods and services at the lowest price possible, cooperatives strategically cooperated, mainly in the area of purchasing.

Cooperatives across the globe today

In 2004, ICA initiated the Global 300 process which categorized, analysed and ranked the world's top 300 cooperative businesses. As of 2006, about 80 percent of all these cooperatives were either in agricultural, financial or retail sectors. Of the world's 300 largest cooperatives 49 percent were established prior to 1940 and four out of five were set up earlier than 1990. The world's top 300 cooperatives shared a turnover of about USD 1,000 billion in 2004. (By way of a comparison, the world's three largest corporate companies in terms of their 2006 revenue – Wal-Mart, ExxonMobile and Royal Dutch Shell – had a combined turnover of USD 1,016 billion.) The largest cooperative in 2005 was Zen-Noh, Japan's federation of agriculture cooperatives. That year, it had 4.4 million members, 12,557 employees, a turnover of USD 63.4 billion and a total member dividend of USD 2.1 billion. Crédit Agricole SA was listed third, with a turnover of USD 30.7 billion in 2005. Coop Norden had a turnover of USD 10.3 billion and was ranked 18.

80 percent of the cooperatives were either in agricultural, financial or in retail sectors

The key challenge for the cooperative business of the future

In a speech at the Pellervo Confederation of Finnish Cooperatives¹, Bengt Holmström, the Paul A. Samuelson Professor of Economics at the Massachusetts Institute of Technology, tried to shed light on what he thought was probably going to challenge the future of the cooperative business model. From the perspective of economic history, he said, cooperatives were successful in times and areas in which the interests of producers and consumers were *not* adequately accounted for by virtue of market alternatives. Mutual insurance companies, for example, did well, he stated, when policy holders feared profit seeking and investor-owned firms. Electric utilities, he continued, tended to be owned by cooperatives in rural areas (where consumers did not have alternatives), but not in cities, etc.

In the sway of the market economy's advancing globalisation market alternatives have increased, he said, implying two things – that user-owners' reasons to exit a cooperative have risen and overall market competition has become stronger. In order to adapt to the latter, corporations *and* cooperatives both have to go through a continual process of structural reform. But since cooperative don't have stock prices signalling the necessity of change and no active investors at hand driving through a

Cooperatives have to go through a continual structural reform to adapt to competition

painful restructuring process, he explained that they will increasingly have to find alternatives that signal the necessity of change.

Coop NKL in detail

The structure of Coop NKL was complex: Coop NKL was owned by 227 consumer cooperatives representing one million user-owners. Coop Norge – as mentioned, a subsidiary of Coop NKL – purchased and supplied goods to Coop NKL, who then sold these to the 1,300 company stores. Coop NKL owned the store concepts, but not the stores as such. These formally belonged to the 227 cooperative societies. The organization's supreme body was the general assembly, which was a gathering of 100 member representatives. Coop NKL's supervisory council and board were elected at the general assembly. The latter stipulated strategic guidelines for the organisation operations and managed the organisation's assets.

As of 2006, Coop NKL had four grocery-retailing formats: (a) a hyper-market selling foodstuff and other items under one roof (Coop Obs!), (b) a supermarket chain (Coop Mega), (c) a discount store (Coop Prix) and (d) a local store concept (Coop Market). Apart from that, Coop NKL retailed electrical equipment (at Coop Elektro), hardware (at Coop Byggmix and Coop Obs! Bygg) and sporting goods (at Coop Sport), as well as home and kitchen products (at Coop Kjøkken og Hjem).

In 2006, Coop NKL had four grocery-retailing formats

In 2007, Coop NKL's 19,000 employees generated revenues of NOK (Norwegian Crown) 21.8 billion (EUR 2.7 billion)², an operating income of NOK 243 million (EUR 30.8 million) and a net income of NOK 160 million (EUR 20.3 million). The total member dividend pay-out between 1996 and 2006 was NOK 3.5 billion (EUR 444 million). By means of comparison, Norgesgruppen's 25,000 employees worked in 1,909 affiliated grocery stores and 790 kiosks in 2006. They produced revenues of NOK 36.6 billion (EUR 4.6 billion), an operating income of NOK 1.1 billion (EUR 100 million) and a net income of NOK 866 million (EUR 110 million). In 2005, a total dividend of NOK 2.5 billion (EUR 300 million) was paid out to shareholders, of which all but 8.8 percent were held by six Norwegian investment groups.

CSR at Coop NKL

As a consumer cooperative, Coop NKL's central value relied on adhering to the essence of the cooperative business model: user-ownership, democratic control and service at cost. As one of the driving forces behind *Initiativ for Etisk Handel* (IEH – the Ethical Trading Initiative of Norway), Coop NKL focused especially on:

Coop NKL focused on adhering to the essence of cooperative business

- improving the socio-economic setting of countries that exported goods to Norway;
- selling goods to consumers that met high social and environmental standards;
- the traceability of products;
- ethical trading principles referring to human and labour rights, among others.

In order to align suppliers and sub-suppliers to these objectives, Coop NKL's business partners had to comply with the company's code of conduct and fulfil a set of obligations in the areas of child labour, forced labour, disciplinary practices, working hours, wages and compensation, discrimination, working conditions, industrial safety, freedom of association and collective bargaining, as well as living conditions. In case sub-standard practices surfaced somewhere along the supply chain, Coop NKL provided a corrective action plan, which helped suppliers and sub-suppliers restore compliance.

Coop NKL also had a long tradition of engaging in development cooperation projects. For example, together with Sweden's KF, one of the former Coop Norden owners, Coop NKL was directly involved in a plant cultivation project in Kenya, Tanzania and Uganda called *Vi Forest*.

An answer to market distortion

In January 2000, as Norwegians practically buried Bjorn Klovstad with emails, faxes and letters requesting him to sell fair trade coffee, coffee producers in the developing world were simply struggling to survive. The prices of the two major species of coffee beans – *robusta* (used chiefly for instant coffee) and high quality *arabica* – had dropped drastically since 1994. According to the Fairtrade Foundation survey *Spilling the Beans on the Coffee Trade*, published in March 2002, the price of robusta plunged from around USD 1.80 per pound in 1994 to a 30-year record low of USD 0.17 in 2001. The value of the high quality arabica bean suffered similarly: It plummeted from about USD 2.50 per pound to USD 0.50.

Coffee – originally discovered and cultivated in the highlands of Ethiopia during the ninth century – was a labour intensive agricultural commodity grown in more than 50 tropical and sub-tropical countries. According to the Fairtrade Foundation's survey, 20 million farmers worldwide (over two-thirds of whom were independent farmers with less than five hectares of land) cultivated coffee shrubs on a total of 10.7 million hectares and produced an average annual crop of about seven million tonnes. Towards the end of the last millennium the bulk of the crop was exported as green (raw) coffee to developed countries in 60-kilogram bags at an average yearly total export value of around USD 8.7 billion. But due to the coffee price drop between 1994 and 2001 most of these 20 million farmers were unable to recover their production costs for several years running.

Consequently, some farmers uprooted their coffee shrubs and turned to other agricultural commodities. Others abandoned their land and tried to work in urban regions. Those farmers who opted to remain in the coffee business faced the challenges of what was often referred to as the *vicious circle of coffee cultivation*: When prices hit a low, many five-hectare coffee-farmers diversified their crops since they were not able to produce higher quantities of coffee to absorb low prices. Decreasing coffee supplies then raised prices again – but not to the advantage of those farmers who had been forced to diversify. By the time newly planted coffee shrubs came into production (after three to four years), prices often dropped again. Not having the means to process or transport their crop to the market (which was usually harvested once a year), and with limited knowledge of world market prices and a debt-driven necessity to sell their crops the moment they were ripe, the small

In 2000, coffee producers in the developing world were struggling to survive

Vicious circle of coffee cultivation was difficult to escape for poor coffee producers

independent farmers were often in weak negotiating positions. Local dealers could practically name their price.

In general, coffee producers were not able to benefit from the volatile coffee market. While it was estimated that at the beginning of the new millennium worldwide coffee trade generated USD 60 billion in annual revenues (double the average yearly amount between 1980 and 1990), the farmers from the coffee growing nations retained just over 10 percent of the total sum compared with 30 percent in the 1980s. Who earned the other 90 percent? A long chain of middlemen, often called *coyotes* in Central America, who pocketed margins as the beans changed hands. In *From Plantation to Cup*, Jan Thomas estimated that coffee beans were traded as often as 140 times before finally reaching the manufacturer (for the grinding, roasting and packaging of the beans), the supermarkets and grocery wholesalers.

After turning off his TV that night in late January, Klovstad knew he had to act. The next day, he set up a meeting with Coop NKL's board, scheduled for mid-February. During that meeting, Klovstad understood that he and the board members had very similar perceptions regarding the social implications of the coffee crisis in the developing world. As representatives of a cooperatively organized company the size of Coop NKL, they also knew that not responding to public pressure was imprudent. In order to move ahead, Coop NKL's CEO, Nils A. Steigedal, asked Klovstad to develop a feasible strategy within two months.

Having re-entered his office, Klovstad went to his flip-chart and tried to outline possible strategy options.

Option 1: Partnering with a labelling organisation

Coop NKL could have shelved a well-known brand name product certified by a fair trade labelling organisation. It would have competed with the 13 other Coop NKL own-brand coffees and seven other brands of coffee sold in Coop NKL stores.

The benefit of this kind of measure was that it was easily implemented. Apart from that, labelling organizations like Germany's Fairtrade Labelling Organization International FLO or the US-based Rainforest Alliance would guarantee that the coffee beans had been bought from farmers in the framework of long-term partnerships with pre-determined minimum prices, and that the producers had received development and technical assistance.

The problem with this approach was that Coop NKL would not have obtained project ownership. Hence, consumers might have perceived this way of responding to public pressure as too re-active. Instead of coming up with a creative idea, customers might have thought that Coop NKL simply wanted to ease public pressure by shelving well-known brand name products.

While standing at his flip-chart, Klovstad said: "I want to show the consumers and the public in Norway that the retail industry can import these products and manage this kind of operation. We do not have to go through a third party. We can do it ourselves. By doing that, we set a good example of being involved in the issues of the developing world." Before leaving his office that evening, Klovstad emailed Jan Fossberg and Benny Larson, responsible for purchasing coffee at Coop Norge, and asked for a joint brainstorming session.

Not responding to the coffee crisis was imprudent for a cooperatively organised company

Partnering with a labelling organisation would have been easy to implement

Option 2: Introducing an own-brand fair trade coffee

During their meeting, which took place in mid-February 2000, Klovstad, Fossberg and Larson considered the possibility of introducing an own-brand fair trade coffee, purchased directly from a cooperative in a developing country. By doing so, Coop NKL would obtain project ownership. The project set-up would be time consuming but feasible: Coop NKL would have to find a reliable coffee producing cooperative in the developing world, negotiate pre-determined minimum wages, secure supply, possibly enhance the product's quality, align packaging and design standards to those of Coop NKL, increase human capacity with local NGOs and, finally, build up consumer confidence in Norway. "Definitively a challenge, but not an impossible one", said Klovstad.

Still, the three remained reluctant: Would a me-too product survive market competition within and outside of Coop NKL stores? And what if the immediate situation for coffee producers in the developing world improved again? Would consumer interest in fair trade products wane? If so, would not consumers then prefer well-established brands? Klovstad, Fossberg and Larson were looking for a way to somehow diversify the risks of introducing an own-brand fair trade coffee.

A me-too product would not have survived market competition

Option 3: Introducing an own-brand fair trade coffee and developing the own-brand concept

Klovstad knew that option three had to be the result of a creative process. "What is the essence of a possible cooperation with a coffee producing cooperative?", he asked Fossberg and Larson during lunch after their meeting. "It's about giving more direct market access to large quantities of coffee produced by poor farmers on the basis of pre-fixed minimum prices", replied Larson, "while increasing our range of product's social value", complemented Fossberg. These answers seemed to re-affirm something Klovstad had been thinking about for weeks: "Well, why don't we do just that?" Larson and Fossberg were somewhat stunned as Klovstad elaborated his ideas. He said that they would drastically increase the amount of fair trade coffee sold at Coop NKL stores if they introduced a new own-brand fair trade coffee and also blended that same type of coffee into their 13 other own-brands. "Who said fair trade coffee can't be mixed and sold together with conventional coffee?", asked Klovstad while ordering an espresso.

Fossberg and Larson immediately understood the implications of his suggestion: Klovstad, they knew, was not only considering the challenge of developing and marketing a new own-brand; he was considering advancing the entire own-brand concept. Instead of being convenient "only", own-brand products would then be both convenient and ethically valuable. Klovstad seemed very content. He had the impression that he had found the USP he was looking for.

Convenience and ethical value was a compelling USP for coffee

Planning a cooperation with a Guatemalan coffee cooperative

Klovstad, Fossberg and Larson were fascinated by the idea of pushing the own-brand concept into a new direction while giving more direct market access to poor farmers. In order to make the idea come true, they had a number of tasks to tackle prior to discussing their ideas with the Coop NKL board in early April 2000:

- Klovstad, Fossberg and Larson had to assess market trends with regard to fair trade coffee. They knew demand was high at the time in Norway. But would demand increase or decrease in the coming years?
- They then had to screen cooperatives in coffee producing nations. They were looking for one that (i) grew high quality coffee, (ii) was large enough to guarantee supply and (iii) was organised well enough to perpetuate the socio-economic development of its farmers sparked by the partnership with Coop NKL.
- Klovstad, Fossberg and Larson also had to conceptualize appropriate sales margins and in-store market shares and come up with a convincing consumer marketing strategy.

Encouraging market trends for fair trade agricultural commodities

The value of global fair trade sales was projected to grow strongly, discovered Klovstad. In 2000, total sales value stood at EUR 200 million according to FLO and was expected to double by 2003. The fair trade sales value ratio of 80 percent handicrafts to 20 percent agricultural goods (the norm in the early 1990s) was expected to invert by 2002. Coffee was expected to be the main growth engine all the while. In fact, up to 50 percent of the total turnover of alternative trading organisations was anticipated to come from coffee sales by 2005.

Fair trade sales were projected to grow strongly

The cooperative Fedecocagua

Fossberg and Larson, who both had been working as purchasers for a number of years, quickly screened various cooperatives in numerous countries according to their production and supply capacity, reliability, the quality of their products, their social development track record as well as the professionalism of their management.

Fedecocagua, they soon realised, stood out: This Guatemalan cooperative, founded in 1969, represented 150 smaller cooperatives and united a total of 20,000 small, independent coffee farmers, 70 percent of whom were indigenous. The cooperative operated in various regions of the country including Huenuetenango, Cobán, Verapaces, Retalhuleu, San Marcos and Zacapa. Its members were represented in a general assembly and elected an administrative board democratically. Together, these farmers pooled human, financial and technical resources and thus increased their negotiating power. “From what we have seen and heard until now”, said Fossberg, “they match our criteria.” They produced quantities at constant levels (reasonable projections estimated that the cooperative was to produce a total of 23.7 million pounds of raw coffee by 2003); they seemed to be very well organized; the quality of their products was above average; and they had a very long track record of contributing to the socio-economic development of their country. “Obviously we will have a close look on site, but they seem to be the cooperative we have been looking for”, said Larson.

Drafting a marketing concept

In 2000, FLO paid a minimum of USD 1.21 per pound of coffee. Max Havelaar and other FLO affiliated companies paid an additional solidarity bonus of USD 0.05 per pound. Fossberg and Larson suggested to pay the same amount FLO did, but to increase their solidarity bonus from USD 0.05 to 0.09 cents. If they were to price the Fedecocagua

The industry's high new product fall-out quota meant a challenge

coffee at the bottom end of their pricing framework (partially sold as a new own-brand and partially sold as admixture), they predicted they would still earn a net profit of NOK 2.5 (EUR 0.3) per pound. It was important, they suggested, to start off with purchasing the relatively small amount of 60,000 pounds in the first year (implying a risk of USD 78,000) due to the industry's high new product fall-out quota (estimated to be at about 70 percent according to Germany's Markenverband). If all went well and demand increased, Coop Norge could then scale up the volumes.

In terms of branding, the three often sat together and envisioned a name for an own-brand fair trade coffee. It would have to encompass giving socio-economic perspectives to coffee producers in Guatemala. Words such as *future* and *tomorrow* crossed their minds. And after a while, *Café Futuro* emerged. This brand name, they decided, ought to label the new own-brand *and* also highlight the own-brands to which Café Futuro was going to be blended into.

A brand name had to be found that conveyed socio-economic perspective

Bringing Café Futuro to the Norwegian market

In April 2000, Klovstad, Fossberg and Larson presented their concept to the board of Coop NKL. CEO Nils A. Steigedal was impressed by the market data as well as by the idea of developing the own-brand concept and the possibility of contributing to the socio-economic development of poor farmers in Central America. He asked Klovstad to meet with representatives of Fedecocagua and fix a one-year deal.

In August 2000, Klovstad flew to Guatemala and met Fedecocagua's commercial manager, Albeto de León. The two had a look at several of the cooperatives' operations. Klovstad was pleased to see the social impact of the cooperative's work as well as their reliability and the quality of their products. As de León had already set up and successfully implemented similar agreements with large fair trade labelling organisations, Klovstad felt comfortable enough to sign a one-year contract. Coop Norge took on the obligation of buying 60,000 pounds of coffee for USD 1.30 per pound. Apart from that, Coop Norge was going to pay an annual average of USD 20,000 for in-store marketing. To familiarise Norwegian consumers with Café Futuro and keep the risk of a product fall-out as low as possible, Coop NKL decided to market the 60,000 pounds as admixture to one of their own-brands. If sales went well, they would then also blend it into their other own-brands *and* sell it as a new own-brand. Finally, if year one went well, they would consider granting Fedecocagua a yearly quality and work-flow audit worth USD 20,000.

On his flight back to Oslo in August 2000, Klovstad had the impression that Coop NKL was on the right track. The first shipment of Café Futuro arrived in Norway the following November. Consumers reacted positively and demand increased. CEO Steigedal was happy to order the purchasing of larger volumes.

Evaluation

For Coop NKL, the cooperation with Fedecocagua was a success story. The 112,435 pounds of Café Futuro that were sold in 2006 for NOK 2 million (EUR 253,000) represented 5.6 percent of Coop NKL's overall coffee sales that year. About 18 percent of Café Futuro was sold as an own-brand and 82 percent was blended into conventional own-brands (at an average Café Futuro admixture ratio of 5.4 percent). Café Futuro

Coop NKL's cooperation with Fedecocagua was a success story

was profitable even though consumers buying behaviour was not as consistent as Klovstad would have liked it. Still, he was content: “We recently introduced these products and in about five years people will be buying Café Futuro in much larger volumes. It takes time to establish a brand.”

De León was also very satisfied with his new customer and hoped to see him buy more in the future. The USD 0.09 solidarity bonus was especially welcomed among farmers. In line with the latter group’s decision, one part of the money was directly re-invested in the cooperative’s operating procedures. A second part was used for local development projects. De León said: “When the farmers heard that there would be an add-on extra from Coop NKL, the excitement rose noticeably and the ideas regarding how to use that money were humbling. Most of the farmers wanted to share these nine cents with those who probably had less than they did.”

A bright future for Café Futuro?

Seen from a wider perspective, the amount of coffee sold to Coop Norge was a tiny fraction (about 0.5 percent) of Fedecocagua’s overall sales. But de León and Klovstad knew that they had just begun and that there was a lot of room to grow, especially if demand in Norway continued to increase as it had between 2001 and 2006. Market surveys gave reason to believe that Coop Norge would be able to buy five percent of the coffee produced by Fedecocagua by 2010. The first step had been made. De León and Klovstad could hardly wait to take step two. ♦

Market survey gave reason to believe that the project had just begun

Notes

¹ The speech was held in the course of the confederation’s 100th anniversary in 1999.

² According to a NOK/EUR exchange rate of 1/0.1269 as of May 27, 2008.

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Coop NKL & Ethical Coffee Trading: Good for farmers and for retailers shows Bjorn Klovstad, the information director of the consumer-owned Norwegian retailer Coop NKL, in a challenging situation: In 2001, the price for raw coffee had dropped to a 30-year record low, threatening the livelihood of up to 100 million coffee producers and retailers mainly from the developing world. Norwegian consumers and public opinion were pressuring the nation's second largest retailer to sell fair trade products. There was an acute need for action.

But would it be possible for Coop NKL to find a place in the fair trade movement as it focused on own-brands? Klovstad assessed the procedures of other Norwegian and European retailers as well as the possibility of cooperating with well-known label organisations like Fairtrade or Rainforest. But instead of adapting to the competition by retailing fair trade coffee that was supplied by a third party, Coop NKL decided to directly import coffee from Fedecocagua, a cooperative in Guatemala – a decision that benefited the farmers (as they were able to receive relatively high and stable payments) and Coop NKL (as it could position itself as the first Norwegian retailer directly engaged in development issues). The idea of blending a lion's share of the imported coffee into the majority of the company's thirteen conventional own brands lifted the imported quantity of coffee and increased brand-value.

Today, customer choices are shaped through an unseen access to information. This contributes to a growing social and environmental sensitivity and to high expectations towards the business world, especially in the USA and Europe. Consumers quickly relate socially problematic issues arising in an emerging country to the respective western companies – who can act in a defensive manner and refer to politics as being responsible for social issues.

Coop NKL & Ethical Coffee Trading: Good for farmers and for retailers delivers compelling insight to those companies who understand solving social problems as a part of a business strategy that is initiated by reputation management. Coop NKL tried to help alleviate poverty among coffee producers in Central America by directly buying large quantities of coffee at stable prices. By doing so, the Norwegian company was able to build up a unique selling proposition. Not only was Coop NKL the retailer that directly helped peasant farmers in Central America, but it was able to further develop the positioning of its own-brands coffees from favourably priced to favourably priced and socially valuable – by blending the fairly traded coffee into conventional own brands.

Even after Coop NKL only bought a yearly fraction of 1.7 percent of the total amount of coffee sold by Fedecocagua, and even after pricing proved to be less advantageous for the producers after 2005, the two partners were very much interested in keeping up a long-term business relationship since it involved strategic advantages for both sides. ♦



Chapter 5

Know-how and Development

From Conflict to Collaboration: Alliances between NGOs and the private sector

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Abstract

In the past, businesses and NGOs spent plentiful resources on playing adversary roles. With globalisation, however, came a fundamental change from conflict to collaboration. Partnerships between businesses and NGOs were favoured with the aim of tackling common concerns of sustainable global development. There are mutual gains: In partnerships, NGOs can help businesses manage relations with a multitude of stakeholders, while businesses can help NGOs become more professional and effective. However, in order to remain functional in their distinct roles, both types of organisations have – and should maintain – differentiated functions in the globalised world.

Traditional roles of private sector and civil society have been reshuffled

Introduction

Why should businesses and NGOs collaborate? In the past, both types of organisations expended energy and institutional resources to do exactly the opposite: NGOs campaigned against businesses, while businesses were busy confronting the criticism. In recent years, however, this has changed. In the process of globalisation, the traditional and well-rehearsed roles of the private sector as well as the civil society sector are being reshuffled. NGOs, which earlier restrained themselves to condemning injustice in the economic realm, are nowadays intensively working on viable solutions to improve social and environmental conditions in global value chains. An increasing number of businesses no longer are content with merely producing and accumulating. Instead, they define and communicate values, principles, policies and traditions; they engage in multi-stakeholder dialogues and reason about their social and environmental responsibility. What has happened?

Businesses, as they departed from the overwhelmingly nation-state-confined scope of activities, have attained a multitude of new global stakeholders. They no longer deal only with public authorities, employees, unions, capital providers and advocacy groups in the location of their headquarters, but in fact with those originating from all locations along their supply chains – which in many cases span the globe. Subsequently, the globalisation of stakeholders causes new issues to arise. For instance, businesses cannot escape the impact of core development issues like global warming, HIV/AIDS or poverty as their operational planning efforts depend on stable and calculable environments. From a business perspective, successful engagement in these issues is gainful: It is usually more effective and far cheaper than costly confrontation with NGOs and other stakeholder groups.

NGOs emerged from social movements, which voiced appeals in isolated cases. In turn, they have become global governance players that effectively influence economic framework conditions. NGOs have long acknowledged the fact that businesses are shaping the global order through investments, production and sourcing. Businesses are therefore as important change agents as governments and international organisations. It is thus in the interest of NGOs that businesses change the world for better rather than for worse.

Along with these developments came change of principle – from conflict to collaboration, favouring partnerships between businesses and NGOs. The case for business-NGO partnerships that is put forward here is that NGOs can help businesses manage relations with a multitude of stakeholders, while businesses can help NGOs become professional and effective.

The purpose of this article is not to re-state the obvious: that NGOs and business are teaming up more often in order to combine comparative advantages. Nor is our purpose to advance the theoretical discussion on cross-sector cooperation. Rather, we want to put forward sound reasons for either side to engage in partnerships by addressing the question: *What's in it for both sides?* We will also identify risks and key success factors for business-NGO partnerships.

Putting forward sound reasons to engage in partnerships

What's in it for the private sector?

In the broadest definition, a business-NGO partnership should achieve something for the business that the business otherwise could not achieve: add value to its

operations. Globalisation seems to have brought along the potential for tangible value added by such partnerships. Before the 1990s, there were very few business-NGO partnerships; however, nowadays, according to a survey, 45 percent of a sample of 554 companies were engaged in such partnerships.¹ Experience in the field of cross-sector cooperation shows that four aspects of added value stand out.²

New legitimacy

Like any other social organisation, businesses need a sound social legitimisation. In practice, however, transnational corporations are often heavily criticised for exploiting developing countries, paying unfair prices, repatriating profits, evading taxes, bribing politicians or crowding out local competitors. Criticism is particularly grave for potentially polluting industries (mining, chemical, pharmaceutical) and labour-intensive production (of garments, footwear, toys, coffee). It is no coincidence that these industries are most actively engaged in discussions on CSR, especially if they are protecting brand names. Working together with NGOs – whose credibility is usually high – is seen by the public as a mark of confidence and increases the legitimacy of the businesses' operations among consumers, regulators, the media and, not least of all, the capital markets. The Body Shop, for example, benefits from the unclouded credibility of human rights NGO, Terre des Hommes. In a May 2007 press release, Terre des Hommes stated that The Body Shop helped to alleviate child labour in South Asia. For a company that has built up an accentuated social and environmental brand reputation, external credibility adds value by helping to retain the marketing focus on the conscious consumer.

There are four main advantages for the private sector

Gaining from complementary specialisation

Among the specific competencies attributed to NGOs, most have decades-long experience in dealing with topics in the social and environmental arena and with engaging in discussion processes with governments and other relevant stakeholders. Sometimes, NGOs are able to use the tools and to seize opportunities of the information society (blogs, newsletters, symbolic action and media campaigning) much better than companies. Businesses, in contrast, have only recently begun to systematically manage issues and stakeholders as a part of their corporate strategies and risk assessments. In partnerships, businesses can gain by learning from the communicative skills and adapted methods of NGOs.

New business areas

In large part, it has been NGOs that have started discussions on a number of business-related issues (industrial pollution, labour rights, transparency), which eventually grew into new business areas such as internal and external consulting and the granting of certifications. Through the inducement of public pressure they created commercial opportunities – e.g., for environmental and social management certification – where before there were none. Through partnerships, certification businesses can draw on NGOs' intimate knowledge of the social and environmental circumstances of a particular value chain.

The inducement of public pressure created commercial opportunities

New markets

In the globalised economy, attaining reliable information on consumers and markets

is an ever-aggravating problem. The marketing units in the headquarters of multinational corporations may be able to collect ex-post sales figures, but they will find it difficult to determine local-market demand for innovative or re-engineered products on the other side of the globe. Innovation, however, is essential, when businesses want to expand to markets in culturally diverse emerging economies. Through partnerships, businesses can tap NGOs' localised in-depth cultural knowledge for product innovation.

What's in it for the NGOs?

Partnerships with businesses may help to further the goals of NGOs.

**Businesses can tap
NGOs' knowledge
through partnerships**

Using business to get a certain message across

The Hong Kong-based organisation CSR Asia that was established to further sustainable business practice in Asia developed training modules on labour rights and work safety. Through a partnership with the Shenzhen office of German consulting and certification company TÜV Rheinland Group, CSR Asia combined their modules with TÜV's modules on lean manufacturing and human resource management, resulting in an integrated training program for south China's manufacturing sector. Thus, the social goals of CSR Asia are conveyed to the manufacturing, labour-intensive companies through the marketing channels of TÜV.

Opportunities for organisational learning

The UN Global Compact states that the 21st century NGO is becoming more flexible, more pragmatic and more business-like.³ On average, however, internal production efficiency of private companies is usually higher than that of NGOs. This can be both explained theoretically and confirmed empirically. In private firms, incentives for cost reduction are stronger since private shareholders are subject to hard budget constraints and, given their own risk, are willing to control the parameters relevant for efficiency more thoroughly. NGOs often lack incentives to improve performance, especially if they are fully publicly financed and not subject to competition. Business partnerships thus pose an opportunity to develop as an organisation through skills such as decision-making, division of labour or project finance.

Financial sustainability of organisations

NGOs drain off much enthusiasm and expertise when they cannot sustain their organisation financially in a way that allows them to reward experts in an appropriate way. NGOs that are dependent on the prolonged self-sacrifice of their staff are not sustainable. They will lose their most valuable assets – the knowledge-bearers and their social capital – and they will have to repeatedly invest time and resources in training new staff. Access to project finance in business partnerships can often be a way to improve the financial situation and to further advance the process of becoming social enterprises.

**Business money
helps NGOs become
social enterprises**

New orientation

Traditionally, some NGOs campaigned in favour of strong states that effectively enforced the rule of law. Sometimes this went against private businesses that were suspected to execute too much of their power against the rule of law or to have

become entangled in bribery and coups d'état. But recently, many NGOs have become disenchanted by the sometimes low effectiveness of governments and have begun looking for new solutions to problems. Aligning with governments, especially in the weak governance environments of many developing countries, might lead NGOs even further away from their goals. Consequently, businesses, as the drivers of change, increasingly became eligible partners to team up with NGOs.

New legitimacy

NGOs usually enjoy a higher legitimacy in the general society than businesses. According to a 2006 representative study, 80 percent of Germans think that high compensation for business executives is not justifiable. However, NGOs' legitimacy cannot be taken for granted either. Among business constituencies, the legitimacy of NGOs might be as low as businesses' in the general society. However, when NGOs approach actors from international financial markets to discuss topics like access to finance services in developing countries, carbon trade, the activities of hedge funds, etc., it is important that they are accepted as partners on equal footing. A track record of business partnerships can enhance the legitimacy of an NGO for these and other rather untraditional constituencies of NGOs.

A track record of business partnerships can enhance the legitimacy of an NGO

What are the difficulties and risks?

As businesses and NGOs pursue different and often even divergent interests, and become aware of the need to respond to different constituencies, partnerships become increasingly difficult to attain and involve risks for both sides. Although this list might not be exhaustive, a few important difficulties and risks attached to business-NGO partnerships can be outlined here:

Window dressing at the cost of the NGO

If NGOs perceive their role in the partnership as an ornament for marketing purposes only, this is usually a deal-breaker. There have been cases when businesses tried to realise reputational gains without real commitment to the common cause. In cases involving the environment, this has frequently been called *green-washing*. The marketing and communication aspects then stand in the foreground and the partnership will accordingly be led by the communication department. To avoid this risk, the test case is whether the top management shows sufficient commitment to the core themes of the partnership. This commitment, in turn, is most likely to be met when the partnership elaborates on core strategic and operational issues of the business (*core business case*) and when a company needs to show credible social or environmental activities to defend the reputation of its brands.

Partnership needs honest commitment from both sides

Information leaking out at the cost of the businesses

Particularly for the core business case, sensitive information might get circulated in a partnership. As every piece of sensitive information on the business – whether good or bad news – might serve as a peg to hang an unwanted story on, businesses are very wary of letting outsiders take too close a look. The campaigning experience and proximity to news media on the NGO side add to that fear. It is therefore important that the partners embrace a viable policy for confidential information on either side, with the greater risk arguably on the business side.

Unreasonable transaction costs

Business-NGO agreements involve transaction costs – e.g., for awarding projects, negotiating services, setting up performance indicators, managing partnerships and monitoring performance. These costs may in some instances exceed the benefits of the partnership. It is therefore important to define clear goals for the partnership – as well as indicators to measure them against – so that interests of both sides are thoroughly communicated and integrated in the partnership agreement. Once the partnership is in place, no further resources should have to be spent on re-negotiating definitions and goals.⁴

Getting the internal buy-in from constituencies

Attaining sufficient consent and support for NGO-partnerships from management and shareholders can pose a problem for businesses. It might be difficult to defend resource allocation to partnerships with abstract long-term strategies that may sound too vague to shareholders. Business media sometimes still call CSR a *suicidal tendency*, as did the Financial Times' German Edition in April 2007. The partnerships must therefore be repeatedly defended against the so-called *Friedman charge* (according to the economist Milton Friedman, shareholder's capital must not get embezzled in activities that do not directly lead to increased profit). Getting the buy-in from constituencies can be just as difficult for NGOs. They will have to prove to their staff, members, supporters and donors that the partnership with the business serves the NGOs' goal attainment without compromising their independence. The suspicion that the NGO fell victim to co-optation for morally inferior money motives will be particularly frequent for NGOs that had previously taken a hard stance against injustice related to and caused by business activities.

A partnership must be defended against the Friedman charge

Key success factors

As we have seen in the previous sections, business-NGO partnerships constitute a promising and increasingly important governance structure. In partnerships, NGOs can help businesses manage relations with a multitude of stakeholders, while businesses can help NGOs become more professional and effective. In order to attain the related benefits, some key success factors have to be observed:⁵

The importance of change agents when starting

At the beginning of a business-NGO partnership, it can be difficult to bridge cultural differences between the organisations involved. Also, the organisations need to think creatively about how to align their goals. This ground-breaking work is more often done by initiators with cross-sector and leadership experience on either side. Those change agents take on ownership and accountability for the partnership on both sides. They defend it internally and externally, manage and broker mutual expectations, and keep the lines of inter-cultural communication busy.

The importance of an institutional anchor when underway

Once the partnership is performing, organisational resources for partners to draw on must be made available in order to achieve positive cost-benefit ratios. If the performance of the partnership permanently depends on the work of the change agents alone, it will cease to exist as soon as they leave. The goal must be to place

Partnerships are a promising governance structure – but key factors are important

an institutional anchor – through partnership policies, rules and procedures or specialised units – to allow the same performance in case of staff changes.

Ground rules as a basis for an institutional anchor

Businesses make money and NGOs advocate goals. This fundamental difference should not be downplayed in partnerships because in situations of conflict, basic interests on either side will prevail. Therefore, some ground rules should be established right from the start. For instance it could be important for credibility reasons that the NGO claims the right to criticise the same business in one forum while partnering with it in another. For the business, it could be beneficial to be able to use the NGO's name for PR reasons or to attract the attention of shareholders to obvious brand and reputation effects.

Managing trust

The groundbreaking work of having change agents, ground rules and institutional anchors ultimately serves the goal of establishing trustful partnership relations. When asked to identify the main challenge in forming business-NGO partnerships, nearly every respondent in a survey mentioned trust as an issue.⁶ The traditional paradigm of business-NGO relations as conflictive will probably never change entirely, since constituencies, goals and the rationale on how to achieve these goals will remain distinct from one another. As this bears likely conflicts, the partnership must, in essence, manage sufficient trust between potential adversaries.

Conclusion

In sum, it can be said that as a consequence of the re-shuffled roles of businesses and NGOs in an era of globalisation, there is a need for cooperation in order to mutually learn from each other's comparative advantages. The complexity and variability of global social and environmental challenges clearly call for unorthodox approaches in cross-sector cooperation. If cross-sector partnerships are governed well, then business and NGOs can trade credibility, advocacy and communication skills for capacities and efficiency. However, in order to remain functional in their distinct roles, borders between businesses' and NGOs' role models cannot be blurred. Both types of organisations have – and should maintain – differentiated functions in the globalised world (i.e., advocacy and political articulation versus production and accumulation). In partnerships, businesses and NGOs have to overcome the hurdles caused by their organisational differences. But if they are successful in this, it is the friction generated by these differences that energises innovation across sectors. ♦

**Friction between
NGOs and business
helps generate
cross-sector innovation**

Notes

¹ See Schiller, *Ethical Corporation Report Business – NGO Partnerships*, URL: http://www.ethicalcorp.com/londonpartnership/FINAL_REPORT_Jan_10.pdf, 2005, p 6.

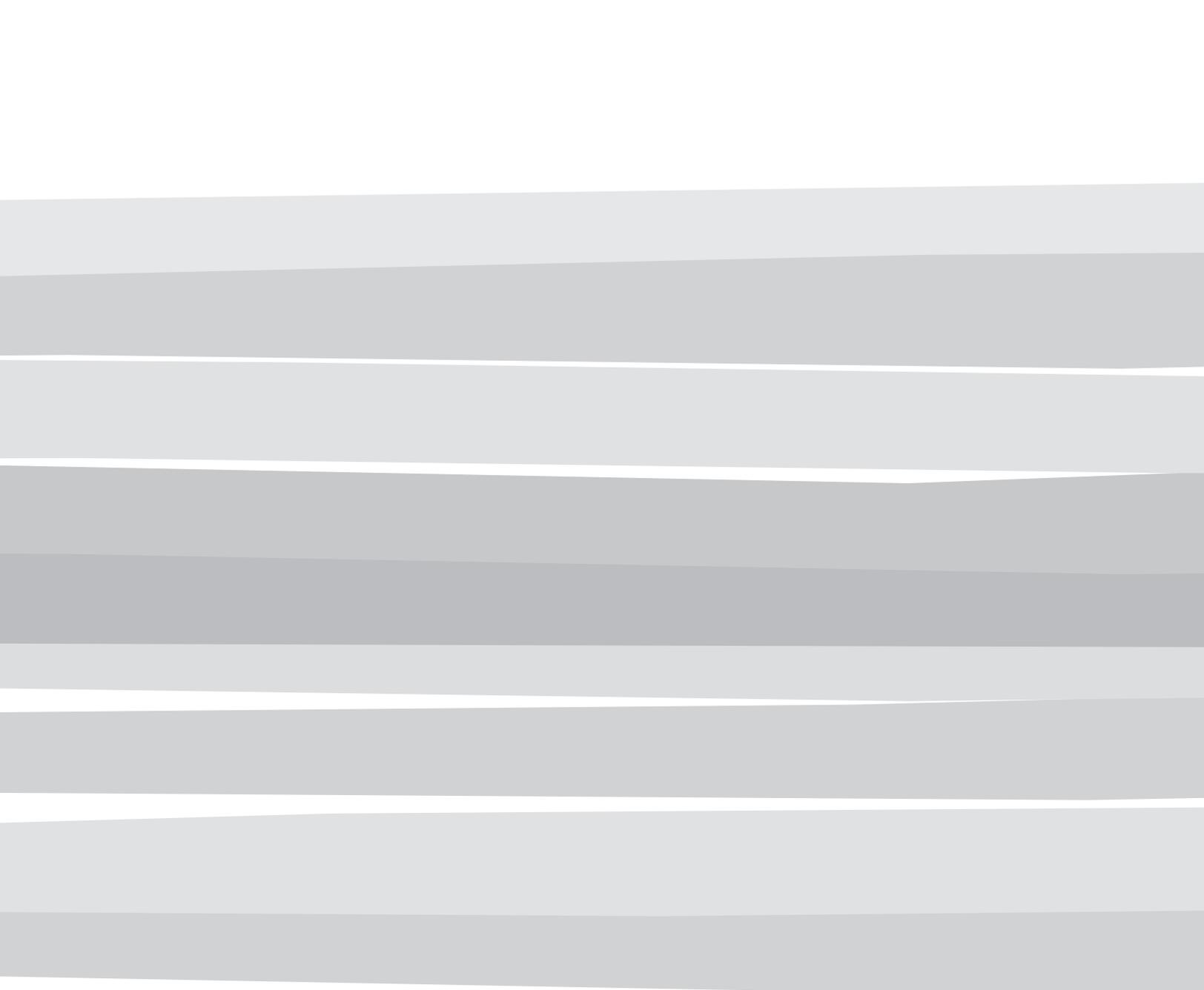
² For earlier ideas on aspects of added value, see Altenburg, *The Private Sector and Development Agencies – How to form successful alliances: Critical issues and lessons learned from leading donor programs*, Deutsches Institut für Entwicklungspolitik, Bonn, discussion paper presented at the 10th International Business Forum, New York, September 11-13, 2005.

³ See Schiller, *Ethical Corporation Report Business – NGO Partnerships*, p. 6.

⁴ See Altenburg, *The private sector and development agencies: How to form successful alliances. Critical issues and lessons learned from leading donor programs*.

⁵ See Semtschück, *Strategische Allianzen zwischen Wirtschaft und Entwicklungszusammenarbeit*, Deutsches Institut für Entwicklungspolitik, Bonn, DIE studies, 5, 2004, pp. 83 ff.

⁶ See Schiller, *Ethical Corporation Report Business – NGO Partnerships*, p. 8.



Business Case

Caixa Catalunya: Pioneering paths for microfinance

Angel Font confidently entered the headquarters of Caixa Catalunya, a savings bank based in Barcelona, Spain. Minutes later, he took the seat in the office of Josep Maria Loza, the bank's CEO offered to him. Font anxiously waited through the small-talk before the interview commenced.

Caixa Catalunya was looking for a managing director for a new area they were going to set up. It would be the fourth foundation within *Obra Social* (Social Work), the bank's social project department, and would start in January 2001, within a few months. Until now, the range of Obra Social did not reach beyond Spain's borders. Yet Caixa Catalunya was increasingly aware of the need to show commitment within the developing world; the directors thought they should and could address this. The new foundation would promote the social and economic inclusion of low-income population-groups in developing countries and in Spain. It was to be called *Un Sol Món* (Only One World). Font smiled, expressed his approval of its chosen name and eagerly listened.

Loza was quite positive he would hire Font. Previously, Font had worked for the international NGO Intermon Oxfam as project coordinator in various Latin American countries and as executive assistant to the general director. With his leadership capacities, his knowledge of the developing world and experience with social development projects, Font was without a doubt the most promising candidate for the new job. It depended on only one determining factor: Did Font have the ambition to start an entirely new foundation and fill it with life? Two main challenges lay ahead: First, the savings bank did not have any relevant experience in social and economic inclusion in developing countries. Second, *Un Sol Món* was a foundation set up by a savings bank and the project somehow had to reflect this fact. Still, Font was filled with optimism.

So Loza hired him – along with Martha Torras, who also had experience in international development. By January, Font and Torras and a few other employees completed the foundation's staff and were moved into the offices of *Un Sol Món* in La Pedrera, the prestigious seat of Caixa Catalunya's *Obra Social*.

Caixa Catalunya: A profile

**The company at a glance:
acting as a bank but
created as a non-profit
institution**

As of 2005, Caixa Catalunya was the second largest savings bank in the Spanish state of Catalonia, and the third largest in Spain. It ranked as number eight among all Spanish financial institutions. Operationally, Caixa Catalunya acted and was organized like a bank, subject to the same regulations and controls. However, its origin and mission were based on a non-profit aim: The financial surplus was devoted to increasing its financial strength and to setting up and managing its own social projects or social activities.

History and competitive environment

The history of savings banks in Spain stretched back more than 150 years. Savings banks were created to meet regional needs. The Caja de Ahorros Provincial de la Diputación de Barcelona (Provincial Savings Bank of the Government of Barcelona), later Caixa Catalunya, was set up in 1926 by Diputació de Barcelona, the provincial government of Barcelona (the capital of Catalonia), with a grant of 50,000 pesetas as foundational capital. The tasks of the new savings bank were developing agriculture, industry and commerce and attracting customers for investment. Ingrained in Catalonia, one of the most prosperous economic zones of Europe, Caixa Catalunya started to widen its commercial area in the early 1960s – after the so-called *regional principle* was abolished, which had legally tied enterprises to certain regions of the country – with a definite focus on other fast growing economic regions in Spain like Madrid and Valencia. By the mid-1970s, Caixa Catalunya had become a modern financial institution.

**Assets of Spanish savings
banks were higher than
Spain's GDP in 2006**

In 2005, the Spanish financial market consisted of 129 banks, 83 credit cooperatives and 46 savings banks. The latter were represented nation-wide by more than half of the countries' total 41,600 branch-offices. With an exponential increase of credits (variation from 2002 – 2005: 79 percent), the savings banks exceeded banks with an outstanding volume of credits (EUR 567 billion). They also outranked banks in deposits (EUR 406 billion). In 2006, savings banks raised their balances by 20 percent each year, exceeding Spain's nominal growth rate by more than 13 percentage-points. Accordingly, at the end of 2006, the total assets of savings banks outnumbered Spain's GDP figure for the first time in history.

Spanish savings banks had neither shareholders nor shared capital. In order to maintain their capacity to compete, they were required to balance their dedication to social work. Recently Spanish savings bank have increased their investment activity in the industrial sector in order to raise their capital.

In their Technical Note on Regulation, Supervision and Governance of the Spanish Cajas 2006, the experts of the International Monetary Fund IMF highlighted the contribution of Spanish savings banks to broadening financial services, the high level of competition in the Spanish financial sector, their close relations with local communities and their support for social, cultural and educational projects, as well as their extensive branch networks and their deep sense of regional identity. The Bank of Spain additionally attested to high improvements in the efficiency of the savings banks in the last few years.

Trends and challenges of the branch

With the highly saturated home markets, the last European Savings Bank Group Forum (September 2007) assessed a definite trend towards the consolidation and internationalization of the banking industry all over Europe with a growing part of retail net banking income generated by international business activities. Furthermore, with the building of an EU domestic market, what used to be international was becoming local. Accordingly, what used to be local needed to open up to cross-border operations and integrate new systems – and ways of working – within a constantly changing legal environment. Cross-border banking became an increasingly important structural feature for the EU banking sector.

In 2006, Caixa Catalunya operated almost exclusively with branches in its highly competitive home market of Spain. Additionally, it operated with 1,600 correspondent banks and had settled cooperation agreements with 20 financial institutions worldwide. As the case will show, Caixa Catalunya found an innovative way of combining its investment in social work with its aspiration to foster its international network.

Internationalisation was a trend in the banking sector in Europe

Caixa Catalunya in detail

During the last few years, Caixa Catalunya successfully increased its credit business (by 24.8 percent from 2005 to 2006, to EUR 42.7 billion) as well as its private savings (by 18.2 percent from 2005 to 2006, to EUR 24.9 billion). By 2006, Caixa Catalunya had generated income before taxes of EUR 479 million and arrived at consolidated assets of EUR 67.5 billion. It had expanded to 7,000 employees with over 1,000 branch-offices in Spain (and one in France). Caixa Catalunya dedicated EUR 70 million to its social work (21.61 percent of profits of 2006).

In comparison, Spain's largest savings bank and third largest financial entity, La Caixa (the common name for the Caixa d'Estalvis i Pensions de Barcelona), generated an income before taxes of EUR 1.5 billion in 2006 (gross income: EUR 4.5 billion) with its Spanish banking sector alone. The total La Caixa group had 23,000 employees across almost 5,200 branch-offices, total assets of EUR 209 billion and dedicated EUR 400 million (25 percent of profits of 2006) to welfare projects.

Caixa Catalunya's Social Commitment: The four foundations

When Caixa Catalunya was founded, it set up Obra Social as a commitment to social work. Obra Social, in turn, created its first foundation in 1987: Fundació Caixa Catalunya, which was aimed at the promotion of art and culture. Obra Social was the instrument, through which the savings bank performed these tasks outside its direct business scope. The aspiration of Obra Social in 2000 was, as the organisation's CSR Report stated, "to give back to society part of the business profits by providing an efficient, innovative response to social needs which received insufficient coverage or were somehow neglected." In 2000, Obra Social managed an annual budget of about EUR 20 million. With this amount of money, Obra Social's committee felt that there was a need of defining and focusing efforts on a few priority fields of action, so that projects were not spread thin. Obra Social created three more foundations: Fundació Viure i Conviure for social and healthcare projects, and support for infants, youth and the elderly; Fundació Territori i Paisatge for research programmes on

The social commitment of the first foundation of the bank was promoting art

environmental protection. In January 2001, Obra Social's staff sought to launch a fourth foundation: Un Sol M3n.

Structure of foundations

Four foundations were created to give society a part of the profits

Obra Social acted autonomously as a coordinator using the bank mainly as a financial resource. The four foundations had access to central services such as administration and communication management. However, each foundation's specialised staff were free from daily bank operations. Each foundation had its own secretary, general manager and managing director independent from Caixa Catalunya's management structure. This management reported to Obra Social's committee, a board which was equal to but independent from the bank's board of directors. Additionally, independent advisers and specialists from all foundations could sit on the board.

Obra Social's budget

Obra Social's budget was based mainly on yearly contributions from its parent Caixa Catalunya. The amounts that Caixa Catalunya set aside from net profits for Obra Social's activities increased annually and were only loosely correlated with the bank's yearly growth. Yet, Obra Social was not conceived as charity. On the contrary, its foundations were encouraged to generate income and thus prove that their activities were sustainable. In 2006, for example, a little less than 8 percent of Obra Social's EUR 69 million budget was generated by income from its foundations.

Obra Social was accountable for each foundation. Since 2001, the distribution of funds varied slightly. Un Sol M3n's share grew only 4 percent in five years compared to the other foundations, but the total amount almost quadrupled: from EUR 2.56 million in 2001 to EUR 9.8 million in 2006 (see *Exhibit 1* for Un Sol M3n's annual budgets and *Exhibit 2* for its 2006 origin of funds).

A new foundation: Un Sol M3n

Un Sol M3n focused on working for the benefit of the developing world

Un Sol M3n was focused on working for the benefit of the developing world as well as for the poverty-stricken communities in Spain. This was an uncommon aspiration in the Spanish banking world. Traditionally, most savings banks sponsored cultural, environmental and sporting events. Meanwhile Spanish society, including Caixa Catalunya's clientele, developed an interest in solidarity and poverty issues. Un Sol M3n's mission was to respond actively to this demand. Occasionally, Spanish savings banks provided financial help to organisations in emerging countries, but Caixa Catalunya wanted to play a more active role. The new foundation Un Sol M3n would promote the social and economic inclusion of low-income populations both in Spain and in developing countries.

When the year 2001 began, the recently hired managing director of Un Sol M3n, Angel Font, invited his staff to present their ideas for different action plans. They came up with microfinance as the first choice. It was a relatively new method of helping the poor, but it was a very promising one. Marta Torras argued: "In some ways, it is logical that a savings bank works in microfinance as it is directly in line with the knowledge of the corporate business and it is connected with the genetic code of the original Savings Bank's mission."

Font was convinced. The first thing was to design a plan and present it to Obra Social for approval.

Gathering information, gaining approval

Caixa Catalunya did not have any previous experience in microfinance, and they could not locate another Spanish savings bank which did. What was even worse was that neither Font nor Torras had direct experience in the subject. They had to acquire knowledge by means of personal studies and specialist consultancies. They decided to take their time to look for experts in Spain and in the rest of Europe and establish relations with those from whom they could learn most. Torras explained: “We decided to join several international networks of NGOs that were working with similar strategies. We undertook a study to select which network would best suit Un Sol M3n’s interests. Finally, we joined SIDI in France, ALTERFIN in Belgium and ETHIMOS in Italy. Each institution had a way of promoting microfinance. We had our own, but the exchange of views and knowledge helped us to contrast our model, polish it and introduce some changes.”

Budget constraints left Font and Torras opting for a low-cost model. Therefore, creating their own local institutions from scratch was discarded from the beginning. What were the synergies they could use? NGOs which supported microfinance in developing countries often worked with specialised NGO-partners, best known as microfinance institutions MFIs. The advantages of this were numerous: These partners were settled in the country and knew the social and economic situations. They had some infrastructure, specialised local capacity, a number of clients, a network with financial institutions and a track record. Torras said: “We would invest Un Sol M3n’s scarce resources in fostering and strengthening their work, instead of paying for the learning curve of newly created institutions. This was the biggest advantage of the local partner support model. Secondly, the collaboration with different MFIs allowed Un Sol M3n to broaden its operations and influence. This might be all too convincing for the committee to pass up.”

This proposition was accepted by the members of the board. The decision was supported by the fact that many of them were familiar with the non-profit sector in Spain and had a certain confidence in the work of national and international NGOs. Some of them were even spending time volunteering in these institutions.

The beginning: Recruiting personnel

With the committee’s stamp of approval, Font and Torras now faced an important question: Who should they recruit for the project? They saw a need for three types of experts: (1) high-level consultants who were able to evaluate the reliability of potential MFIs and draft action plans with the MFIs; (2) people with banking experience who could instruct the MFIs; and (3) diverse staff members to administer and promote the foundation’s work in each country.

For the consultants, Font wanted high quality personnel from Caixa Catalunya. In addition, they would also search for experts in target countries. The idea was to have a pool of experts for each geographical focus who were specialised in local microfinance operations. Un Sol M3n wanted to utilise Caixa Catalunya practitioners for working directly with MFIs. Depending on future necessities, external specialists were also an option. Font and Torras, however, had their doubts: Would the committee permit them

**Proposal to begin
microfinance activities
in the developing world**

**Acquiring knowledge
from international NGOs
to find the best
microfinance models**

to recruit Caixa Catalunya staff for the task? They would prepare an extra proposal on this issue. They knew that some staff had to be local. For this, they would rely on the partner organisation.

Partnering with MFIs: The selection process

The primary question arose: With which MFIs would they cooperate? Whatever institution they chose, they would need to hold long-term relations with the bank. They preselected the regions where they would look for potential partners: South America, with the advantage of having the same mother tongue, and North Africa, with the advantage of being geographically close. Countries were then chosen on the basis of income and sufficient political stability to allow microfinance sector development. Torras explained: “We defined the international microcredit portfolio as a development tool which aimed to provide poor members of low-income countries with economic opportunities so that they could escape from poverty by their own means.”

After reducing the number of prospective countries, Torras and her colleagues evaluated the remaining countries based on three criteria:

- preference to countries where Spanish development organisations were working;
- special interests of private and public Spanish financial donors;
- preference also to those countries from which Spain had migrants.

The second criterion could outweigh Caixa Catalunya’s preferences one and three. With this they drafted the first list of target countries. In South America: Ecuador, El Salvador, Paraguay, Colombia and Nicaragua; and in Africa: Mozambique, Morocco and Senegal. The next steps were clear: They had to inform the microfinance sector in the target countries of their project and, from the feedback, Un Sol Món could select its partners. The call for proposals was kept brief. They informed the countries that Caixa Catalunya was looking for young, ambitious, non-profit financial institutions serving the poor that were interested in cooperating with the bank on microfinance services. Fundació Un Sol Món received more than 100 requests from different MFIs. To make sure they found the best partners, the foundation decided to sketch a partner profile to assess prospective MFIs during the selection process.

Assessment of MFIs

How would they select their partners? From the start, it was clear that *Un Sol Món* would only rely on institutions that were committed to financial sustainability and at the same time did not abandon their social orientation. They wanted to be sure that their input in money would not be lost and their input in kind was not in vain. MFIs that had expanded to a wider range of customers, addressing not only the underserved population, were thus excluded. Sketching the profile of possible partners, they identified the following criteria:

- Institutions should have a similar focus and mission as the foundation (because sharing common goals was the basis of understanding and collaboration between people from both institutions).

The to-be chosen MFIs would need to hold long-term relations with the bank

Criteria were developed to select MFIs

- Institutions should be at an early stage of development but show potential for growth.
- Institutions should be able to prove their minimum capacities and organisation levels in order to maximise the support received.

For some institutions risk ratings were available which were also taken into account. After the foundation's pre-selection of the applicants, they presented the prospects to Caixa Catalunya consultants who evaluated them and chose the MFIs they saw fit for partnership. A team from the central office including Torras then visited the candidates in their respective countries. Torras concluded: "For us, the local management team was the determining factor. We thoroughly assessed the motivation, leadership, capacity and commitment of the staff involved in the local institution."

The foundation compared their observations with the opinions of the consultants and finalised the partnerships. The first two contracts were made with AMC in El Salvador and Tchuma in Mozambique. Both were credit and savings cooperatives – with AMC offering financial services to SMEs that worked for socio-economic change, and Tchuma offering savings and loan facilities for emerging micro-enterprises, especially those of women. Between 2001 and 2006, Fundació Un Sol Món worked with 12 MFIs in seven countries.

First two contracts were made with MFIs in El Salvador and Mozambique

Measures taken: Financial and technical assistance

What would Un Sol Món offer the MFIs? How exactly would it support them? Torras proposed that financial support through credits was always needed. This was visible aid to the country and a benefit to Caixa Catalunya's reputation. More importantly, they would offer technical assistance in training and improving the operation of their partner MFIs. The two different support strategies would act independently from each other but in the same accord. Torras said: "Technical support was the priority for Un Sol Món. Financial support was aligned with technical support in order to provide an added value to the local partners. From the very beginning, support to local partners was conceived in this way and this approach became clearer with time and experience."

Two different types of support: financial and technical assistance

Financial support

One of the preconditions for selecting MFIs was potential growth and the ability to continue rendering financial services to the deserving poor population. Caixa Catalunya was prepared to grant them funds to do so. The social committee allocated each country an annual budget, which was expected to increase in relation to the MFIs local returns (see *Exhibit 3* for the 2006 distribution of funds per country). Un Sol Món's financial support had to meet two conditions:

The funds were not to be granted blindly and without expected returns. MFIs had to reimburse Un Sol Món within a designated time frame. Torras explained: "Returns were used to sustain the value of the portfolio and to pay for variable costs related to the supervision of the activities, such as travel expenses, etc. Without this, Un Sol Món would have needed to charge the MFIs higher interest rates."

Given that they wanted to benefit not only the MFIs and their clients, but the country as a whole, they did not want any competition with local commercial funds.

In no way did they want to disturb the local market. Instead, they wanted to act as a bridge fund for those institutions without access to funds. Torras assured: “We do not want to work against the local markets. Our aim is to promote sound local financial markets. When the institutions do not have access to local funds, we provide the finances, adjusting our terms in the most favourable way to the MFIs.”

In Latin America, where local commercial banks were more available for MFIs, Un Sol M6n worked close to the market conditions. In contrast, in Africa, where access to local funds was further out of reach, Un Sol M6n provided finances with adjusted conditions. Un Sol M6n offered three financial products:

**Three loans offered:
warranty, equilibrium,
conventional**

- *Warranty funds*: These were commonly used in countries with a high devaluation risk, with the help of a local bank in order to give the MFI credits in local currency.
- *Equilibrium loans*: Provided there was a high level of trust and shared goals, they offered loans of lower interest rates (4 to 6 percent) to long-term local partners.
- *Conventional loans*: Such loans were based on an analysis of the local financial market (e.g., whether commercial funds were available for the MFI). These had flexible conditions adapted to the needs of the institution – in terms of length of loan, interest, grace period, etc. It increased the institution’s funds, hence strengthening its financial situation vis-à-vis other institutions. The foundation shared the risk with the MFI and the return depended on the profits earned. This type of loan was granted for a longer period, in particular, between seven and ten years.

How should they organise financial support if they wanted to achieve the maximum effect and minimise the risks of losing funds? With the aid of Caixa Catalunya consultants, the team created a strategy for the process of attributing funds. First, investments would always be based on recommendation from the country specialist – the consultant hired by Un Sol M6n – and an analysis from Font. The committee authorised Font to invest even more if the MFI presented new high quality proposals and if Un Sol M6n had collected fund reserves. Field monitoring was second. This was in the hands of the local consultants in the field, but all evaluations were sent to the Barcelona headquarters where overall portfolio data was gathered.

As an example, in 2005, AMC de RL in El Salvador signed a long-term conventional loan for EUR 260,000, from which EUR 50,000 would be received in 2006 and the remainder in the following years. With that capital, the MFI would be capable of gathering more financial resources and, therefore, developing greater social impact. One of AMC de RL’s clients, Rosa Aminta, had a small enterprise where she manufactured about three hammocks a day. Thanks to a EUR 530 microcredit, she improved her facilities and managed to increase production up to eight units per day, helping her achieve income growth.

Technical support

Successful microfinance programmes relied heavily on the quality of service and client satisfaction of MFIs. Furthermore, they depended on the institution’s outreach and whether its microcredits reached new markets of unattended lower

income populations. Technical support aimed to balance the social and financial performance of the MFIs.

To reach this goal, Torras suggested that Un Sol Món improved the MFIs' organisation and management with training and consulting from Caixa Catalunya. There was not one sweeping general approach to all 12 MFIs, because each MFI was differently positioned when taking into account know-how, experience, technical equipment and budget, among other attributes.

Financial support was simple: Money transactions would be conducted from Barcelona. Technical assistance programmes required more personnel, but who was to fill the positions? If Caixa Catalunya aspired to strengthen these financial institutions in developing countries it was logical that it would want the best practitioners available and these, they believed, were its own staff. The foundation decided to rely upon its own: Caixa Catalunya volunteers. Additionally, Un Sol Món had invested a large amount of capital and therefore had an interest in being represented on the boards of its local partners. This was also envisioned as an opportunity to strengthen the institutions from the inside.

Successful microfinance programmes relied on quality of service and client satisfaction

Technical assistance programmes required more personnel than financial support

Volunteers from Caixa Catalunya

The volunteering system allowed direct transfer of know-how from Caixa Catalunya to other institutions that lacked experience. Volunteers became connected to the company, as it was personally and professionally rewarding. They gained a deeper insight into new cultures which, in turn, led to a higher commitment for Caixa Catalunya. Long-term volunteers provided a means to create a close relationship with the local MFI.

These arguments were more than persuasive for Caixa Catalunya's committee to agree to send staff volunteers abroad. The board of directors valued the volunteer programme as a means to achieve their social mission and to provide an opportunity for their employees. They granted them permission to recruit full-time volunteers among Caixa Catalunya's staff.

In 2002, they started recruiting. Un Sol Món published a call for volunteers via the internal communication system, requiring certain expertise and experience in the field. One volunteer per partner MFI was sufficient. He or she would spend one to two years working with a local partner and living abroad. The salaries for the volunteers were assumed by the foundation, as well as all travel and accommodation expenses. The call was well received: 70 people applied for one year of volunteering. Two staff members with ten years experience were selected to work closely with the partner MFIs in Mozambique and El Salvador. Torras commented: "The programme was very successful with respect to its acceptance within the company. Demand for volunteering would always exceed the number of available placements. There were some difficulties with long-term volunteering, however. It was difficult to reintegrate our staff into the company after spending a year abroad. For the company it was difficult to hand over some of its most qualified employees for a year or two – and to reacquaint them when they returned."

Volunteering system allowed direct transfer of know-how

In 2003, collaboration with four microfinance institutions required six Caixa Catalunya employees. But a decision was made to shorten the duration to three or four months. In 2006, the bank stopped sending volunteers abroad in order to gather the information from the different experiences and assess the performance of each project. Torras said: "In the end, we came to the conclusion that short-term, well-

defined technical assignments were more convenient and efficient. Now volunteers only spend three to four weeks abroad. The key was that the volunteer profile perfectly suited the MFIs' need and that the assignments were clearly designated."

Technical assistance from volunteers complemented the work of permanently employed locals. Years later, Torras said looking back: "With respect to the difficulties, we found that having a team of involved, qualified and demanding professionals was highly important."

Caixa Catalunya as Un Sol M3n's financial backbone

Strategy was to invest as much money as possible in the first years

From the annual budget that Obra Social contributed to Un Sol M3n for investments and fixed overhead costs, the foundation invested EUR 325,000 in 2001 into funds for microcredits (12.7 percent of the year's EUR 2.56 million budget). In 2006, it again invested the same amount, this time representing only 3 percent of its budget (see *Exhibit 4* for Un Sol M3n's annual microcredit investments). Their strategy was to invest as much money as possible in the first years with expectations of interest returns. Interest then supported the funds and Un Sol M3n reduced its fresh money input. The plan was that the microcredits would become entirely self-sufficient, easing themselves from dependence on Un Sol M3n and Caixa Catalunya's resources. If they released the foundation from investing in the microcredits, Un Sol M3n would free up money for other projects.

To achieve this goal, Un Sol M3n realised it needed to raise additional money from outside the bank's resources. The circumstances were favourable. The programme was shaping up well and 2005 was the designated International Year of Microcredit, promoting microfinance as a means to reach the MDGs. Un Sol M3n was welcomed with open arms. The Catalan Agency for Development Cooperation channelled EUR 500,000 to Un Sol M3n annually for five years to be used for MFI grant loans. Un Sol M3n also received support from some private institutions such as Fundaci3n Roviralta.

With this, Font and Torras decided to appeal to the public. Caixa Catalunya promoted its credit card through its Total Plus Programme. Private customers accumulated points with their credit purchases that they could exchange for gifts, cash or donations to Un Sol M3n's projects. The first year they launched the point system (in 2006), they collected EUR 16,400. Although this was a modest sum in comparison with the MFIs funds, Caixa Catalunya was able to bring its social work to the public light.

MFIs were to become entirely self-sufficient

In 2005, the estimated self-sufficiency rate amounted to 40 percent. One year later, the accumulated microcredits totalled an impressive EUR 1.9 million, nearly Un Sol M3n's entire budget for 2006, and the organization had plans to reach 100 percent self-sufficiency by 2007.

Linking worlds: A transnational development programme

The microfinance programme had proved successful, but there was still one thing missing. After a 2003 visit to Ecuador, Torras discovered that many of the MFIs' clients had torn families. She met two children living with relatives who explained that their parents left for Spain years ago to find work. Torras was later told that 50 percent of the families were separated with parents living abroad and children remaining in Ecuador. She started thinking: How can our foundation help?

Upon return to Spain, Torras started to understand that the 200,000 Ecuadorian immigrants were quite an appealing target group for Un Sol M3n. As long as they were living in Spain, they were potential clients for Caixa Catalunya; if and when they returned to their home country they became potential customers for their partner, MFI Codesarrollo. She developed a project with shared interests of Ecuadorian immigrants, the MFI and Caixa Catalunya. The project was a co-development project, meaning that Un Sol M3n and Codesarrollo worked for the benefit of the same people. Torras wanted to foster development in Ecuador by using the knowledge immigrants had acquired living in Spain. This was mainly comprised of valuable experience in entrepreneurship. Torras said: “We knew that Ecuador immigrants would only return to their country if they could prove themselves winners. Going back as entrepreneurs surely coincided with this expectation.”

200,000 Ecuadorian immigrants: an appealing target group for Un Sol M3n

The plan unfolded. The new programme, Reinversi3n de Talento en Ecuador (RETALE – Reinvesting Talent in Ecuador), assisted immigrants in starting their own businesses. Un Sol M3n provided loans at 6 percent interest rates, no commission, up to a maximum of EUR 20,000 and with a four-year amortisation period. Additionally, they offered training and consulting in Spain, and when someone returned to Ecuador, Codesarrollo had stationed consultants in different areas to support them execute their business plans.

By 2007, RETALE had assisted the start-up of 30 businesses in Ecuador, ranging from retail shops such as digital photography studios and pharmacies, to textile workshops, agricultural greenhouses and a boot factory for export to Spain. Of these businesses, seven received microcredits in Ecuador; 13 received credits from Un Sol M3n; and the remaining ten did not require any additional credits. Over 100 jobs were effectively created. For example, Denny Zambrano from Guayaquil, Ecuador, worked as a gardener for three years in Spain. With the advice from RETALE, he decided to launch his own gardening services company in Ecuador. He returned home at the end of 2006 to manage his own business.

Attempting to reunite torn families who split to find better work

Evaluation, results and outlook

Torras was more than pleased with the results, saying they were “better than expected.” By the end of 2006, the foundation had established partnerships with 12 MFIs in seven countries, granting EUR 2.2 million in microcredits to more than 13,000 people. Font said: “Microfinance is first and foremost an investment into the future, not a business. We most definitely do not expect high profits. Perhaps this is why, for the moment at least, we are the only Spanish savings bank that dares to venture into this area.”

Measuring impact in the target countries was difficult, above all because data of funds, credits and beneficiaries were hardly comparable when working with such different institutions, sometimes without a defined structure. And working toward 100 percent self-sufficiency was quite a challenge. Without a doubt though, the programme was a door opener. Caixa Catalunya and Fundaci3n Un Sol M3n, through its international microfinance program, were able to find a new way to foster the use of microcredits. The MFIs’ funds were so prosperous that Un Sol M3n had enough returns to spread partnerships in more countries such as Colombia and Gambia.

**RETALE project offers
low interest loans and
entrepreneurship
training for emigrants**

Torras found RETALE, the spin-off project, was the most important initiative of the foundation. “We believe RETALE is a wealth creation project”, she affirmed. She was delighted that in December 2006 the programme was recognised in the category of *Assistance and Cooperation* at the Spanish Business Patronage and Sponsorship Awards promoted by AEDME (Spanish Association for the Development of Business Sponsorship). To her, the biggest challenge was replicating RETALE in other countries. Morocco was one future prospect.

As of 2007, international microfinance was a strategic area still pursued by Caixa Catalunya. In April 2005, Caixa Catalunya joined the UN Global Compact, another public commitment toward global efforts in alleviating poverty. It was the only Spanish savings bank with microfinance activities in developing countries. Font knew in 2001 that they were about to begin some major pioneer work, but he assumed other banks would soon join the initiative. Font said: “My plan for the future: promoting microfinance in other countries and in rural areas. That is, let us foster microfinance to alleviate poverty and social exclusion worldwide.” ♦

Exhibits

Exhibit 1: Fundació Un Sol Món's annual budget (in EUR)

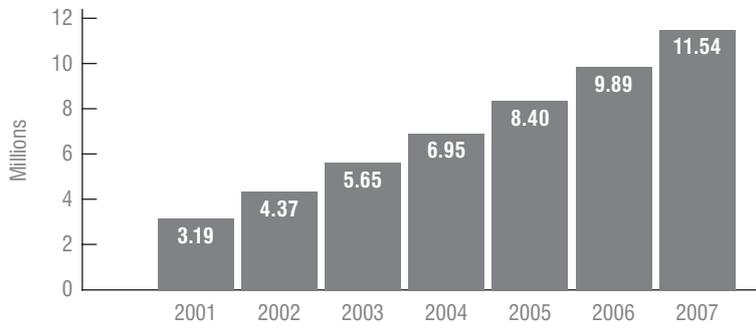


Exhibit 2: Fundació Un Sol Món's origin and distribution of funds for 2006 (Euros)

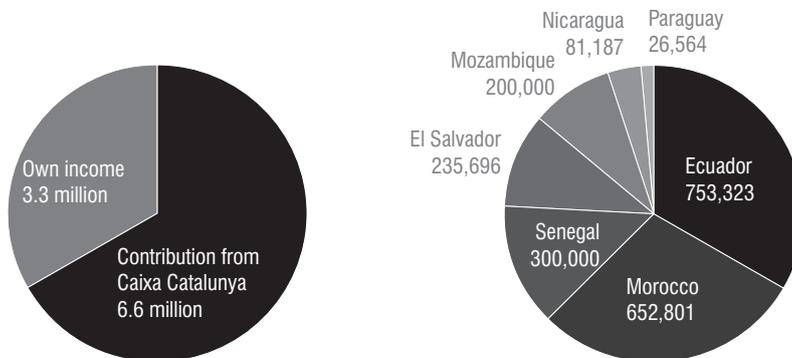
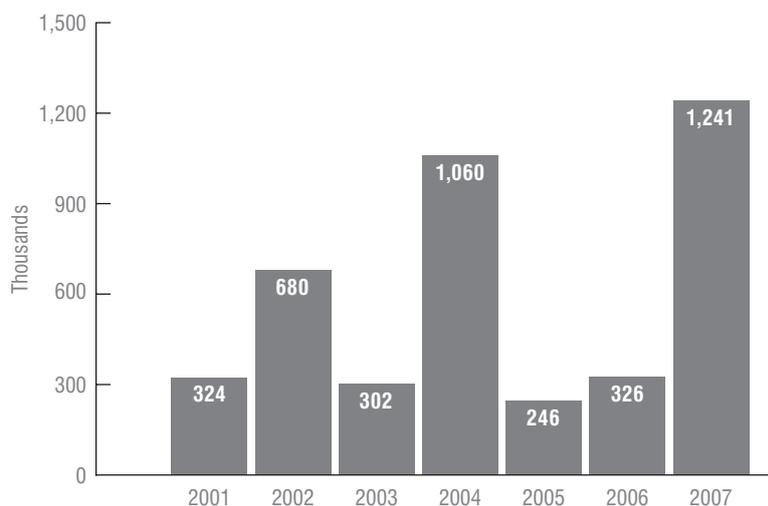


Exhibit 3: Fundació Un Sol Món's annual microfinance investments (in EUR)



Sources: Caixa Catalunya

Credits

Author: Ursula Weber (ICEP)

Research: Javier Morales Mediano (IESE), Ursula Weber (ICEP)

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Teaching Note: Caixa Catalunya

Caixa Catalunya: Pioneering paths for microfinance introduces Angel Font, the managing director of Un Sol M6n, one of Caixa Catalunya's four foundations. In 2001, the then eighth largest financial institution of Spain decided to establish Un Sol M6n with the objective of promoting the social and economic inclusion of low income population groups in the developing world. To Font it made sense that the foundation of a large savings bank – which originally was created to meet socio-economic needs – should support microfinance institutions MFIs in developing countries. But instead of simply giving away funds, Font wanted to create a win-win situation that benefited the poor and Caixa Catalunya.

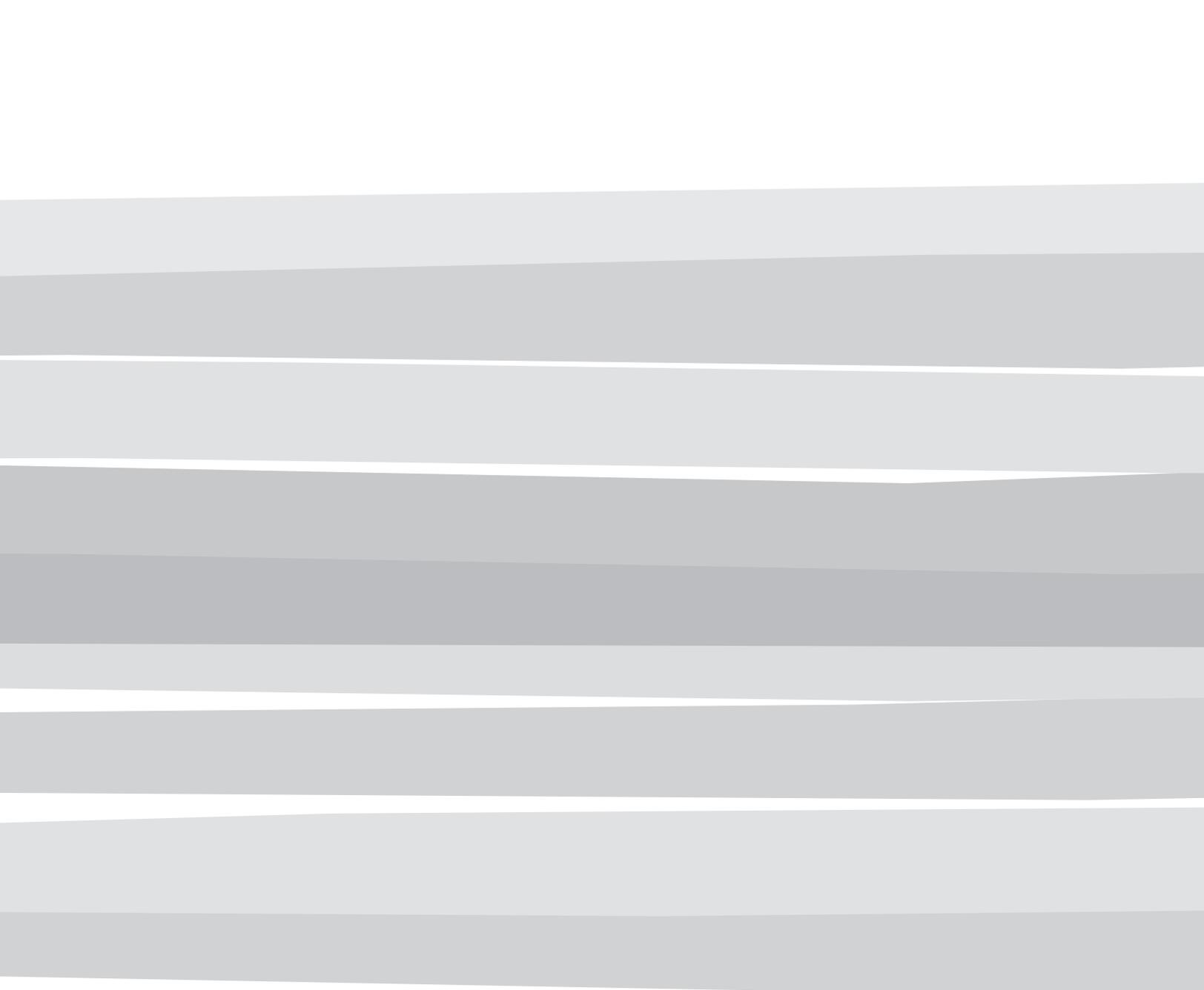
How did he proceed? He generated social value by granting technical know-how from Caixa Catalunya employees to selected MFIs in order to boost their efficiency parallel to selling financial products to them. He thereby chose organisations that provided financial services to the poor and represented possible strategic advantages for the bank: Potential partner MFIs had to be financially sustainable besides incorporating the capacity to grow. They had to be located in countries situated in Latin America (given the language advantage) or in North Africa (given the geographical proximity), that were considered to be politically stable, known to be appealing to Spanish investors and from which Spain had immigrants. Between 2001 and 2006, Un Sol M6n managed to pass on technical assistance to 12 MFIs in seven countries and sell financial products (namely warranty funds as well as equilibrium and conventional loans), which were adjusted to local capital markets (if available). The MFIs were expected to reimburse the provided funds and be self-sufficient. Expectations were met: By 2006, the foundation had disbursed EUR 2.2 million to more than 13,000 individuals via their partner MFIs. The self-sufficiency rate stood at 40 percent as early as 2005 and was expected to reach 100 percent by 2007.

In essence, corporate social commitment is as old as the industrialised societies we live in: Companies have always donated large sums for what they considered to be worthy causes in the social setting of their businesses. In this, foundations have also played an important role. Looking upon this donation practice from the perspective of the enormous processes of rationalisation that formed companies in the last 150 years, corporate social commitment has a lot of catching up to do: Instead of simply granting funds which tend to be strategically unfocussed from a corporate perspective, managers are increasingly orchestrating corporate social commitment within long-term business strategies – in order to contribute to the socio-economic development of communities and to companies' economic prosperity.

Caixa Catalunya: Pioneering paths for microfinance exemplifies how company foundations can transcend their classical fund-granting role: By strategically blending various company assets they can turn into company CSR-organs that benefit communities within the realm of business strategies. Font could have arbitrarily selected what he perceived to be supportable MFIs. But, instead, he chose those organisations that seemed to embody benefits for the poor and the company.

This approach may be considered to be self-centred. Instead of helping in an unreserved manner, one might think Caixa Catalunya helped in order to gain. But the

facts of this case suggest that helping in order to gain truly helps others and actually increases one's own capacity to help: As early as 2003, Un Sol M6n was able to initiate a spin-off project together with one of its partner MFIs in Central America aimed at reuniting families in Ecuador. Together they helped former Ecuadorian immigrants in Spain set up successful businesses in their mother country. ♦



Business Case

AstraZeneca: Commitment to fighting tuberculosis

Dusk was falling on central London. It was May of 2000 and it had been a mild spring day. Most of AstraZeneca's employees had already left the company's headquarters at Stanhope Gate. The members of the board, led by CEO Sir Tom McKillop, were gathering for a meeting.

The company's top management had initiated a process which aimed at reorganising and restructuring the newly consolidated pharmaceutical giant, AstraZeneca PLC, born of the merger of Swedish Astra AB and British Zeneca Group PLC thirteen months earlier. A general revision of the company's product portfolio and R&D capacities was at the top of the agenda as well as strategic planning. Until then, CSR at Astra and at Zeneca had meant striving towards sustainable success through a strong commitment to competitiveness and performance, based on high ethical standards, as well as actively contributing to social causes through donations, sponsorships, disaster relief efforts and other initiatives. But while these activities remained important, a new challenge had surfaced: Pharmaceutical companies were accused of concentrating solely on diseases which disproportionately affected the developed world, while disregarding poverty related, pandemic diseases, such as malaria, tuberculosis TB or HIV/AIDS, which were widespread in the developing world. Perhaps it was time to integrate measures that focused on the latter within the company's CSR strategy.

In the search for a person to head the assessment phase of a new initiative, Aileen Allsop was the one who stood out. Allsop had been working in the pharmaceutical industry for over 25 years, initially in drug discovery, later in drug development and most recently in science policy. She was a leading team member for AstraZeneca's R&D. When McKillop asked her to take on the job, she accepted saying: "I suppose our main challenge will be to find new activities that concentrate on the pressing medical needs of the poorest populations, but in a way that adds value to our company in terms of reputation, company identification and business development."

McKillop found this reassuring and at that moment knew that Allsop was the right person to make CSR activities expand and run.

AstraZeneca: Market leader in a demanding context

As of 2006, AstraZeneca was one of the world's leading pharmaceutical companies, focussing its commercial and R&D resources on six therapy areas: cancer, cardiovascular, gastrointestinal, infection, neuroscience and respiratory/inflammation. The company's product portfolio included medicines like Arimidex, Crestor, Nexium, Seroquel and Symbicort.

Brief history, competitive environment and challenges of the industry

The company was formed on April 6, 1999, through the merger of Astra AB of Sweden and Zeneca Group PLC of the UK, two companies with similar science-based cultures and a shared vision of the pharmaceutical industry. The merger aimed to improve the combined companies' ability to deliver long-term growth and enduring shareholder value. In 2006, with revenues standing at USD 26.5 billion, AstraZeneca was the world's fifth largest pharmaceutical company, topped only by Pfizer (with revenues of USD 48 billion in 2006), GlaxoSmithKline (USD 47 billion), Sanofi-Aventis (USD 40 billion) and Novartis (USD 37 billion).

AstraZeneca: world's fifth largest pharmaceutical company in terms of revenues in 2006

At the beginning of the 21st century the pharmaceutical industry was facing enormous chances as well as unprecedented challenges. A 2007 PricewaterhouseCoopers publication, *Pharma 2020: The Vision – Which path will you take?*, offered a comprehensive analysis of the situation. According to the authors of the survey, the global pharmaceutical market's total value will more than double by 2020 and reach USD 1.3 trillion. This increase will be driven by soaring worldwide demand for medicines as the population grows, ages and becomes more obese. However, the authors noted that the pharmaceutical industry is strongly affected by *thinning pipelines* (meaning the industry's declining ability to deliver a steady volume of new drugs) and skyrocketing operating costs, while calls for lower prices and regulatory burdens increase.

Steve Arlington, global pharmaceutical research and development advisory leader at PricewaterhouseCoopers and principal author of the report, stated: "The core challenge is a lack of innovation. The industry is investing twice as much in R&D as it did a decade ago, only to produce two-fifths of the new medicines it produced then."

The industry's core challenge was a lack of innovation

What makes things worse, he said, is a comparatively poor share value performance over the previous years (between 2001 and 2007, the FTSE Global Pharmaceuticals Index rose only by 1.3 percent, while the Dow Jones World Index rose by 34.9 percent). Arlington recommended that, over "the next decade, the industry shift its investment focus more towards research and less on sales and marketing. Pharma's traditional strategy of placing big bets on a few small molecules, marketing them heavily into primary care with the aspiration of achieving blockbuster sales, will no longer suffice. It must focus on the development of medicines that prevent, treat or cure. These must demonstrate tangible benefits and tackle unmet medical needs. Governments must play their part and ensure the industry is rewarded for these efforts."

The developing world – a blind spot?

But these were not the only challenges the industry was facing. According to the 2000 World Health Report, published by the World Health Organization WHO, diarrhoeal

diseases, TB, malaria and childhood illnesses like polio, whooping cough and diphtheria were responsible for 17 million deaths in 1999. More than 90 percent of these occurred in developing countries. Apart from that, a total of up to 20 million people had died of HIV/AIDS since it surfaced in the early 1980s, with the vast majority of those infected living in Sub-Saharan Africa.

But pharmaceutical companies concentrated on diseases which primarily afflicted western populations (e.g., cardiovascular diseases, diabetes mellitus, obesity, cancer and psychiatric diseases). Poverty related, pandemic diseases were never at the heart of their efforts. Why this disregard of the developing world?

One reason was the low purchasing power in the developing world. It did not even compensate the enormous R&D costs necessary for the development of medicines. Another reason was the lack of meaningful intellectual property rights in the developing world. This problem was especially prevalent in India, a rapidly growing consumer market for pharmaceuticals and a R&D powerhouse. Since 1970, Indian pharmaceutical companies had been legally allowed to *reverse engineer*, meaning they could decode elements of medications protected by patents in order to recombine them using their own procedures. This, of course, dropped expenses and treatment prices in India, but it also fenced off western pharmaceutical know-how and companies from that low-price market, who then often had to take the blame for not fighting the vast spread of poverty related diseases in developing countries.

The year 2000 marked the beginning of a change: While only 13 new drugs that were developed for neglected diseases between 1975 and 2000, 60 drug-development projects for neglected diseases were now initiated. In addition, two new drugs were in the registration stage and 18 new products were in clinical trials between 2000 and 2004.¹

Pharmaceutical companies focused on diseases relevant in developing countries

Number of neglected disease drug-development projects started to grow after 2000

AstraZeneca in detail

AstraZeneca's 66,000 employees generated revenues of USD 26.5 billion in 2006, EBIT of USD 8.2 billion and EBITDA of USD 8.5 billion. AstraZeneca's share was worth USD 46.70 on April 6, 1999, the day Astra and Zeneca merged. It dropped to USD 29.15 on September 2, 2002, and then performed strongly to reach USD 66.37 on October 25, 2006. On December 29, 2006, the share stood at USD 53.82. In 2006, shareholder returns totalled USD 5.3 billion, EPS stood at USD 3.86 with USD 2.2 billion in dividends paid out to shareholders.

Ownership of AstraZeneca PLC in percent of total stock, Dec. 31, 2006			
The Capital Group Companies, Inc.	12.6	LGIM Ltd	3.3
Wellington Management Co., LLP	5.0	Barclays PLC	3.2
Investor AB	4.1	Free Float	71.9

The industry's main competitor was the US company Pfizer with 100,000 employees, revenues of USD 48.4 billion, EBIT of 13.02 billion and EBITDA of 19.33 billion. Pfizer's EPS was USD 2.66 in 2006, more than USD 1 lower than AstraZeneca's EPS. This shed light on the British-Swedish company's profitability.

AstraZeneca outperformed the industry's peer in terms of profitability

More than half of AstraZeneca's staff worked in Europe. The remaining 27 percent worked in the Americas and 15 percent in the rest of the world. With an extensive global sales and marketing network, AstraZeneca was able to sell its products in over 100 countries, boasting major market presence in the US and a growing market presence in South Korea, Egypt and Mexico. R&D at AstraZeneca employed about 12,000 people at eleven R&D centres in seven countries: the UK, the US, Canada, France, India, Japan and Södertälje, in Sweden, the company's R&D headquarters. In 2006, AstraZeneca spent over USD 16 million every business day (or USD 3.9 billion per year) researching and developing new medicines.

Like every research-based pharmaceutical company AstraZeneca relied on intellectual property rights. This allowed the company to patent its discoveries for a certain amount of time (usually eight to 15 years) in order to protect them from being copied by generic manufacturers. This gave AstraZeneca the chance to generate the revenue it needed to recover its R&D investment (see *Exhibit 1* for an overview of AstraZeneca's R&D cost structure).

CSR at AstraZeneca

CSR at AstraZeneca was not regarded as an "add-on extra", but rather as an "integral part of everything we do", according to CEO McKillop's statement in the AstraZeneca 2000 CSR report. In June 2000, only 13 months after the merger, the company published a Code of Conduct with which all employees were required to comply "both in spirit and letter". Integrity, honesty, diligence and care were the cornerstones of that code. In addition, the Safety, Health and Environment SHE policy was agreed upon by the board, along with the company's mission to be the "first for innovation and value in the provision of products and services to improve human health and quality of life".

SHE applied to all employees and all activities. Compliance was mandatory and ensured by a corresponding SHE management system.

These measures, among others, were meant to show the company's willingness to take responsibility for society and their desire to be "welcomed as a valued member of the global community", as stated the company's first CSR report. Along with these efforts, a new initiative focusing on pandemic diseases would be assessed. As a leading pharmaceutical company, responding proactively to the industry's current challenges was part of AstraZeneca's entrepreneurial vision.

CSR at AstraZeneca was not regarded as an add-on extra

Getting to a new level

Shortly after Allsop had taken up the challenge of assessing possible new initiatives, she set up a small team to brainstorm new activities for a specific target group: the developing world. The team consisted of John Patterson (who was responsible for the global marketing of all AstraZeneca brands as well as the management of the AstraZeneca product portfolio, licensing and business development), Barry Furr (AstraZeneca's chief scientist) and Claes Wilhelmson (executive vice president of AstraZeneca R&D), as well as three other members of management. Would they be able to come up with meaningful activities that would meet public expectations?

A team started to brainstorm new activities for a specific target group

Allsop said: “We knew it was not going to be easy, but we acknowledged the relevance for our company’s and for the industry’s reputation.”

In their first brainstorming session in July 2000, two months after the aforementioned board meeting, Allsop and her team focused on the idea of drug donations in which AstraZeneca would give out free medications to the poor. The merged companies, Astra and Zeneca, each had experience doing this in the past – but doubts remained. To Allsop and her colleagues it was clear that donating medicines was only helpful in areas where medical infrastructures were well established – and often enough this was not the case in the developing world.

In August, Allsop asked the team to meet and to hold frequent conference calls. During their meetings, numerous ideas surfaced:

One was to initiate strategic partnerships with pharmaceutical companies in the developing world – partnerships that would build up capacities on both the commercial and R&D sides so that the gap between the poor and urgently needed medicine was bridged. Yet this idea posed strategic problems.

Another idea aimed at funding research in biology and biochemistry at universities in the developing world. But would this have targeted the centre of the problem? Funding academic research was a promising idea, but faced with time constraints, countries needed medicine more urgently than research.

A third idea was to cooperate with NGOs who committed themselves to providing access to medicine in the developing world. This activity could have met one of the most pressing needs of public health authorities in Asia, Africa and Latin America. But AstraZeneca did not have the appropriate medication at hand.

Clear political interest

In the first half of 2000, a worldwide political consensus with regard to neglected diseases started to take shape. In May 2000, the then president of the European Commission, Romano Prodi, announced his intention to place the fight against infectious diseases at the top of the agenda. As he saw it, they were the “plagues of the modern world”. In July 2000, at the end of their meeting in Okinawa, Japan, the G8 pledged to fight communicable diseases, most notably HIV/AIDS, malaria and tuberculosis, in an effort to break the vicious circle of poverty and disease. At the UN Millennium Summit in New York in September 2000, 150 heads of states committed themselves to halting the spread of these diseases on a global scale by 2015.

These commitments were intriguing because they showed that politicians were not only accepting the moral imperative to stop the vast spread of poverty related diseases, but they were also talking about necessary contributions that had to be made (e.g., via public-private partnerships PPP).

In addition, the transitional period granted to developing countries to recognize the patentability of pharmaceutical molecules according to TRIPS (Agreement on Trade-Related Aspects of Intellectual Property Rights) was about to expire. The agreement was originally negotiated during the so-called *Uruguay Round* of GATT – the precursor of the WTO – in 1994. Common minimum standards were set. All WTO member countries – India among them – were required to definitively introduce these standards into their laws by 2005. The least developed countries had to do so by 2016.

Politics committed itself to fighting poverty-related diseases

To Allsop and her team a new quality of political will (implying public funding) and forthcoming patent right standards were perfect preconditions for bridging the gap between the pharmaceutical industry's legitimate interest to generate a return on investment and the ethical demand to ensure access to medication for the poor in the developing world. Activities that would make a real difference in combating poverty related diseases and would build up reputation and social legitimacy now appeared to be more feasible. But what kind of action was most appropriate for a global player and health care company like AstraZeneca?

New perspective: R&D on poverty related diseases

Developing a medication for the poor would enhance the company's social competence

During a brainstorming session in September 2000, Barry Furr remarked: "We do not have a drug in our portfolio that was developed to treat diseases prevalent in the developing world, but now it was a perfect time to change that as a general revision of the product portfolio is barely half-way through." Also, he said, the public is being sensitized to these neglected diseases as the issue has received attention from politicians around the globe. Coming up with a medication for malaria, TB or HIV/AIDS, he concluded, would be the best way to enhance our social competence.

With the impression that they were moving along the right track, Allsop said: "The idea, if implemented, will not only help the poor and be perceived well by the public and public authorities, it will also be at the centre of one of the things we do best: R&D."

There were three crucial question that had to be answered in the next step: Research on what? In what dimension? And where? With regard to location, they considered the Bangalore facility in the fast growing economic hub of south-west India. They knew that the board was actually reconsidering the strategic necessity of this site, but they thought Bangalore still had its advantages: First, it was important to conduct R&D in a country where poverty related diseases were widespread. Second, in addition to its scientific strength, India also had enormous market potential. Internal and external experts alike estimated that the value of the sub-continent's pharmaceutical market stood at USD 4 billion and projected an annual growth rate of 10 percent until 2010. India's drug market promised to rank among the largest in the world. In 2000, AstraZeneca held less than 1 percent of market shares in India and they definitively wanted to have more. To Allsop and her team, Bangalore seemed to be the ideal place to implement R&D on neglected diseases.

AstraZeneca was interested in fighting TB and increasing its market share in India

During a board meeting in October 2000, Allsop reported the team's ideas and recommendations. The board members assured her of their support and felt that an assessment should identify the exact field of intervention.

For a number of months, several teams worked independently on the assessment. A review committee specifically set up for this purpose, consisting of Allsop, Furr and Julian Davies, the then vice president for strategy of AstraZeneca R&D, supervised the process.

Bangalore as strategic R&D centre?

Set up by Astra in 1984, the company's site in Bangalore consisted of a manufacturing facility, a marketing unit sponsoring symposia on infectious diseases in India and a small biomedical research division, devoted to tropical and other infectious diseases that affected Indian society. Over the years, Astra built up a stable network

comprised of close contacts to governmental and scientific institutions. The 65 scientists employed at the centre were of the highest quality in terms of education and enthusiasm. They also had broad experience in conducting research on infectious diseases. An additional argument for the use of this site were the lower costs of employment (wages in India were a third or less of those at AstraZeneca's R&D centres in Europe and the US). With a staff of 65 and sufficient resources, the board decided that the Bangalore facility was just the right site to conduct research on medication for neglected diseases.

Bangalore had sufficient resources to initiate a solid research project on neglected diseases

Focus on tuberculosis in India

Allsop teamed up with Tanjore Balganes, head of R&D in Bangalore, to find the centre's pivotal point. What should Bangalore focus on: TB, malaria or HIV/AIDS? Or maybe on two or all three? Or perhaps it should focus on another disease?

Taking into account the site's strengths and resources at the time, they quickly decided to concentrate on a single disease so as to achieve maximum impact over the next few years. They short-listed seven neglected diseases (HIV/AIDS, tuberculosis, malaria, filariasis, amoebiasis, schistosomiasis and leishmaniasis) and prioritised them according to the following criteria: medical need, available expertise, infrastructure required, competition, impact potential and new scientific opportunities.

But there were several important arguments for AstraZeneca to commit itself to finding a new medication for TB treatment:

The WHO's World Health Report stated that TB spread rapidly. The WHO estimated that more than two billion people worldwide (one third of the world's population) were infected by TB. Eight million were newly infected each year. TB was estimated to be the single largest cause of adult death from infectious disease in the world. At the beginning of the new century, two million people (mostly living in the developing world) died every year of TB. If co-infected with HIV/AIDS, it often broke out after having first appeared in a dormant stage. But apart from these indicators, TB had an especially severe impact on the Indian sub-continent: Every year, two million Indians were infected with TB. (See *Exhibit 2* for the global spread of TB and *Exhibit 3* for an overview of the global development of TB incidences.)

Discerning which disease to focus upon in Bangalore

Recent developments in molecular science had revolutionized anti-infective drug hunting, which increased the ability to sequence the TB genome. By 1998, the "complete genome sequence of the best-characterized strain of *Mycobacterium tuberculosis*, H37Rv", said Stewart T. Cole and others in *Nature* (No. 3393, June 1998), had been "determined and analysed in order to improve our understanding of the biology of this slow-growing pathogen and to help the conception of new prophylactic and therapeutic interventions."

At AstraZeneca, this nourished hopes of initiating novel approaches to treatment. The need for new, high quality medication was extremely high: In 1882 Robert Koch's discovery of the *mycobacterium tuberculosis* bacillus spurred the development of a TB vaccine, which was prepared out of a strain of the bacillus calmette-guérin BCG. TB vaccination eventually became available in the 1920s. While its protective efficacy for preventing serious forms of TB in children was high, it proved to be not so successful

The need for a new, high quality anti-TB drug was extremely high

when treating adolescents and adults. Adults were still susceptible to TB infection, even if they had been vaccinated during childhood. The era of TB drug development started with the introduction of Streptomycin in 1944 and ended with the introduction of Rifampicin in 1963. It was proven that TB therapy was more efficient and less likely to end in drug resistance when – instead of using one drug – several drugs were combined making multiple drug regimens the standard treatment. But no new anti-TB drug class was developed ever since 1963. It was time for a new anti-TB drug or treatment.

Furthermore, there were no potential competitors on the horizon in 2000. There was no other leading pharmaceutical company that was doing research on TB or that had a promising drug in clinical trials. Consequently, AstraZeneca would be the first mover with strategic advantages if R&D in Bangalore came up with a new drug.

The main objective: Shortening TB treatment time

TB treatments had a 95 percent success rate but the treatments were very lengthy: The drug regimens recommended by the WHO in 2000 – which still represented a state-of-the-art treatment – included a two month *intensive phase*, during which four different drugs were normally administered, and a four to six-month *continuation phase*, during which patients were treated with two drugs. If patients were to give up the therapy once the symptoms were no longer apparent (with the infection not fully treated), this could lead to relapse and make drug resistance more likely.

Length of TB treatment made it unaffordable to many in developing countries

Precarious living conditions (such as malnutrition and housing in overcrowded areas without sanitation) and the absence of rapid and reliable diagnostic and treatment systems made people in developing countries most vulnerable to TB. Once infected, patients in many countries had free access to TB treatment, but they normally had to bear the cost of the six-month therapy, which, on average, depleted 30 percent of yearly household earnings.² Many never went to the doctor in the first place because they knew that it would cost them their income. The lengthy treatment was probably the biggest problem in the fight against TB in the developing world.

For AstraZeneca, shortening the duration of TB therapy to improve patient compliance was the most essential aspect of the new drug. Shorter treatments would have an enormous effect on the developing world. Apart from this first objective the company formulated three others: The new drug had to eradicate the disease; it had to act on drug resistant strains; and it had to be compatible with HIV/AIDS therapies.

Preparing for research on a candidate drug

On April 25, 2001, AstraZeneca announced its plans for Bangalore: USD 10 million would be invested to create new research laboratories and another USD 5 million per year would be made available to support research activities. Tanjore Balganesch continued to head R&D in Bangalore. Barry Furr was appointed to lead the site with its staff of 65 and planned to recruit more scientists over the next five years from India and overseas. In addition to that, a process research and development PR&D laboratory was being planned. AstraZeneca hoped to have a candidate drug CD for introduction to human studies by 2008.

Cost expectations

Discovery costs for a new clinical entity NCE, the main component in any new drug, were always difficult to estimate, no matter where the research was undertaken. Research expenses and expected future revenues had to be balanced within a time frame of up to twenty years. Industry experts estimated a sum of USD 800 million (see *Exhibit 1*). These were high costs, especially when facing the developing world's low purchasing power and its poorly funded healthcare systems (see *Exhibit 4* for the correlation of wealth and health expenditure). Would AstraZeneca earn money with an anti-TB drug? On June 2, 2003, the day AstraZeneca India Pvt. Limited AZIPL opened, McKillop said: "AstraZeneca will make any TB medicines discovered in these laboratories available for clinical development and will supply to the world's poorest countries at low prices, in partnership with governments, healthcare systems, international agencies and others. All countries must play their part in the treatment of TB and I hope that the G8 Ministers, who will meet this week, will agree on an international step-by-step change in the allocation of resources for the treatment of this devastating disease."

AstraZeneca said to supply any TB medicines to poor countries at low prices

It was imperative for AstraZeneca to make treatment available at affordable prices to those who needed it in the poorest countries. Thus the undertaking was labelled not-for-profit from the very beginning.

Tackling TB on a global scale with collaborative efforts

The preparations for the opening of the new Bangalore research centre in June 2003 were manifold: State-of-the-art equipment had to be installed; staff had to be trained for their new jobs; newly recruited employees from top research institutions and universities had to be integrated; leading scientists had to be nominated to the scientific advisory board to leverage research efforts; and a formal workflow process had to be set up with the company's genomics and infection research centre in Boston, Massachusetts (USA). Apart from that, Furr and Balganesch hoped that AstraZeneca's efforts would foster an atmosphere of collaborative efforts to tackle TB on a global scale.

The preparations for the opening of the new research centre were manifold

In order to complement in-house capabilities, AstraZeneca partnered with external institutions (such as governments, academic institutions, foundations) and NGOs (like the Global Alliance for TB Drug Development), as well as biotechnology and other pharmaceutical companies – thereby showing their awareness that an international, collaborative effort was fundamental to drug discovery given the large investments that were necessary. In addition, costs could be shared by multiple organisations, ultimately lowering the investment burden borne by a single entity.

Among others, Win Gutteridge from the WHO's Special Program for Research and Training in Tropical Diseases TDR; Gary Schoolnik, professor and chief, Division of Geographic Medicine and Infectious Diseases Microbiology and Immunology at Stanford University, California; and Stewart T. Cole³, head of the Unité de Génétique Moléculaire Bactérienne at the Institut Pasteur in Paris, were appointed to be members of AZIPL's scientific advisory board: With regard to the objectives of the Bangalore research site, Schoolnik said: "AstraZeneca is the only pharmaceutical company to recognise this area of medical need with a research programme in India dedicated to TB, and I am delighted to be able to work with them on this important project."

The anticipated side effect – an intensified atmosphere of collaborative efforts to tackle TB on a global scale – occurred due to the sheer composition and the flow of communication within the AZIPL advisory board.

The EU enhanced academic collaboration on TB treatment by funding EUR 11 million over a period of 60 months starting in January 2006. The so-called *European Union Framework Program VI Collaboration* (NM4TB - New Medicines for Tuberculosis), coordinated by Stewart T. Cole, incorporated 15 of Europe's top scientists, three SMEs (that focused on medication development) and AstraZeneca's Barry Furr and Tanjore Bangalesh. The collaboration's number one objective was to find an anti-TB drug that could reduce TB treatment time.

Partnerships with external institutions were set up to complement in-house capabilities

Keeping track

Although the discovery process needed more time than assumed, the project was certainly already successful in the sense that it provided a positive source of identification for AstraZeneca employees. Balganesh said: "They were proud of the fact that AstraZeneca had a research centre that was working on a disease of such great importance to the developing world. Working for a company that supported a good cause contributed to motivating AstraZeneca employees who were enthusiastic about the project."

As far as public relations were concerned, Allsop pointed out that AstraZeneca "didn't want it to be a token effort, but wanted to deliver real results." They therefore followed the low-key approach of engaging in rather reactive public relations in the beginning, and only increasing proactive communications once the project had achieved significant results. Although it might have been tempting to communicate AstraZeneca's CSR efforts, AstraZeneca's top management consciously abstained from seeking high profile public relations. Instead, it considered the Bangalore project as an integral part of the company's pharmaceutical business and as a long-term investment that should not be endangered by short-term media coverage.

AstraZeneca's then head of public relations, Chris Major, also believed that the company had a responsibility not to set expectations too high and prevent the media from raising people's hopes in an inappropriate way. His words were: "As a research-based company, AstraZeneca can't guarantee results. In research, you never know if things are going to work as imagined and if you are going to reach the targets. Hence, it would be inappropriate for us to pro-actively approach the media to tell them about the great things we are doing at the moment. Some of our competitors are pro-active about their projects, but you have to revisit these stories in five years time. Our reputation is based on maintaining our commitment to the Bangalore project, and I believe that actions speak louder than words."

Discovery process needed more time than assumed

This was well understood by the public. In *Purchase Commitments: Big business bias or solution to the 'neglected diseases' dilemma?*, published in the Australian Review of Public Affairs (October 2005), Hans Löfgren of the Deakin University in Australia said that in order to confront the so-called *neglected disease dilemma*, companies like AstraZeneca accept that final products will be available at not-for-profit prices. He admitted that this decision was "likely to form part of a strategy of building a presence

and reputation in developing country markets and may also be driven by genuine ethical concerns.”

It was still unclear in 2007 when a new anti-TB drug would be available. With regard to some of the uncertainties of the interim project, Allsop explained: “The research team has added a lot of technology and has developed new ways of looking at things that have allowed it to move ahead faster. Hence, little was yet known about what kind of drug would be found, if patients would have to take a combination of drugs, what the price would be, if there were any side effects, or when the drug would be available.”

Given the progress in research and the situation at the time, Allsop had to revise the time schedule: “We hoped to have a candidate drug for introduction into human studies during 2007-2008, but the stringent criteria that we have set for success within this complex area of research means that our current programme is some three to four years away from candidate drug delivery. We have therefore revised our key performance indicators in this area, and do not expect to deliver any earlier than 2010.”

Considering the large worldwide TB death toll, every day without a new drug obviously was a day too many. But research on TB was difficult, as pointed out by Ian Orme of Colorado State University in a March 2007 article published by the National Institute of Allergy and Infectious Diseases in the US: The microbe that causes TB “demands careful handling”. Still, “this is a jolly interesting time in tuberculosis research”, said the expert in the light of the world-wide effort to tackle TB – an effort to which AstraZeneca contributed enormously. ♦

Drug delivery was not expected any earlier than 2010

Notes

¹ Mary Moran, *The New Landscape of the Neglected Disease Drug Research and Development*, London, 2005.

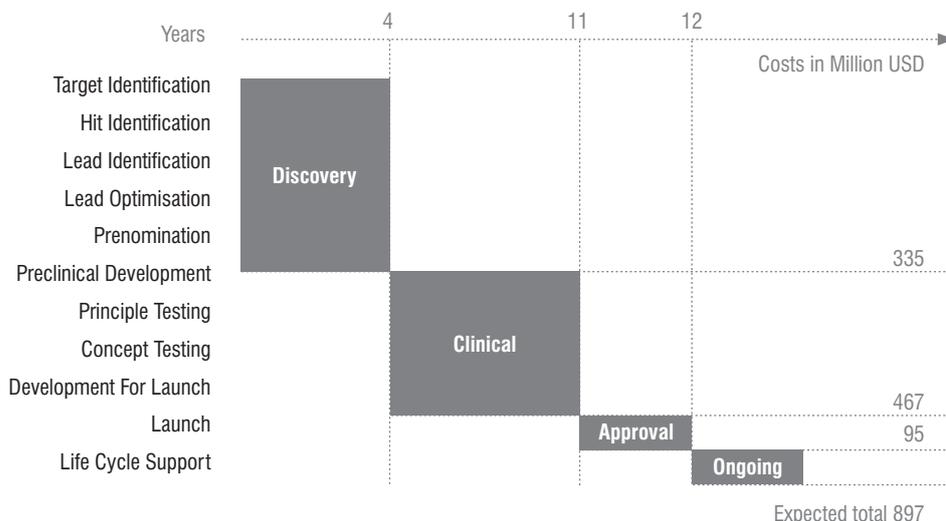
² WHO calculated that the average TB patient loses three to four months of work-time and up to 30 percent of yearly household earnings. Globally, this meant that TB annually robbed the world’s poorest communities an estimated sum of USD 12 billion. Source: Stop TB Initiative.

³ Cole pioneered the work on the sequencing of the TB genome and was one of the authors of the aforementioned Nature article.

Exhibits

Exhibit 1: AstraZeneca R&D: General estimation of time and costs

The chart illustrates the period of time that elapses until a new drug can enter the market and the corresponding expenditures.



Source: AstraZeneca

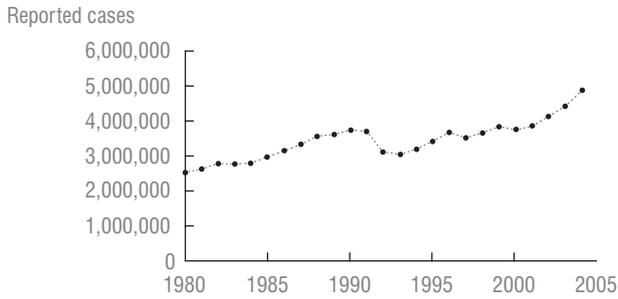
Exhibit 2: Global spread of TB: Ranking of total cases

1. India	12. Russian Federation
2. China	13. Vietnam
3. Indonesia	14. United Republic of Tanzania
4. Nigeria	15. Brazil
5. Bangladesh	16. Uganda
6. Pakistan	17. Thailand
7. South Africa	18. Mozambique
8. Ethiopia	19. Myanmar
9. Philippines	20. Zimbabwe
10. Kenya	21. Cambodia
11. Democratic Republic of Congo	22. Afghanistan

Source: WHO-Report, 2006

Exhibit 3: Global incidence of TB

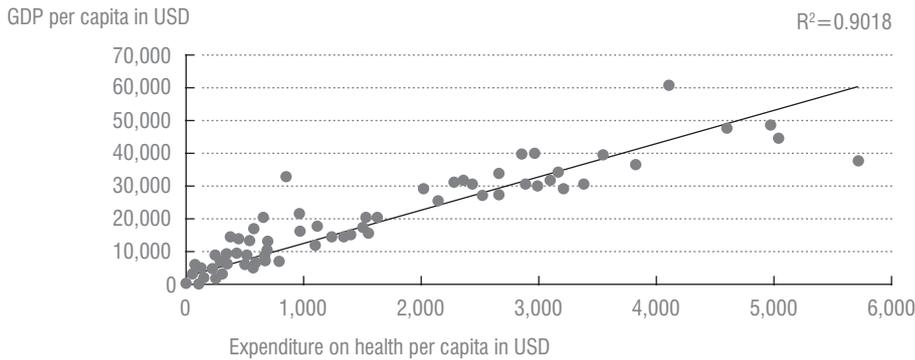
TB steadily increasing over the last decades.



Source: WHO-Report, 2006

Exhibit 4: Correlation of wealth and health expenditure

Research of the WHO indicates that there is a correlation between the overall wealth of a country and its health expenditures.



Source: WHO, 2003

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Teaching Note: AstraZeneca

Aileen Allsop, leading team member for AstraZeneca's R&D division, is the protagonist of *AstraZeneca: Commitment to fighting tuberculosis*. The case opens in May 2000 and portrays the pharmaceutical company's efforts to enhance its *social licence to operate*. At the beginning of the third millennium, the pharmaceutical industry was not only struggling with *thinning pipelines* (meaning the industry's declining ability to deliver a steady volume of new patents), it was also perceived to be passive, given the vast spread of poverty related diseases in developing countries. A lack of meaningful intellectual rights and low levels of purchasing power within these regions gave strategic reason to focus instead on illnesses relevant primarily in the developed world. But public opinion expected leading pharmaceutical companies like AstraZeneca to contribute more strongly to the overcoming of diseases such as malaria, HIV/AIDS or tuberculosis.

How did AstraZeneca cope with this situation? Instead of giving away medication to the poor in gestures of charity (with a strong, but short-term PR echo following), the company decided to confront both mentioned challenges with a global CSR strategy that would benefit the poor and potentially the company itself. India had the world's highest relative tuberculosis rate, a dynamically growing pharmaceutical market and, in 2005, the country's authorities were going to introduce a higher legal standard with regard to the patentability of pharmaceutical molecules. Allsop and her team thus recommended to re-align a corporate facility in Bangalore, India, to the discovery of a new medication for tuberculosis treatment – a social effort that was also designed for the company to gain momentum in India's pharmaceutical market. The board approved. In April 2001, AstraZeneca announced its plans for Bangalore and prepared to introduce a candidate drug to human studies by 2008.

Strategically implemented CSR can enhance a diminishing social licence to operate if managers creatively find ways to integrate social objectives within the realm of their companies' economic goals. This is a general conclusion that can be drawn from *AstraZeneca: Commitment to fighting tuberculosis*. Favouring communities (by means of charity) and highlighting these contributions to society (by means of PR) can thereby play important roles. But if a concise CSR strategy framework is not given, charity and PR as such will not suffice to increase a company's social licence to operate. Why should a company only want to benefit communities with genuine altruistic gestures (which are professionally communicated to the public)?

AstraZeneca: Commitment to fighting tuberculosis not only stresses the strategic value of CSR with regard to companies' social licence to operate, it also shows how global CSR (how thinking and acting in socio-economic categories in the developing world) can be used as a strategy to develop underserved markets. Due to widespread poverty, developing countries are often characterised by (very basic) needs, not by (market driving) demands. Next to product innovation and process optimisation (aimed at selling according to needs), companies can help build human capacity – whereas human capacity can be understood as the intellectual capacity to create social or economic value or, as the AstraZeneca case shows, as the biological precondition needed to participate in social and economic life. By initiating the mentioned social efforts, AstraZeneca will transform needs into future markets.

How? First, by increasing the amount of healthy people (thereby increasing the potential amount of future AstraZeneca customers). Secondly, by being recognised as an important partner in health care by those public institutions which grant patents to the actors of the pharmaceutical industry. AstraZeneca's contribution to the discovery of a new tuberculosis treatment is, thus, social by nature, but contains enough (potential) economic value for the company to perpetuate it in a sustainable way. ♦

Glossary

CEO	Chief Executive Officer
CSR	Corporate Social Responsibility
EBIT(DA)	Earnings before interest, taxes, (depreciation and amortisation)
EPS	Earnings per share
FAO	Food and Agriculture Organisation of the United Nations
FTSE	Financial Times Stock Exchange
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
ISO	International Standards Organisation
MDG(s)	Millennium Development Goal(s)
MNC(s)	Multinational Corporation(s)
NGO(s)	Non-Governmental Organisation(s)
OECD	Organisation for Economic Co-operation and Development
ROCE	Return on Capital Employed
SME(s)	Small and Medium Enterprise(s)
UN	United Nations
UNICEF	United Nations Children's Fund
UNIDO	United Nations Industrial Development Organization
USP	Unique Selling Proposition
WTO	World Trade Organization

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