

Chapter 5 Roles for other players

This report has outlined many ways that businesses can improve their impact on society, while also benefiting themselves. The business case matrix summarizing those relationships, however, shows that there are several areas where the business case can be further strengthened.

Undoubtedly some business benefits exist which are simply not being attributed or reported, which helps to explain 'holes' in the matrix. But the role of other players — governments, investors and other stakeholders — also has an important impact on the business case. These players are tending to demand greater action from companies on sustainability, but there may also be actions they could take to strengthen the business case.

This chapter examines what key players can do and are doing based on the cases we studied, as well as interviews with experts from companies, business associations, NGOs and academia. The main trends are summarized in the table on page 50. Our aim is to sketch out some of the important issues and key players which we feel are relevant to the business case in many emerging markets. We acknowledge, however, that there is not enough space here for an exhaustive discussion.

Emerging market governments

Many of those we spoke to highlighted **government** as one player that generally could do much more to strengthen the business case. Weak governance is a major problem for emerging market businesses, with issues such as unsuitable economic policies, corruption, general policy instability and inconsistent regulations topping the list of grievances. Environmental laws are often described as being too rigorous — to the point of being impossible to comply with. Yet enforcement is generally weak, with the result that there is often insufficient incentive for companies to attempt to comply with regulations.

A recent study showed that, on average, neither pollution nor the number of accidental poisoning cases fell as the number of regulations imposed by governments across the world increased.⁵⁶ Some government policies actually create incentives that weaken the business case, such as subsidies encouraging environmentally damaging activities. Estimates of these 'perverse subsidies' range from \$500 billion to \$1.5 trillion a year worldwide.⁵⁷

Few emerging market governments are using alternative policies such as environmental charges, taxes and other economic instruments⁵⁸ to support the business case for good social and environmental performance — due in part to a lack of capacity to develop and implement such policies within the state institutions of most emerging market governments.

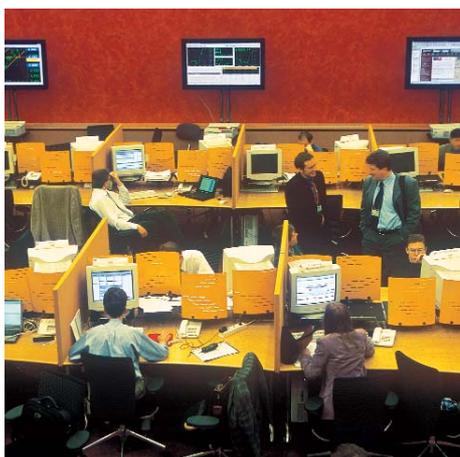
Overall, good governance, regulatory certainty and an appropriate mix of policy tools — including clear and enforceable regulatory standards, economic instruments and voluntary initiatives — each have a key role to play in promoting the business case for sustainability. While there is some evidence of emerging market governments implementing innovative policies despite institutional capacity constraints, there is nevertheless significant potential for government to have a greater impact.

Investors and lenders

Investors are a very broad and diverse group — as well as being very influential. They range from the local financial community in emerging markets to international private investors and financial institutions. As the evidence grows for the link between a company's sustainability activities and financial performance, this community will be increasingly likely to favor more sustainable companies in their investment decisions — further strengthening the business case.

However in this research, access to capital was the only business benefit which did not have a strong link to any of the sustainability factors. While there are undoubtedly more examples of this benefit which we have not uncovered, this also suggests that providers of capital are failing to reward good social and environmental performance in emerging markets, despite the fact that they have been rewarding them in developed markets.

The nature of the **local financial community** varies significantly between countries, but bank loans remain the dominant form of capital, and one which rarely rewards sustainability activities as such. As local banks become more cognizant of asset and reputational risks, as well as sustainability risks and opportunities, they can be expected to use lending policies to move companies towards more sustainable behavior.



Monetary exchange, Russia

For **companies listed on a stock exchange**, the incentives from the financial community to undertake sustainability activities are already greater and definitely increasing. For example, the 'Novo Mercado' is a new listing segment of the São Paulo Stock Exchange.⁵⁹ Companies listed on the Novo Mercado commit themselves to the highest standards of corporate governance, thereby seeking to reduce the general 'corporate governance discount' applied to Brazilian firms. **BNDES**, the Brazilian national development bank, offers these companies special lower interest rates, while the pension fund regulator allows pension funds to invest a larger proportion of their assets in companies listed on Novo Mercado.

The efforts of **international financial institutions** (IFIs) to disseminate good practice in sustainability suggest that they can also be increasingly important. For example, the IFC has developed leading-edge expertise in social and environmental issues in emerging markets, which is used to help companies, other lenders and governments negotiate difficult issues such as the impact of projects on natural habitats and indigenous peoples. The role of IFIs is two-fold: first, to ensure adherence to strong 'do no harm' environmental and social standards; and second, to disseminate best practice and understanding of evolving risks and opportunities related to sustainability. In emerging markets, especially during this period in which private capital flows have receded, IFIs have wide influence on what firms do. Many of these institutions could do more to strengthen their role in both these areas, and encourage the convergence of economic development and sustainability objectives.

Private investors, entrepreneurs and venture capitalists are also playing a role, by investing in sustainable enterprises throughout the emerging markets. But in general investors could do much more to strengthen the business case – for example by becoming more sophisticated in assessing and selectively rewarding companies' sustainability performance. There is a tendency for international investors to make blanket decisions regarding an entire country or region, without considering the merits of individual companies.

For Lawrence Pratt of the Institute of Business Administration of Central America (INCAE), a key question is how to demonstrate sustainability performance and value to the company without excessive documentation which does not match realities on the ground. 'Europeans are obsessed with certification and documentation,' he notes.

Box 11 Socially responsible investing

Socially responsible investment (SRI) aims to encourage sustainability by investing in special portfolios of the most sustainable companies ('screening') and/or by putting pressure on companies to improve their sustainability performance ('engagement').

It has developed rapidly in North America and the UK since the mid-1990s and is beginning to spread to emerging markets. The value of screened funds in the US was put at \$2 trillion in 2001,⁶⁰ while the figure for the UK was £4 billion (\$6 billion).⁶¹ The Dow Jones Sustainability Indexes and FTSE4Good from the UK now provide mainstream indices focusing on sustainable companies.

While this provides opportunities – and risks – for companies seeking international equity capital, local funds are also springing up. For example the Association for Sustainable and Responsible Investment in Asia (ASRIA) was launched in 2001.

'The activities that Latin American companies are doing do not show up because it's just a normal part of doing business. Companies down here do way more for the community but they get no credit for it from European and American analysts.'

Business customers

Through their supply chain, **business customers** have been an important influence in motivating emerging market companies to improve labor standards and environmental performance. Many companies, particularly in developed economies, are under considerable pressure from NGOs and consumers over their sustainability performance. These companies in turn place demands on their suppliers – many of which are based in emerging markets. **Nike** is a prime example. Responding to pressure from developing country NGOs, Nike has begun strengthening relationships with their key suppliers, creating 'strategic partnerships' where there is exchange of expertise to improve conditions in many sub-contracted factories.

In Brazil, Banco Real launched the ABN AMRO Ethical FIA, a mutual fund for companies with good social, environmental and corporate governance practice. Unibanco, Brazil's fourth largest private sector bank, also began to carry out SRI research in January 2001 (the first in any emerging market). In South Africa, Frater Asset Management specializes in SRI and has launched a unit trust focusing on good corporate citizenship.

Evidence suggests these opportunities will continue expanding. Media coverage of SRI in Latin America and Asia has grown exponentially over the past five years, although the frequency of mentions is still small compared with Europe or the US.⁶² And local Business Councils for Sustainable Development in South Africa and Argentina are aiming to develop a sustainability index for their local markets.

However, the decision by CalPERS, the California Public Employees' Retirement System, to stop investing in Asian emerging economies, partly on the ground of social concerns, also suggests that socially conscious investors, like mainstream investors, consider at least some emerging economies too risky at the moment.

Concern has been raised, however, that emerging market suppliers are left to bear a disproportionate amount of the costs in meeting international standards. Greater collaboration along an entire supply chain to help emerging market suppliers overcome capital and capacity constraints is one way that companies in developed markets can enhance and protect their own reputations, while maintaining their supplier relationships. Nike's policy is to negotiate both improvements and the costs with their 'strategic partners', while guaranteeing orders for a certain length of time. This reinforces the long-term intentions of both parties plus ensures tangible improvement all round.

Consumers

Although the impact of **consumer** activism in developed economies has sometimes been considerable, consumers in emerging markets have so far played a relatively small role in driving sustainability. That helps to explain the weak business case we found for companies to focus on developing environmental products and services for local markets.

	Current impact of influence	Trend of future influence	Means of strengthening impact on business case
Emerging market governments			<p>Providing a clear and stable framework of demanding targets and enforceable minimum standards.</p> <p>Creating an enabling environment for the adoption of stakeholder partnerships and voluntary initiatives where appropriate.</p> <p>Promoting the internalization of costs by using economic instruments and by eliminating economic disincentives.</p> <p>Participating in the development of international codes of conduct and/or developing local ones.</p> <p>Providing information to help overcome market failures.</p>
Investors			<p>Understanding the business case for sustainability and how it impacts the quality of investments.</p> <p>Developing tools to incorporate sustainability-related considerations in lending criteria, taking into account local context.</p> <p>Implementing appropriate SRI screening funds.</p>
International business customers			<p>Encouraging the adoption of sustainability practices in the supply chain, sensitive to regional differences and constraints.</p> <p>Assisting suppliers with resources and technology – allowing adequate time for improvements.</p>
Emerging market consumers			<p>Questioning companies about their sustainability performance.</p> <p>Making purchasing decisions that reflect personal values.</p>
Emerging market NGOs			<p>Partnering and engaging with companies.</p> <p>Exposing companies with poor performance, but also rewarding those making sustainability efforts.</p>

Negative
 None / not discernible
 Weak positive
 Strong positive
 Some negative
 Increasing

Even in affluent countries, most consumers put price and quality before other considerations. Price is even more significant in regions where poverty levels are high. Consumers often do not have the luxury of putting pressure on companies through their purchasing – and goods are often bought through the informal sector.

However, some recent surveys⁶³ have shown that there is a genuine concern among consumers in emerging markets about the sustainability performance of companies, and these consumers are set to be an increasingly strong driver for the business case as economies develop. These consumers can enhance the business case by acting on their values – questioning companies about their sustainability commitments and performance, and following through with their purchasing decisions.

As discussed, consumers in developed markets can also affect the business case in emerging markets through their pressures on corporate supply chains.

Non-governmental organizations (NGOs)

Local NGOs and community groups strengthen the business case by granting responsible companies the local license to operate, while exposing those companies with poor performance – although their influence is much greater in some countries than others. NGOs can also exert influence by lobbying governments for more effective regulation or the elimination of perverse subsidies.

NGOs have also begun to realize that collaboration with responsible companies can be effective in enhancing their mutual sustainability objectives – especially in relation to community development. In the Philippines, for example, mistrust between NGOs and business has historically been high – based on NGOs' view of business as having been tied to the patronage of the Marcos regime. But at a recent tri-sector conference both NGO and business organizations vowed to try harder to move beyond their comfort zones and identify areas of collaboration.

International collaboration and new governance forms involving NGOs, business, governments and other players is emerging as a promising area in disseminating knowledge, sharing good practice and building new coalitions. One major initiative has been Business Partners for Development, which has highlighted strategic examples of tri-sector partnerships between NGOs, government and business.⁶⁴

Figure 13 Influence of stakeholders on business case

NGOs can also weaken the business case by targeting companies which are starting to make efforts towards sustainability, rather than the real laggards. Failing to recognize honest efforts, even if the companies concerned still have a long way to go, discourages companies from being more transparent and from making efforts towards sustainability.

Others

There are several other groups which have not been considered here in detail, but which nevertheless have an important influence over companies, and have the potential to strengthen the business case in future.

Employees are a key group. Individually, they can enhance sustainability at the company they work for by bringing their personal convictions and experiences to bear, and contributing to change and innovation. They strengthen the business case when they choose to work for companies with a strong sustainability reputation. Through trade unions, workers can also apply pressure on companies, especially in relation to labor standards – although unions do not always have the necessary legal framework to support action, and they are often less supportive of environmental objectives.

Local business associations can help their members reach the standards that will give them a competitive edge, by providing expertise or helping businesses achieve economies of scale in purchasing environmental technologies, for example.

The **media** could be another significant player in driving the business case forward, by providing information on sustainability, and highlighting the good – and bad – that companies are doing. Nevertheless, with some notable exceptions, the media is falling well short of its potential role.

Finally, **international agencies** can play a catalytic role in stimulating awareness of opportunities. For example, the United Nations Environment Programme (UNEP) organized the Financial Institutions Initiative, which promotes the integration of environmental considerations by financial institutions into all aspects of their operations. As of May 2002, the initiative had 195 signatories, over a quarter of which are banks from emerging markets.⁶⁵ Another example is the Round Table on Corporate Social Responsibility – a joint initiative by the UK's Department for International Development (DFID) and the Canadian International Development Agency (CIDA) to help disseminate information on the links between business and poverty alleviation.

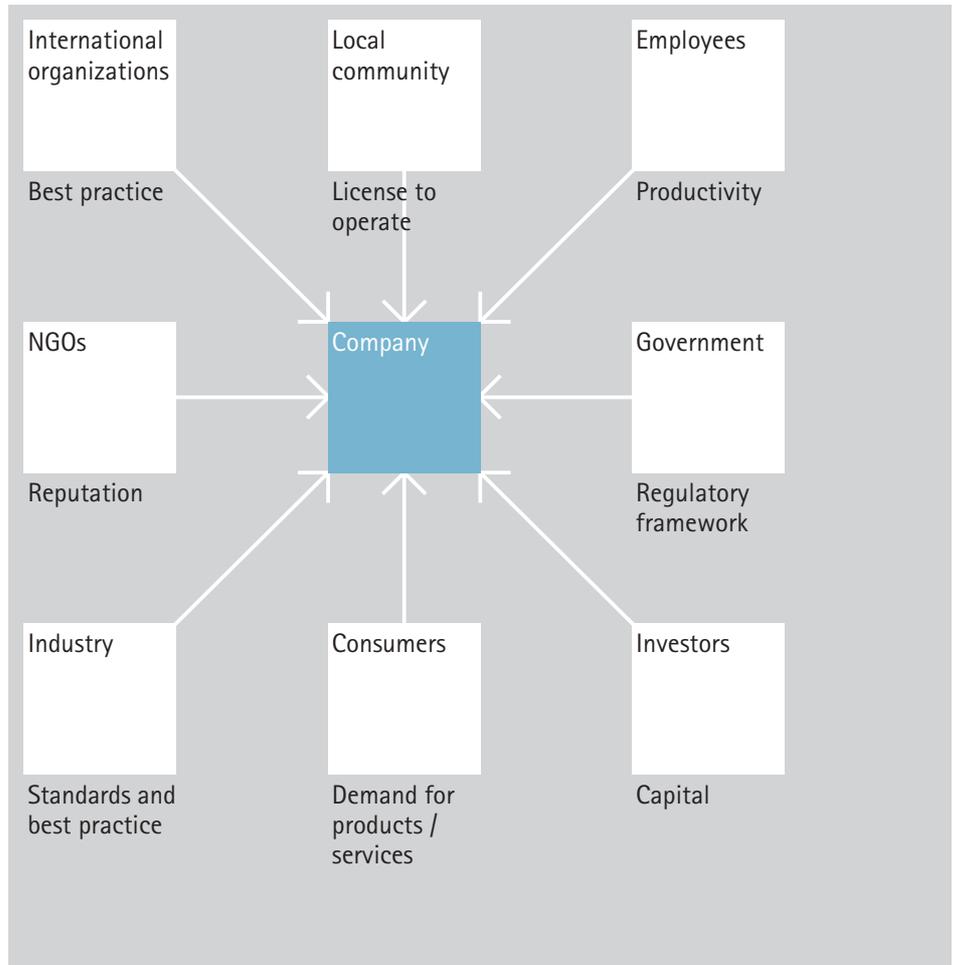


Figure 14 Stakeholder impact on the business case

Conclusion

New coalitions and new forms of governance will be important in achieving societal goals, while the actions of the 'other players' described above will drive the evolution of the business case. Over time we expect to see our business case matrix change – and strengthen – reflecting more and more companies that successfully build and measure sustainability and the benefits they gain from it.⁶⁶

We have shown in this chapter that important trends in this direction can be seen in the financial community and civil society. More action is needed from governments, which have the responsibility to create and maintain framework conditions for business that offer maximum stability and create the right incentives. However, capacity limitations will be an ongoing constraint, while the social, economic and political context in a given country will also continue to influence the business case.

'Inclusive globalization must be built on the great enabling force of the market, but market forces alone will not achieve it. It requires a broader effort to create a shared future based upon our common humanity in all its diversity.'
Kofi Annan, secretary general
United Nations
Report to the Millennium Assembly, 2000⁶⁷