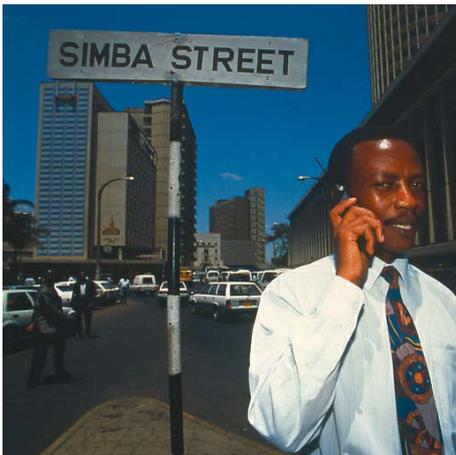


Chapter 2 The best opportunities



Stockbroker, Kenya

The aim of this study was to assess the business benefits, if any, which companies in emerging markets gain from sound environmental and social performance and good governance structures.

We tapped into business networks, spoke to local experts, searched through documented cases and drew on IFC's own project portfolio experience, ultimately analyzing 240 cases from 176 companies. These cases include all types and sizes of companies from small to multinational – though large national companies were predominant. They cover a wide range of sectors such as agriculture, manufacturing, infrastructure, and information technology all over the world in emerging markets.

We explored relationships between seven sustainability factors and six business success factors, with the results of the analysis illustrated in a matrix (outlined below). This business case matrix demonstrates graphically the connection between a particular sustainability action (environmental process improvement in this outline) and the resulting business benefit (cost savings). The shading in the cell indicates the strength of evidence for each particular link.

The full matrix appears at the end of this chapter, along with a more detailed description and acknowledgement of the limitations of this approach. The mini-matrices which appear throughout Chapter 2 serve to orient the reader by highlighting the matrix cell(s) being described in each sub-chapter.

The business case matrix		Sustainability Factors						
		Governance & engagement		Environmental focus		Socio-economic development		
		Governance & management	Stakeholder engagement	Environmental process improvement	Environmental products & services	Local economic growth	Community development	Human resource management
Business success factors	Revenue growth & market access			↓				
	Cost savings & productivity		←					
	Access to capital							
	Risk management & license to operate							
	Human capital							
	Brand value & reputation							

Figure 2 How the business case matrix works

Analyzing our case studies based on this matrix, we found the evidence was the strongest for several key linkages that we explore in depth in this chapter. They are:

- 1 **Save costs** by making reductions to environmental impacts and treating employees well;
- 2 **Increase revenues** by improving the environment and benefiting the local economy;
- 3 **Reduce risk** through engagement with stakeholders;
- 4 **Build reputation** by increasing environmental efficiency;
- 5 **Develop human capital** through better human resource management;
- 6 **Improve access to capital** through better governance;
- 7 **Other opportunities** from community development and environmental products.

These key links highlight the nuggets of good practice we have discovered which present the best business opportunities, although the evidence for the last two links was not as strong as for the others. Environmental products & services currently show the weakest business case but we believe there is potential here because of the scope for alternative business models and customer demand for sustainable products.

Box 4 Methodology explained

The six business and seven sustainability factors used in this study were determined primarily through a process of tailoring SustainAbility's work on *Buried Treasure*¹⁸ to fit the emerging market context as well as IFC's internal framework for assessing the contribution of private sector investments to sustainable development. The final selection also reflects the combined experience of the three author organizations in working with businesses in emerging and developed markets on the sustainability agenda.

The sustainability factors are divided into three main aspects of sustainability – governance & engagement, environmental focus and socio-economic development. The business factors are a mix of direct financial performance measures that are key to any business – cost, revenue and access to capital, and important financial drivers – risk management, human capital, reputation and brand value.

The case studies included in the report were selected from a thorough search of company case studies from publicly available information and reports that highlight best practice, IFC's own portfolio of projects, and conversations with experts and company managers in emerging markets. Inevitably there is a bias towards cases that build the business case, because companies are less willing to share information on sustainability initiatives that went wrong. Exploring this potential downside is an area for further work.



Fruit market, Bolivia

2.1 Save costs by making reductions in environmental impacts and treating employees well

The business case matrix		Sustainability Factors						
		Governance & engagement		Environmental focus		Socio-economic development		
		Governance & management	Stakeholder engagement	Environmental process improvement	Environmental products & services	Local economic growth	Community development	Human resource management
Business success factors	Revenue growth & market access							
	Cost savings & productivity							
	Access to capital							
	Risk management (in income to operate)							
	Human capital							
Brand value & reputation								

Highlighting cost saving & productivity resulting from environmental process improvement and human resource management. Full matrix is on page 31.

What's in it for business?

Businesses can reduce costs by making environmental improvements which deliver an immediate impact on the financial bottom line. We have also found strong evidence that treating employees well can generate financial returns by improving productivity – producing more with less – again resulting in direct cost savings.

Environmental process improvements

More than one in five of all the cases in our database demonstrated cost savings from environmental improvements – often described as eco-efficiency. Some savings flow directly from using less energy and materials. Others come from lower pollution costs, in the form of charges for waste handling and disposal, fees, licenses and fines for breaking environmental regulations. Reorganizing production processes, material flows and supplier relationships can also produce benefits such as higher productivity of capital and/or labor. For example, reducing waste volumes can reduce the need for labor and machines which handle waste. The evidence comes from many sectors, all types of company and all regions.

Intercell, Poland's second-largest producer of unbleached packaging paper for commercial and industrial use, wanted to cut \$2 million per year in environmental fees for discharge permits, penalties and water consumption charges. In 1992 the company installed new equipment which reduced water use by 7%, while chemical oxygen demand concentrations in liquid effluent and hydrogen sulfide emissions were slashed by 70% and 87% respectively. Over the next seven years the discharge fee rates grew threefold. By meeting higher standards, the company saved approximately \$12 million in pollution tariffs over five years.

Smaller businesses can also benefit. **Shivji and Sons**, in Dar es Salaam, Tanzania, has just 45 permanent employees, making laundry soap through a process which uses steam from a diesel-powered boiler. The company replaced leaking steam valves and taps, halved the time required for heating the fat storage tank through efficiency improvements and minimized steam consumption during the cooling stage. These measures cut diesel use by more than 50% and have resulted in annual savings of \$188,000 a year from an initial investment of \$830. This represents a payback period of just 1.6 days.

Human resource management

Effective human resource management can cut costs and boost the productivity of the workforce. Sound employment practices such as fair wages, a clean and safe working environment, training opportunities, and health and education benefits for workers and families can all increase morale and productivity while reducing absences and staff turnover. As well as productivity benefits, companies also save on costs for recruitment and training of new employees.

The Argus Group is one of the largest clothing manufacturers in the Caribbean. Alfonso Hernandez, the founder, realized that 85% of absences were caused by employees having to miss an entire day of work to reach state-provided medical facilities. In an effort to reduce absences he decided to offer free, full-time medical services on-site and health care for each employee's family. The investment in medical services has paid off in an absenteeism rate of 4%, compared with an industry average of 10%.

Laredo, a sugar company in Peru, improved the working conditions in its facilities and saw a reduction in accidents of 38%. This has improved employee relations and reduced costs.



Flower exporter, Kenya

Action on HIV/AIDS is another area where companies can deliver important benefits to workers and their families, and save costs at the same time. **Volkswagen do Brasil** launched an AIDS Care Program in June 1996, spreading awareness using the company radio, internal newspapers, bulletin boards and special brochures. Condom machines were installed in factories and offices. The program includes access to infectious disease specialists, social workers, nutritionists, psychologists, referrals to specialized hospitals and home care treatment. Patients are also given access to clinical tests and drugs. By the end of 1999, the company reported a 90% reduction in hospitalizations, a 40% reduction in the cost of treatments and care under its Health Plan, and found that 90% of the patients were active and without symptoms due to awareness, prevention and treatment of staff. There were also savings from reduced absenteeism and turnover of employees, and employee satisfaction with the company has increased.

Ignoring these issues can also result in higher costs. **Thor Chemicals**, a British company, set up a mercury reprocessing plant at Cato Ridge, South Africa in 1978. In 1991, tests showed that 87% of workers had mercury levels above safe limits, and a formal enquiry by the Department of Manpower found gross negligence leading to the poisoning of at least 29 workers. In 1994, the South African government forced the plant to close. In 1998, the families of workers who died from mercury poisoning sued Thor in British courts and received almost \$2 million. In 2000, a further 20 workers brought a second class-action lawsuit against Thor in Britain and obtained a settlement of \$400,000. The company settled out of court without admitting liability.¹⁹

**Sustainability factor 1
Environmental process improvement**

Also termed 'eco-efficiency', environmental process improvement involves producing the same level of output with fewer resources, emissions and less waste. Eco-efficiency can be increased by using alternative raw materials, redesigning equipment or techniques, using more efficient technologies, reorganizing the supply chain and/or siting production processes in a manner that reduces overall environmental impacts.

Why it matters

Reducing the use of energy and raw materials and limiting emissions and waste from production processes are key contributions that business can make to tackling the environmental challenges facing the world. Emissions from industrial activity can have serious impacts on human health and the natural environment. They also contribute to climate change, ozone depletion, acid rain and contamination of surface and ground water and soils. Maintaining finite resources is key for future growth and development.

Future trajectory

Concern for the environment is likely to grow in importance in emerging markets as populations grow, living standards increase, and environmental standards and expectations rise. Local communities are likely to become more concerned about environmental standards as awareness grows of the health and other impacts of pollution. Greater awareness is also driven by NGO activity and by greater access to environmental information, especially through the internet.

At the international level, climate change and loss of biodiversity are key concerns. The private sector is seen as a critical player and many multinationals have adopted environmental policies which extend through their supply chains in the form of requirements for suppliers to adhere to sustainability certification (see Box 5).

Box 5

Social and environmental credentials

Companies can demonstrate environmental and social responsibility by obtaining certification or labeling based on adherence to a management or product standard. These schemes are often developed independently of the industry concerned, although in consultation with companies as well as NGOs, and usually require some form of external verification. Some are international, while several countries also have their own codes, like the Kenya Flower Council Code of Practice and the Thai Green Label scheme. The main examples cited in this study are:

- **ISO 14001**, which prescribes corporate environmental management systems. Over 20,000 companies have been certified to ISO 14001 – nearly a fifth of which are based in emerging markets.²⁰ www.iso.ch
- **SA8000**, which focuses mainly on labor standards in manufacturing industries. Over 100 factories were certified at the start of 2002, three-quarters of which are in emerging markets.²¹ www.cepaa.org/sa8000_review.htm

- **Forest Stewardship Council (FSC)**, for wood from sustainably managed forests. FSC certification has been spreading from developed countries to markets such as Poland, Brazil and South Africa. www.fsc.org

The business case for such schemes can be very strong. Some cost is involved but this can be seen as investment which improves access to developed markets, including sometimes a price premium. Companies also find that these schemes help improve management control, resulting in cost savings and improved productivity.

There are potential drawbacks, however:

- Some codes or certification schemes do not relate adequately to emerging market conditions.
- It may be difficult for emerging market businesses to justify the initial investment, especially if multinational buyers do not provide technical or financial assistance.
- Verification of compliance can be technically difficult, costly and in some cases superficial. Certification also may not translate sufficiently to improved performance.

2.2 Increase revenues by improving the environment and benefiting the local economy

The business case matrix		Sustainability Factors						
		Governance & engagement		Environmental focus		Socio-economic development		
		Governance & management	Stakeholder engagement	Environmental process improvement	Environmental products & services	Local economic growth	Community development	Human resource management
Business success factors	Revenue growth & market access							
	Cost savings & productivity							
	Access to capital							
	Risk management (in income to operate)							
	Human capital							
Brand value & reputation								

Highlighting revenue growth & market access resulting from environmental process improvement and local economic growth. Full matrix is on page 31.

What's in it for business?

There are many opportunities to increase sales by improving the environmental impact of production processes and by taking action which helps local economies.

Successful approaches have been to innovate and develop new products, and to view 'wastes' as potentially saleable by-products. Improved processes can also make existing products more attractive to concerned customers. Recognition as a responsible producer – informally or through formal certification – can also open the door to some markets in developed countries.

Action which helps develop local economies, such as local recruitment, using local suppliers and providing finance and telecommunication facilities, can boost sales and may also have important public relations benefits for companies that are seen to be integrating into the community. Local small and medium sized enterprises themselves are involving their communities and finding innovative ways to grow sales, both locally and abroad, e.g. through eco-tourism and organic farming.

Together, these actions provide opportunities to:

- develop new products;
- sell more of existing products because:
 - they are more attractive to customers
 - local supplies have increased
 - greater local prosperity means more spending power;
- earn a premium selling price for products with positive environmental or social attributes;
- find markets for by-products or waste;
- gain or improve access to markets because of sustainability credentials.

We have identified such benefits for most types of companies across all regions. Local investment is particularly relevant in South Asia and Sub-Saharan Africa.

Environmental process improvements

Meeting environmental or social standards is increasingly recognized by formal certification schemes e.g. ISO 14001 for environmental management systems or the FSC certification for sustainable forestry. Such independent recognition can help companies gain access to markets or achieve premium prices. For example **Aserradero San Martin**, a Bolivian logging and wood products company which sells predominantly to North America, reports that FSC certification helped it to earn a premium of 10-15% over normal prices.

This can apply in many industries. In 1994 a German customer of Bombay-based **Century Textiles and Industries** required the company to comply with the Eco-Tex sustainability standard (developed by a European consortium, covering chemical use and other environmental issues). This involved changing dyestuffs, which resulted in a marginal cost increase. But Century, which is one of India's largest manufacturers and exporters of cotton and other materials, capitalized on meeting the Eco-Tex standard – the first company in India to do so. Compliance and associated quality improvements allowed the firm to increase prices by 8-10%. Sales volumes also increased – by at least 10% in the first year – as Century attracted new buyers from the US and the UK.

But certification is not essential to make money from environmental improvements. **Perion** is a medium sized company based in Budapest, Hungary, which makes batteries. It has created a new business line reprocessing car batteries, based on its own patented technology which has significant environmental benefits compared with the traditional process. This market opportunity developed from the company's efforts to improve its health, safety and environmental performance and avoid heavy fines for hazardous discharges and waste. Perion then saw the opportunity to collect used batteries through its store network. The business is sufficiently profitable to pay \$1 for each used battery. It brings in an extra 30 million forints per annum (\$110,000) for the company.

The development and implementation of an environmental management system by **Tecon Salvador**, which owns and operates a container and cargo terminal in Northeast Brazil, allowed it to secure a major contract with a newly established plant. The contract which is equal to 10% of the terminal's total volume helped the company achieve an increased market share of 75%.

'Trade is better than aid. We will only be able to reduce social exclusion if we are granted access to markets.'

Luiz Furlan, chairman

Sadia, Brazil

Financial Times / IFC conference
May 2002

Local economic growth

Building linkages with local businesses and employing local residents is key to local economic development and can also increase revenue for the companies involved. A clear link has also been established between poverty reduction and business growth.²²

Hindustan Lever is the Indian subsidiary of the Unilever Group. In the early 1970s its dairy factory in the Etah district was operating at only 50% capacity and incurring significant losses because of inadequate milk supplies. In 1976 Hindustan Lever established an Integrated Rural Development Program. The program set out to help farmers increase milk production, by addressing a range of farming practices that could be improved. The company sponsored education and training in animal husbandry, the development of basic infrastructure and the establishment of village development committees. Beginning in six villages, the project area expanded to more than 400. Milk supplies to the factory increased significantly to meet its capacity and the dairy is now one of the company's most profitable units.

Providing tools for economic growth, such as microfinance and telecommunication facilities, can be a viable business.

Local SMEs themselves are involving their communities and finding innovative ways to grow sales. For example, **Kuapa Kokoo** in Ghana is a cooperative set up in 1993 by the farmers to buy their own cocoa and sell it on. In 1998 they partnered with Twin Trading, Christian Aid and others to start the Day Chocolate Company to launch their own chocolate brands – Divine and Double – internationally, through fair trade which allows them to charge a 10–20% premium. Approximately 1,000 tons of cocoa is sold to the European fair trade market. When it started, Kuapa Kokoo had 22 societies. In 1998 this figure rose to 160 and in the 1999–2000 season, Kuapa had 460 village society members and 35,000 farmer members while being operational in five cocoa growing regions.

Sustainability factor 2 Local economic growth

This factor is about how companies can share the benefits from their investment activity with local businesses or provide tools for economic growth to local communities. Companies can transfer skills and technology to local residents and businesses, use and pay fair prices to local suppliers, help develop and support local SME suppliers and service providers, and provide microfinance and telecommunications facilities to local communities. The factor is also about how local businesses themselves can develop and grow through community involvement and innovative business approaches.

Why it matters

Economic development is a key objective for emerging markets and local communities are the foundation for such development. Shrinking public sector budgets have greatly increased the importance of the private sector in the developing world, and the sharing of benefits has become a major development issue.

Changed circumstances have required owners and managers to reassess their responsibilities to all stakeholders, while still keeping the profit motive in mind. This process has led to the recognition that, beyond taxes paid to government, some project revenues must be retained within local communities.

Investment to support local economic growth ultimately leads to a better pool from which to staff the business, cheaper and more reliable supplies, improved reputation and a more affluent local consumer base. Failure to aid local development can result in resentment and hostility – negatively impacting on a company's license to operate.

Future trajectory

Concerns about the impact of businesses on local communities have been growing and will continue to do so as the globalization debate focuses attention on the ways wealth is generated and shared. Action by leadership companies will increase expectations and put pressure on others to follow. Equally, NGOs are working to ensure that businesses in emerging markets share the benefits of investment with local communities.

Box 6

Alternative business models

Traditional business models are preoccupied with delivering conventional products or services to other businesses or to relatively affluent consumers. New models break out of this straitjacket to deliver new kinds of products or services, in unconventional ways, to new markets, or with unconventional business structures.

There are three broad categories of alternative business models:

- Multinationals or other conventional businesses developing products or services specifically for the poor, e.g. **Deutsche Bank** introducing microcredit.²³
- Smaller producers finding ways to access the global market, often with premium products which bypass conventional distribution systems including organic and 'fair trade' products, eco-tourism and certified forest products.

- Social enterprises, not-for-profit organizations, cooperatives or other institutions developing innovative solutions that provide a social, environmental or economic benefit to the community. Examples include 'digital dividend' projects which bring telecommunications and internet access to poor communities and solar power projects which bring electricity and other services to off-grid communities.

These are financially viable solutions which often particularly benefit vulnerable groups who may otherwise be excluded from economic activity. Business benefits include finding market niches and being able to charge a premium for the products.

While many of these developments have emerged without official stimuli, supportive government policies will help to expand the opportunities, for example efforts by Kenyan farmers to sell organic produce have been hampered by a lack of government assistance in obtaining certification. Attempts by emerging market producers to enter new markets also need appropriate trading relationships and rules.

2.3 Reduce risk through engagement with stakeholders

The business case matrix		Sustainability Factors						
		Governance & engagement		Environmental focus		Socio-economic development		
		Governance & management	Stakeholder engagement	Environmental process improvement	Environmental products & services	Local economic growth	Community development	Human resource management
Business success factors	Revenue growth & market access							
	Cost savings & productivity							
	Access to capital							
	Risk management & license to operate							
	Human capital							
	Brand value & reputation							

Highlighting risk management & license to operate resulting from stakeholder engagement. Full matrix is on page 31.

What's in it for business?

Businesses can reduce financial, reputational and political risks by engaging with stakeholders. Understanding the concerns and interests of employees, customers, NGOs, politicians and business partners helps a company to manage environmental and social expectations better, resulting in reduced risk of civil action or brand assassination, improved access to capital and insurance, cost savings and reduced vulnerability to regulatory changes.

Risk is intrinsic to business and cannot be eliminated. But companies can improve their risk profiles for environmental and social performance by understanding the expectations of a broad spectrum of stakeholders. Engagement helps companies understand stakeholders' changing expectations and needs. It allows companies to keep a finger on the pulse of the general social and political environment and helps to identify issues which could become crises or simply lead to changes in the way a business operates.

Social and environmental problems can have serious impacts on financial performance and therefore on borrowers' ability to maintain interest payments and repay capital. They can also extend to the lenders' reputations, as institutions involved in controversial dam projects have discovered, or can generate specific financial liabilities if a borrower causes environmental damage and cannot meet its liabilities.

The evidence for risk reduction through engagement and transparency is strongest for larger companies because regulators, international stakeholders and local communities expect more of them, but also because of the sensitive sectors in which many of these companies operate (e.g. mineral extraction).

Stakeholder engagement

Stakeholder engagement is essential to increasing community understanding of business operations. Community understanding of private sector activity, sometimes called a 'local license to operate', can sometimes be a major factor in a firm's operations. Such acceptance can help with reputation and brand value, and failure to have such acceptance can raise operational and production risks, at times with very significant costs to the companies involved. As examples below indicate, this local license to operate — obtained through consultation and good relations with affected communities — is sometimes the license with the greatest impact on a company.

The global climate is such that companies are seen as obstructionist when it comes to matters of environmental impacts and social development. To combat the climate of suspicion and mistrust companies must engage with stakeholders to learn their concerns and expectations.

According to Saroj Datta, executive director, **Jet Airways**, 'India has become an extraordinarily suspicious society, which can only be corrected through greater transparency, and the acceptance and practice of corporate citizenship and social responsibility by all companies.'²⁴

Electropaz, a private Bolivian electricity distribution company serving the cities of La Paz and El Alto, decided to improve its distribution system. There was opposition from the community of El Alto to an existing high-tension tower whose conductors were running over their houses. Electropaz held several public meetings with the community and the municipal government and reached an agreement to re-route the transmission lines as well as to relocate the tower. Responding to community concerns by relocating project assets helped it build community acceptance and reduce the risks of future grievances.

'India has become an extraordinarily suspicious society, which can only be corrected through greater transparency, and the acceptance and practice of corporate citizenship and social responsibility by all companies.'
Saroj Datta, executive director
Jet Airways, India

The **Inka Terra** tourism company in Peru, which operates two small hotels near Machu Picchu and the Madre de Dios forest in Amazonia, engages with the local community, government, NGOs, academics and other stakeholders. It employs locals and works with scientists to preserve the extensive biodiversity of the surroundings, which include the world's greatest diversity of ant species in a single location and the largest known collection of native orchid species. With funding from the Global Environment Facility, the company is developing plans for working with local communities to generate alternative livelihoods to mining and logging. This has enabled the company to get longer land leases and licenses to expand. It also maintains the support of the local community.

The **Sarshatali** coal mining project in India's West Bengal region worked with local NGOs, community institutions and the district authorities to reverse rising levels of dissatisfaction with the project. Relationships with the eight communities in the area had suffered because of loss of income to the population following land acquisition by the mine owners, and the situation was made worse by delays in securing finance, which stalled the mine development. Working with the NGOs, government and community partners, and independent facilitators, the project rebuilt trust and negotiated a Memorandum of Understanding. Pilot projects worked on restoring income for those most affected by lost land, and longer-term development projects were also identified. Improved relations gave the company the confidence to proceed with design and early construction work, based on evidence that the risk of social tensions had been reduced.

Sustainability factor 3 Stakeholder engagement

Stakeholder engagement is about consulting with business and non-business stakeholders on key sustainability issues facing the company. Such engagement can take place in many ways, including open dialogue and consultation on environmental and social impacts, public reporting, and ultimately through the inclusion of business and social partners in business decision-making processes. Engagement is more than communication. It is a two-way process leading to shared learning between a company and its stakeholders.

Why it matters

For private sector development to be mutually advantageous to both shareholders and other stakeholders, transparent and frank consultation with affected groups is essential. Shareholders are informed through annual reports and can voice their opinions through their votes or by divesting their shares.

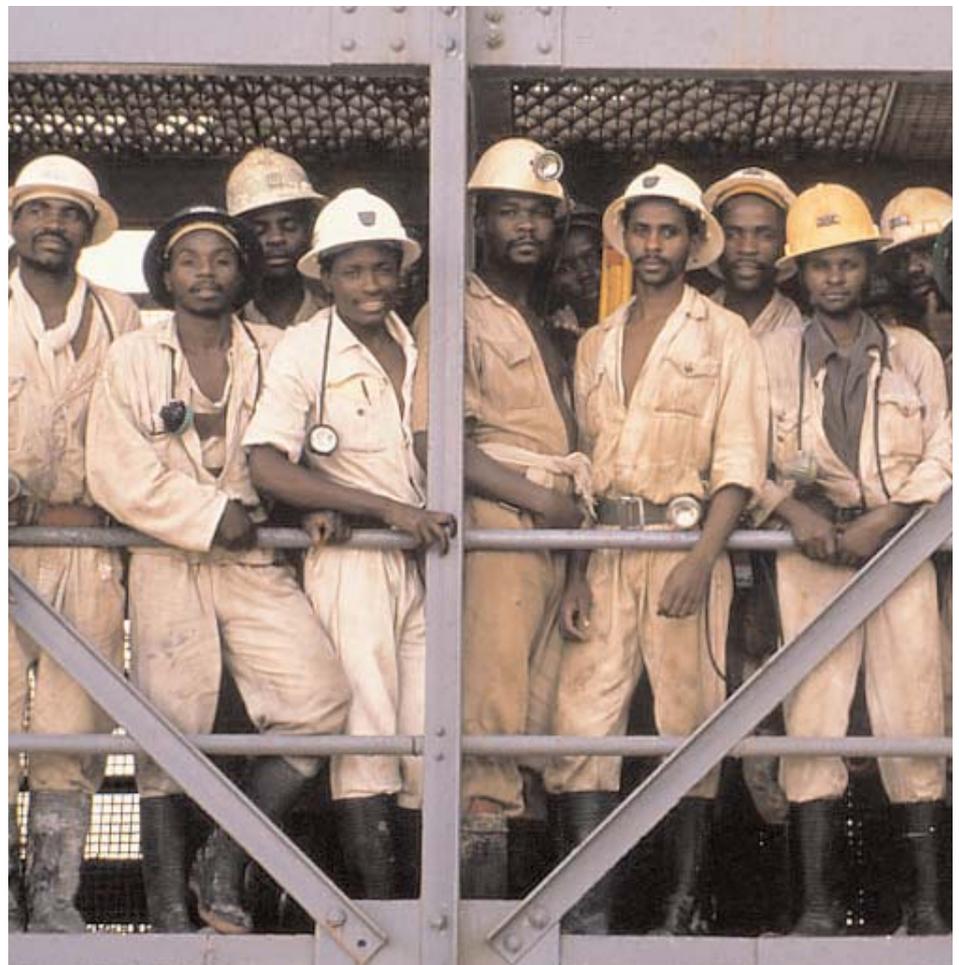
Other affected groups, for the most part, have no formal lever to change company actions or policies – although, as evidenced throughout this report, they can and do make their voices heard. Transparent and thorough engagement with stakeholders is a necessity for sustainable, win-win development outcomes for business and society.

Future trajectory

An increased level of transparency and honesty provided by companies is a key feature of stronger relationships. Expectations of increased business transparency have grown continuously in recent years, and the trajectory appears to be rising.

NGOs are becoming increasingly vociferous and other groups such as lenders and investors are also introducing risk management systems that include disclosure of environmental and social impacts and performance as key features. The importance of reporting on sustainability efforts is emphasized by many organizations such as the Global Reporting Initiative.

www.globalreporting.org



Copper miners, Zambia

2.4 Build reputation by increasing environmental efficiency

The business case matrix		Sustainability Factors						
		Governance & engagement		Environmental focus		Socio-economic development		
		Governance & management	Stakeholder engagement	Environmental process improvement	Environmental products & services	Local economic growth	Community development	Human resource management
Business success factors	Revenue growth & market access							
	Cost savings & productivity							
	Access to capital							
	Risk management & license to operate							
	Human capital							
	Brand value & reputation							

Highlighting brand value & reputation resulting from environmental process improvement. Full matrix is on page 31.

What's in it for business?

Brand value & reputation can be significantly enhanced by action which improves a company's environmental and social performance.

A company's reputation is intangible but it helps to build sales, attract capital and business partners, and recruit and retain workers. It can be separate from, but related to, brand image. And in emerging markets, where brands tend to be fairly weak, the brand owner's reputation can be a significant competitive factor. There are many components of reputation but sustainability is an increasingly significant factor for governments, NGOs, customers and investors.

Measurement of reputation is not as precise as for many components of business success, but it can be assessed through customer satisfaction surveys, public opinion polls and rankings in lists such as 'most admired companies'. Brand valuation methodologies are also becoming increasingly sophisticated and include tracking of a company's overall reputation. Another rough but easy proxy for brand value for quoted companies is the difference between the company's book value and its worth on the stock market.

Reputation is not an end in itself. It matters because it enhances the ability to attract capital – both human and financial – to mitigate risk and to build a company's license to operate. A good reputation also provides companies with what might be called a buffer zone – space to make mistakes without being attacked, as might happen if the company did not have the trust of stakeholders. This is important at a time when companies are still coming to grips with the sustainability agenda and when even leadership companies are far from perfect.

Environmental process improvements

We have found that reputation can benefit from improving environmental processes more than from other dimensions of sustainability. In fact a worldwide survey²⁵ found that environmental responsibility was the third most important expectation of companies, after provision of jobs and quality products.

Most of the evidence we found of improved reputation is in the form of companies receiving recognition and awards from organizations, governments, rating agencies or public surveys. While awards are not necessarily the best benchmarks for reputation and brand value, they are a reasonable proxy indicator. National companies saw the greatest reputational gain, and it held across most regions.

Jolyka Bolivia is the first South American producer of laminate and other tropical hardwood flooring products to be certified by FSC.²⁶ It sells to the US and Europe, where consumers are increasingly concerned about the sustainability of tropical wood. In 2000, Jolyka was one of the winners of the business plan competition for promising enterprises that incorporate social and environmental benefits held by New Ventures, a World Resources Institute program. This brought direct reputational benefits, including coverage in the media as a viable, dependable and 'green' company. It also helped to raise new capital as in the following six months Jolyka was visited by four investors and has renegotiated \$2 million in long-term debt finance.

Girsa, a Mexican chemical company, has invested more than \$20 million in environmental efficiency improvements, including the capture and use of energy generated in the carbon black process, which yielded \$30 million in savings and has substantially reduced emissions and waste. From 1991 to 1998, carbon dioxide emissions and wastewater per ton of production were cut by more than 80%, and solid waste per ton of production reduced by more than 90%. The net income as a percentage of sales was improved drastically. The plant has gone from being a major source of controversy in the community to a model corporate citizen that locals are proud of. It has won numerous accolades for its performance at national and international levels, including the Mexican Environment Ministry's National Quality Award in 1997 and the National Award for Ecological Merit in 1999.



Textile printing, Bangladesh

Buried Treasure found that in developed countries brand value & reputation had the strongest link to a company's sustainability efforts – even more than cost savings and revenue growth. This suggests differences in perception between developed and developing countries. It could be explained by some companies in emerging markets still concentrating on basic business survival, rather than being concerned about reputation or brand value. Or it could stem from the fact that brands are more established in developed countries and receive greater management and investment. Either way, it suggests that as emerging markets develop, companies are likely to see an upsurge of interest in brands and should even now be building this into their strategies.

Nevertheless, in emerging markets a company's brand may be tied into the owner's reputation, and may sometimes become synonymous with its sustainability deeds. In India, the name Tata is associated with a professionally run, respected company that has cared for its employees and neighboring communities while making excellent products.²⁷ The company invested in its employees and community and its reputation as a social and ethical company spread through word of mouth. In fact, the **Tata Iron and Steel Company (TISCO)** had gained enough recognition for its social deeds that it could run a television advertisement showing investment in social project like schools and sports, with the catchline, 'We also make steel.'



Recyclable adobe bricks, Cuzco, Peru

Zimele, Anglo American South Africa



Stimela Rail, railway maintenance company supported by Zimele



Anglo American is a South Africa-based global mining and natural resources company, with operations and developments in Africa,

Europe, the Americas and Australia. It has a long record of support for disadvantaged black communities in South Africa.

One aspect of this is now known as Zimele, a Zulu/Xhosa word which means independence, in the sense of standing on your own two feet and making your own way in the world.

The name is appropriate because the unit exists to invest in SMEs. It has emerged from a concern with unemployment, and now operates as a self-sustaining venture capital unit within the Anglo group.

Economic initiatives

The unit exists specifically to build local economies, especially black communities, by helping to expand the small business sector. As well as being open to approaches from any entrepreneur looking for backing, each Anglo division has a Zimele business development manager who looks for opportunities to invest in new businesses which can supply products or services the division may want to outsource.

Dr Lia Vangelatos, Zimele's senior business development manager, says the aim is to create sustainable businesses, not to hand out charity: 'The businesses we back have to be viable. The entrepreneurs may not have the skills or sophistication but they have to be passionate about their projects and committed to making money.'

Ventures have ranged from catering to lighting, and even include a banana farming business. Examples include Envirolight, which manufactures energy-efficient lighting units for both the mining and housing sectors, and Surmap Services, created to produce high quality maps using the latest photogrammetric technology.

Zimele takes a minority equity stake and may make loans to the businesses it backs. Crucially it also takes a seat on the board and continues to support the new entrepreneurs. It can also call on the skills of Anglo's managers – from information technology to mining expertise – and makes sure these new businesses adopt the high standards of health and safety which Anglo subscribes to.

'It is a hand-holding approach. We are not there to run their business but we are close behind, and that makes a difference,' Dr Vangelatos said. She distinguishes this from what she calls 'balance sheet support' – providing finance without the necessary management support, and without giving the recipients an equity stake in the business.

Originally support was aimed at micro-enterprises but now the targets are bigger, which led to the formalization of Zimele as a self-sufficient business unit in 2000, with 15 million rand (\$1.5 million) to invest. It is not a profit center, but is expected to cover costs, and did so in 2001 – the first year after being established formally as a separate operation. 'The message is invest it but don't lose it,' Dr Vangelatos said.

This is an intensive support operation, so there are only six to eight deals a year, but they can now be companies aiming for initial revenues of as much as 40 million rand (\$4 million).

Early in 2002 the operation had investments in 22 companies which together provided work for 1,300 people and had revenues of 145 million rand (\$15 million).

Benefits and challenges

Apart from the general benefits from helping to build – and being seen to build – a more vibrant economy, the Zimele operation also meshes with Anglo's policy of outsourcing many non-core operations. It means there are reliable, viable, local businesses which can become suppliers to the group with more fruitful and trusting relationships than would be the case with outsourcing based solely on price.

Zimele has some important advice for other companies wanting to follow this community investment path. It believes entrepreneurs should put in some capital themselves so they will have a serious stake in the business. But Dr Vangelatos also cautioned that this is not a get-rich-quick option, either for the entrepreneurs or for their backers. 'There are no shortcuts. You have to build the networks, roll up your sleeves and get involved,' she said.



Cembrit factory



Addressing environmental and social issues early on can often boost both the profitability and the environmental and social

benefits of private sector investments.

Cembrit, whose modernization program IFC helped finance through a \$5 million loan in 1995, is a producer of building materials in the Czech Republic. The experience of this company illustrates the practicality of a sustainable approach. Cembrit is a relatively small company, employing fewer than 400 people in two factories. But with the aid of external finance and expertise from IFC and its new owner it has penetrated new markets in Europe, as well as helped to clean up the local neighborhoods.

In the early 1990s the Czech government announced it would prohibit the use of asbestos materials in line with the trend throughout the European Union (EU). Such legislation would have shut down the formerly state-owned plant. But Cembrit began to address the regulatory requirements – including those of the EU.

The focus of the \$15 million project was switching from a hazardous, asbestos-based production process for making roofing materials to an environmentally sound cellulose-based process. The project also facilitated an extensive environmental clean-up, including the safe and proper decommissioning of the asbestos cement operations.

Cembrit was then able to expand its operations through exporting to the EU and other markets which had previously not been accessible. Although the original business plan projected that only 20% of production would be exported, today exports exceed 50%.

Mr Bubla, managing director, comments, 'The biggest benefit of our proactive approach was a new opportunity to start selling goods to attractive Western European markets. The asbestos ban had taken place there, and the new technology was the only possibility of exploiting these markets. Sales in 2000 were \$17 million, a 22% increase over the previous year and more than double what they were in 1996. Exports now account for more than half total sales, whereas previously it was impossible to export to Western Europe because of environmental regulations. We would not be in business today without these changes, so the benefits were tremendous.'

Following the success of the initial program, Cembrit has made further environmental and social investments as part of a long-term sustainability strategy. In 2002, Cembrit became ISO 14001 certified. This is in line with its commitment to continuous environmental improvements.

Business benefits

If asbestos had not been eliminated the company would have shut down. But by proactively addressing future regulatory requirements it has built competitive advantage, which has resulted in expansion, despite intense competition.

'The whole purpose of the exercise was to get ahead of competition and conquer new markets,' Mr Bubla confirmed. Access to markets has been the key element, but this opportunity would not have been grasped effectively without adequate finance, motivated and well-trained staff, and that has been another benefit from the sustainability approach.

The managing director is convinced: 'The investment allowed us access to both financial and human capital. Our employees became more motivated working in a healthier environment. Productivity has more than doubled since 1996 with the same number of employees. The company has a very low staff turnover in an area where unemployment is under 5%.'

Social and environmental benefits

In addition, the modernization resulted in many benefits to human health and environmental quality. The immediate benefit has been the removal of hazardous asbestos, which has enhanced life expectancy and reduced negative health impacts on workers and the local population. By converting from coal to gas-oil fuel, the plant reduced air emissions almost 100% and made a cleaner source of energy available to local neighborhoods. By constructing a pre-treatment facility and connecting to the municipal sewage system, the project stopped the discharge of untreated liquid effluent into the Berounka River.

The prosperity of Cembrit has also helped the local economy, indirectly as well as directly through wages of the employees. A third of the company's suppliers are local and they have benefited from Cembrit's growth through winning more orders. Local businesses such as suppliers of pigments and spare parts have seen \$3 million in incremental sales per year.

2.5 Develop human capital through better human resource management

The business case matrix		Sustainability Factors						
		Governance & engagement		Environmental focus		Socio-economic development		
		Governance & management	Stakeholder engagement	Environmental process improvement	Environmental products & services	Local economic growth	Community development	Human resource management
Business success factors	Revenue growth & market access							
	Cost savings & productivity							
	Access to capital							
	Risk management & income to operate							
	Human capital							
	Brand value & reputation							

Highlighting human capital resulting from human resource management. Full matrix is on page 31.

What's in it for business?

Human capital means the knowledge, skills, motivation, health and empowerment of workers. A quality workforce is critical for key aspects of competitiveness such as productivity, product quality and innovation. This applies in emerging markets even though in many cases there may be a large pool of available workers. The key is finding the right people and motivating them, and there are often shortages of the right people for the job – from contract labor to managers. Mistakes cost money to rectify, while committed workers can be invaluable in achieving required quality levels and boosting innovation.

Health issues in the developing world, particularly HIV/AIDS and other infectious diseases, are pressing areas of concern for human capital. An unhealthy workforce can lead to increased absenteeism, loss of trained employees and high costs for replacement and training.

Better human resource management

Effective human resource management can improve the quality of the workforce by setting the right policies and practices. Aspects include good working conditions, paying what are seen as fair wages and appropriate benefits, training and development, and ensuring equal opportunities regardless of gender, race, religious persuasion or other factors. We found all types of company benefiting from this opportunity, especially in Latin America and Sub-Saharan Africa.

A recent study in India²⁸ covering 52,000 employees in more than 200 companies across 15 industries found a correlation between employment practices and financial returns. The best employers showed growth in return on capital employed despite most sectors recording negative returns in the period. According to the study, 'Indian CEOs are more than aware that they now handle a global talent pool. While the labor cost-advantage has eroded gradually, the biggest challenge for CEOs is to retain people and manage career aspirations, whether through motivation or training.'

The same organization also did a survey of the *Best Employers in Asia*,²⁹ in which the CEOs of the top 20 companies stressed the importance of people as key to their success. The CEOs also described acquiring and training talent as one of the main issues facing their business. They believe that employees are attracted to and stay with their companies because of learning and development opportunities, company image and culture, and the workplace itself.

Fernando Capellán, founder and president of the Dominican Republic company **Grupo M**, says, 'We have proven that you don't have to run a factory like a sweatshop in order to be profitable and to grow. We believe that we have been able to innovate, to expand, and to do what we have done because of the way that we treat our people. Everything that we give to our workers gets returned to us in terms of efficiency, quality, loyalty, and innovation. It's just smart business.'³⁰

The company operates 26 textile factories in the country and has become the country's largest private employer with 13,000 workers. It started providing better working conditions due to the requirement of its buyer, Levi-Strauss, but then progressed even further. The company provides subsidized transport, day care centers, medical and dental services for employees and their families, training at various levels, and pays wages of roughly 1,000 pesos a week – well above the country's minimum wage of 555 pesos a week. While apparel makers in countries like Honduras and China have lower labor costs, Grupo M can compete because its workers produce more goods of higher quality.

Opportunities exist for smaller companies as well as multinationals or large national businesses. **LMC Enterprises**, an auto parts dealership in India, found benefits included a high retention rate and productivity from providing perks like paid holidays and medical help to its employees. According to the owner-manager, Ashish Jain, 'People drive a business and a focus on human relations is key.'

'Everything that we give to our workers gets returned to us in terms of efficiency, quality, loyalty, and innovation. It's just smart business.'
Fernando Capellán, founder & president
Grupo M, Dominican Republic

Alexandria Carbon Black (ACB) is Egypt's only carbon black producer and with 400 employees also a major employer. Mr K N Agarwal, the managing director, says ACB's phenomenal growth is linked to staff enthusiasm and his company's excellent reputation in the community. 'We are the fastest growing carbon black company in the world. You cannot increase production this rapidly unless your workforce is behind you and you have trust from the community you are operating in and the partners you are working with. If you work in an emerging market context you have to think very differently. To attract the best talent available in the country, you have to create a clean, green and healthy environment and an atmosphere where the people would like to work and grow, which is extremely important for improving the bottom line of the company. Then, through commitment to training and empowerment of local staff, you have to improve morale to improve productivity and increase efficiency. Then, you can develop and grow.'

Sustainability factor 4
Human resource management

Human resource management is concerned with the conditions under which employees work, the benefits afforded by their employment and their opportunities for development. Indicators of the degree to which a company considers human resource management a priority include the safety and cleanliness of the workplace, the provision of health care for employees and their families, the existence of policies to address issues such as freedom of association, forced/child labor and discrimination, and the availability of training and development opportunities for employees.

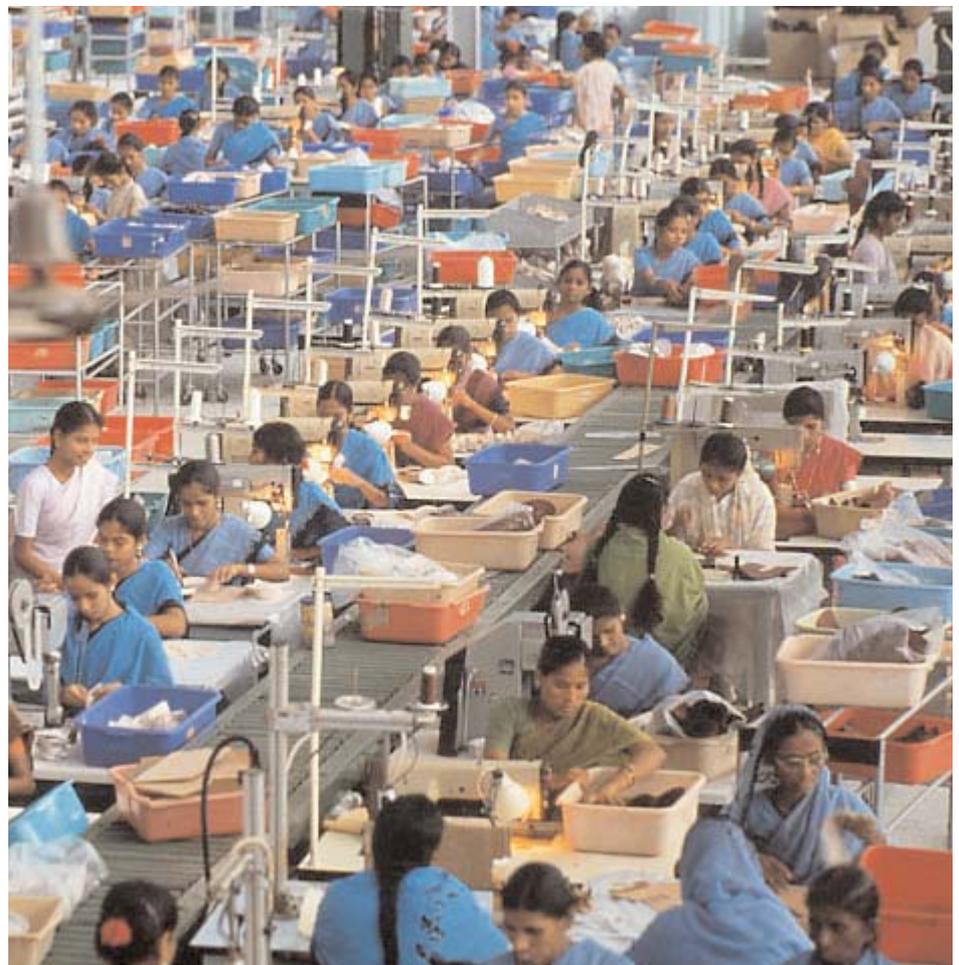
Why it matters

Companies' most basic and fundamental impact is through employment. Employment opportunities offering a safe, high-quality work environment, technical training, education or medical care make important contributions to reducing poverty and improving the quality of peoples' lives.

Future trajectory

Labor conditions have been rising up the international agenda for several years, and will continue to do so. The International Labour Organization has sought to raise the profile of what it terms the 'core labor standards'. These include prohibitions against forced labor, the worst forms of child labor and discrimination and the right to freedom of association and to bargain collectively.

NGOs and trade unions, internationally and locally, are also seeking to ensure minimum conditions are adhered to, through standards such as SA8000 (see Box 5, page 13). Consumers around the world are also sometimes boycotting company products that are believed to be produced using forced labor or in 'sweatshops'.



Clothing factory, India

2.6 Improve access to capital through better governance

The business case matrix	Sustainability Factors							
	Governance & engagement		Environmental focus		Socio-economic development			
	Governance & management	Stakeholder engagement	Environmental process improvement	Environmental products & services	Local economic growth	Community development	Human resource management	
Business success factors	Revenue growth & market access							
	Cost savings & productivity							
	Access to capital							
	Risk management (in income to operate)							
	Human capital							
	Brand value & reputation							

Highlighting access to capital resulting from governance & management. Full matrix is on page 31

'We believe we can gain a competitive advantage by going beyond generally accepted corporate governance standards.'
Zarir Cama, chief executive
HSBC, India
Centre for Social Markets conference
December 2001

What's in it for business?

Demonstrating that governance structures and management systems are designed to encourage attention to sustainability issues can help companies raise capital at attractive rates. Access to capital is critical for any company wanting to invest and grow, but it can be a serious constraint in emerging markets where equity is typically in short supply, and debt can be expensive and difficult to obtain except on a short-term basis.

Restricted access to capital is an even more important constraint in the present business environment in developing countries, with an economic slowdown, sharp decline in long-term fixed investment, low long-term debt flows and the retreat of many strategic investors. Sustainability action provides several opportunities to unlock capital:

- High standards of corporate governance reassure lenders and investors that the board is properly constituted, that shareholder and stakeholder rights are respected and that the highest standards of transparency and disclosure are maintained.
- Financial institutions are increasingly likely to require evidence of sound management of environmental and social issues as a condition of any deal.
- Since the cost of capital is driven by perceived risk, companies which can demonstrate good relations with stakeholders will reassure investors about potential volatility and should benefit through lower rates.
- Some specialist funds are available specifically for products or projects which will enhance sustainable development (see Box 11, page 49).
- Ultimately sustainability action is likely to enhance shareholder value for all the reasons covered in this report, which naturally improves a company's ability to raise all forms of capital.

Governance & management

We found evidence of opportunities to improve access to capital linked to all seven sustainability factors, although no one factor stood out as having a particularly strong link.³¹ The strongest evidence is connected to governance & management.

On the other hand, poor governance and a lack of transparency (implicated in the Asian financial crisis which hit many businesses in the region) is still a cause for concern. One prominent investor survey by McKinsey has demonstrated that international investors have been unhappy about the slow progress of corporate governance reform in emerging markets.³²

We found that enhanced access to capital through sustainability activities was particularly relevant for the larger national and multinational companies.

The **Bank of Shanghai** in China has attracted international investment after bringing its management and corporate governance up to international standards for commercial banks. In December 2001, HSBC signed an agreement to acquire an 8% equity stake in the Bank of Shanghai for approximately \$63 million (see page 9).

In El Salvador, **Banco Cuscatlan** obtained a credit line from IFC for on-lending to SMEs. It subsequently moved beyond IFC's minimum requirements for the specific credit line and started expanding environmental reviews to its entire portfolio and to all new commercial projects, enhancing its reputation as an environmental pioneer in that country. As a result, Cuscatlan has improved its ability to access long-term funding from multilateral and bilateral organizations. The fact that Cuscatlan has an environmental management system has helped to secure a credit line from Netherlands Development Finance Company (FMO).

There is also evidence of the negative impact of inadequate governance. **Samsung**, the South Korean electronics company, has battled to convince investors that its corporate governance is sound. Yet one financial analyst has estimated that poor governance represents a price drag of as much as 50% on Samsung stock. Hasung Jang, a shareholder rights activist and economist at Seoul's Korea University, has commented, 'Investors question [Samsung's] corporate governance. That's why its shares are so seriously devalued, compared to its US and even Taiwanese competitors.'³³

The **Itaú Bank** in Brazil has recently upgraded its corporate governance practices by extending 'tag-along rights' to its non-voting shareholders. This rare move in Brazil means that in the case of a sale of the company, the minority shareholders with non-voting shares would receive the same price as the controlling shareholder. The company's share price rose nearly 7% in the two days following the decision. The Itaú Bank is also among the first companies in Brazil adhering to the 'Special Corporate Governance Level 1' of BOVESPA, the São Paulo Stock Exchange. Its shares have been promoted to the most highly valued stock in the banking sector. The Itaú Bank also has the highest corporate market value in Latin America, close to \$20 billion.³⁴

Even for smaller companies starting along the sustainability path, specific investors are emerging. **A2R** in Brazil provides investment funds for financing environmental projects. Its Terra Capital private equity environmental fund can finance environmental projects with biodiversity benefits in areas including organic agriculture, non-timber forest products, fish farming and eco-tourism. Terra Capital was launched with an initiating investment from IFC and complimentary grant funding from the Global Environment Facility and includes additional capital mobilized from the Inter-American Development Bank, the Swiss government and private investors.

E+Co was established in 1994 with funding from the Rockefeller Foundation as an independent not-for-profit company focused on, 'Bringing together technology, people and funding to create viable local enterprises that deliver affordable and clean energy to those in need'. It has provided \$9.3 million in seed capital to 77 local clean energy enterprises in 34 countries in Africa, Asia and Latin America, e.g. 12 Rural Energy Service Companies (RESCOs) that serve more than 31,000 previously unelectrified households in Bangladesh, Brazil, Costa Rica, Dominican Republic, El Salvador, Gambia, Honduras, India, Lesotho, Morocco, Nepal, South Africa and Vietnam.

Sustainability factor 5 **Governance & management**

This factor focuses on the management systems which underpin a company's sustainability performance, as well as its governance structures.

It is about setting in place systems and processes that make a company more accountable to shareholders and other stakeholders. It covers the inclusion of sustainability concerns in mission statements, business principles, values and ethics, codes of conduct including policies on bribery and corruption and human rights, financial and sustainability transparency, reporting and audit. It is important that the management systems incorporate structures and responsibilities for sustainability issues at the highest levels within the company and align incentives and pay systems with this commitment. It also ensures alignment between a company's government-related activities and its sustainability principles.

Why does it matter?

A company's management systems and processes are the first steps to improved financial, social and environmental performance. They allow companies to plan, monitor and manage key issues with better control. Environmental and social management certification schemes such as ISO 14001 and SA8000 are often used by investors, as well as customers and civil society, as a proxy for the company's commitment to good environmental processes or good labor force management.

Future trajectory

Pressure on companies to improve governance & management, as well as the benefits to companies in terms of access to capital is increasing. This is reflected in initiatives from organizations like the World Bank and OECD to foster the development of appropriate national corporate governance frameworks.³⁵ With the increased scrutiny, the number of companies gaining certification of their environmental and social management is also increasing (see Box 5, page 13). This trend is likely to continue as companies begin to compete for markets and access to capital.

Box 7 **Corporate governance: building stakeholder trust**

Corporate governance is the 'system by which companies are directed and controlled'.³⁶ It is about improving the governance structures and processes of companies to improve their performance and make them more accountable to shareholders and other stakeholders. It covers issues such as the structure and operation of the board of directors, financial reporting, transparency and audit, separation of powers and minority shareholders' rights.

In emerging markets, where family firms undertake much of the business activity, the main divergence of interests is most often between the family shareholders and the external minority shareholders. In emerging markets the quality of corporate governance has become widely recognized as crucial. Weak corporate governance leads to what can be described as a general 'corporate governance discount'³⁷ which reduces foreign investment and capital flows to developing economies.

An increased international awareness is reflected in a growing number of initiatives from organizations like the World Bank and OECD to foster the development of appropriate national corporate governance frameworks.³⁸

The work of the King Committee in South Africa is groundbreaking and has led to a significant improvement of local corporate governance practices among listed companies. The committee suggests that corporate boards in South Africa should actively solicit and take into consideration feedback received from stakeholder groups other than shareholders.³⁹

In Brazil the initiative has been taken by BOVESPA (the São Paulo Stock Exchange). BOVESPA created the 'Novo Mercado' (New Market) in 2000, a voluntary approach to improving corporate governance standards. Companies that choose to list on the Novo Mercado commit themselves to following a stricter set of rules, including equal rights for all shareholders, higher standards of disclosure with annual reports, and improved procedures for election of the board of directors.

2.7 Other opportunities from community development and environmental products

The business case matrix		Sustainability Factors						
		Governance & engagement		Environmental focus		Socio-economic development		
		Governance & management	Stakeholder engagement	Environmental process improvement	Environmental products & services	Local economic growth	Community development	Human resource management
Business success factors	Revenue growth & market access							
	Cost savings & productivity							
	Access to capital							
	Risk management in income to operate							
	Human capital							
Brand value & reputation								

Highlighting opportunities from environmental products & services and community development. Full matrix is on page 31.

The previous sections have highlighted the business opportunities for which we have found the strongest evidence. But other opportunities exist to bring value to both business and society, although the evidence is weaker. In this section we examine two of these areas – community development and environmental products & services.

Community development activity has a strong tradition based on philanthropy⁴⁰ and has often been the starting point for business sustainability in emerging markets. At the other end of the spectrum, environmental products & services are often part of a new business model, with the entire strategy based on environmental superiority going beyond just technology and encompassing the whole life cycle of the product – from raw material to disposal.

Community development

Companies have for some time recognized the need to ensure surrounding communities develop as a result of setting up a company's operation, for example by the building of schools, hospitals, roads or water facilities. What began as philanthropic gestures made to aid pet causes have since evolved into targeted interventions to address fundamental community needs and assist business objectives. This is not to say that company owners and executives do not still fund their special interests or make philanthropic contributions – only to point out that many businesses have recognized the strategic importance of community development and have exploited the opportunities that exist to improve their overall performance. Brand value & reputation benefits most from community development, but we found benefits in all the business success factors, especially revenue generation.

The creation of special community development departments and/or foundations by many companies, particularly those in the extractive industries, has permitted the scaling up of strategic actions designed to optimize positive returns for both the community and the business.

There is also evidence of community development helping to reduce costs as well as risk. For example, where there are large mining or exploration projects that may displace people and adversely affect their livelihoods, companies that work to affect local social and economic development positively may find it easier to win a local license to operate and to reduced delays and contain the costs of the project.

In Mozambique the \$1 billion aluminum smelter, **Mozal**, helped the government to manage the resettlement of people occupying the area specified by the government for the Beluluane Industrial Park, on which Mozal would be the anchor tenant. Mozal used its own and third party resources to help provide housing and replacement farmland in order to comply with IFC and World Bank standards regarding resettlement. It also supported the relocated people with agricultural know-how, seed and fertilizers, while its fully funded Community Development Trust provided further support including marketing support for agricultural commodities. This helped raise local income levels and provided support to the wider community in the form of projects covering infrastructure, education, sport, culture, health and small business development. IFC is working with Mozal to develop and implement social responses to AIDS-related issues and malaria. This has helped Mozal maintain its local license to operate as well as build good community relations.

Environmental products & services

There is a growing market for products and services that provide environmental benefits. It includes niche markets for environmental infrastructure and pollution abatement technologies, such as water supply, waste management, soil remediation, air and water pollution control, and other established environmental technologies. A distinct niche focuses on the growing demand for eco-efficiency, including industrial products and know-how which reduce the use of energy, water and other resources in production processes. There are also green niches of established industries that provide alternative ways of meeting market needs, such as renewable energy, sustainable agriculture, forestry and fisheries, and eco-tourism.



Teapickers, Sri Lanka

Products and services based on environmental considerations – from the raw material extraction to disposal – potentially command a price premium while also catering to the needs of specific target markets.

Creating an environmental product or service needs to be based on a coherent strategy which will embrace a company's entire operations and possibly business partners. In some cases such a strategy has been adopted by small enterprises following new business models that explore new opportunities and needs of customers around the world (see Box 6, page 13).

Emerging markets have specific advantages over developed countries in building alternative product and service markets. For example, countries can leapfrog stages of technology – in power, moving straight to off-grid renewable energy without ever having polluting power generation plants. Vast forests and concentrations of biodiversity represent natural capital not available in most developed countries, which may become valuable as carbon sinks, watershed protectors or the research laboratory for bioprospectors that developing countries are beginning to generate.

Eco-tourism opportunities in developing countries clearly offer an experience that is simply not available in the developed world. Eco-tourism – responsible travel to natural areas that conserves the environment and sustains the well-being of local people – is growing at almost 30% a year, compared with the 4% growth of general tourism. Eco-tourists are also found to be willing to pay more than the standard traveler.⁴¹

The **Conservation Corporation Africa** operates 27 lodges and camps in safari locations spanning six countries – including South Africa, Zimbabwe, Kenya and Tanzania. It is Africa's largest eco-tourism group, employing approximately 3,000 people. Since the early 1980s, the company has successfully raised equity from overseas investors by stressing the social responsibility of its operations. Much of this foreign-generated capital has gone into the construction of four lodges at the 30,000 hectare Phinda Game Reserve, in the southern part of Maputaland in KwaZulu-Natal, one of the most biologically diverse areas of the country.

Sustainability factor 6 **Community development**

Companies can go beyond economic growth in a community and support it through provision of health, education, water and sanitation, helping fight corruption and upholding indigenous and human rights. Support can be in the form of financial contributions or staff time and expertise. Companies may also seek to mitigate their potential negative impacts, including the siting of operations, security arrangements and relations with local government.

Why it matters

In many emerging markets the services, structures and human capital necessary for healthy communities may be absent to some extent. Local and national governments may not always be able to provide basic services such as clean water and power. Access to medical care and education may also be limited. Local populations may not have the skills and experience necessary to establish and run civil society organizations.

Without such important elements of infrastructure and human capital, communities will be unable to provide the environment necessary for people to achieve their potential. Helping to ensure amenities are available to the community creates opportunities for social and economic development.

This kind of business support will help to build positive relationships, enhance companies' reputations and provide a suitable environment for business success. In many settings such support has come to be expected of companies and in many cases the companies themselves do not consider community development an option but rather a necessity for doing business.

Future trajectory

As long as governments continue to lack resources or capacity to supply infrastructure and services for community development, the expectations regarding the role of business in this area will remain high. Companies which have embraced community development have found it to be a highly effective means of improving business prospects.⁴²

Box 8

The business case – private provision of public goods

The private provision of public goods, such as infrastructure and health care, is unique in making the business case for sustainability. Not only do they enhance the providers' bottom line, but the spill-over effects of the public good can be substantial. IFC's experience in these sectors demonstrates how business efficiency promotes sustainability. While economic and financial objectives are usually the prime motivation for transferring public services such as railways, ports or water supply to the private sector, there can also be significant environmental and social spin-offs.

The provision of public goods by private providers in emerging markets can deliver improved efficiency as a result of fewer resources being used to deliver the same service or the service being expanded without extra resources. Further, the benefits of the expanded service or production can spread well beyond the project, leading to greater opportunities for employment as well as community development.

New jobs may be created in the expanded service, or often in the new small businesses set up to support the community. For example, the investment plan of a water concession in Latin America has created jobs for 15,000 small contractors. Throughout Latin America, affordable basic water services have been extended to all population groups. Access to clean water and power has also made it possible for schools, health clinics and small businesses to be set up in poorer neighborhoods. The installation of sewage networks in some poorer communities is an example of how companies have demonstrated their high level of community interaction.

Private investment in clean water and wastewater treatment can also have important social spin-offs. Firstly, improved sewage collection and treatment reverses the trend of environmental degradation of surface water and public health problems caused by lack of sanitation. Secondly, actions taken to reduce water losses from the system help to conserve underground water resources. Finally, easy access to clean water can mean that girls can go to school rather than standing in line to collect water.

The organic food market demonstrates the potential of environmental products. In Austria and Switzerland, organic products represent as much as 10% of the food market, while the US, France, Japan and Singapore are experiencing growth rates that exceed 20% annually. This is a major opportunity, and emerging market suppliers can command premiums as high as 20% in these markets.

Café Mesa de los Santos is among the largest producers and exporters of organic coffee in Colombia. Its target market is North America, where the demand for organic coffee is increasing 15% annually. In 1999, the company produced more than 2% of all specialty coffee consumed in North America, and there are plans to expand to Japan and Europe. Its coffee is sold at the highest price paid in the marketplace.

Similarly, the São Francisco mill in Brazil produces an organic sugar called **Native**, which commands a premium of 60% over common sugar. Sold in 24 countries, with annual revenues of \$5 million, Native is one of the largest producers of organic sugar in the world. As well as earning a price premium, the sugar costs less to produce than the common product because of cost savings from productivity improvements and savings from the non-use of chemicals.

Vilniaus Bankas (VB), established in 1990, is the largest and most profitable private bank in Lithuania and second largest bank in the Baltics. VB is the dominant player in foreign trade financing, corporate, investment and e-banking. It has adopted a proactive strategy on environmental issues by building up a small portfolio of environmental investment loans as well as integrating environmental risks into its credit appraisal systems. Several of the bank's corporate and SME borrowers face significant environmental challenges, particularly as Lithuania has adopted EU environmental standards. VB identifies and tracks these issues and has provided project finance for the necessary capital expenditure programs, often as a co-financier with the State Environmental Fund. These pilot environmental investment loans are adapted to the Lithuanian economy, dominated by small processing plants and trade, and the products have been in demand mostly for upgrades of heating systems, ISO 14001, and dairy farming. VB expects the demand to increase with EU integration.

Sustainability factor 7 **Environmental products & services**

Analyzing environmental impacts throughout the life of products and services – from raw material extraction through to disposal – is recognized as increasingly important. Though much focus is placed on production processes, impacts that take place during the 'use' and 'disposal' phase can be very significant (for example in the case of cars the environmental impacts of their use far outweigh those associated with their production). Product stewardship, or embedding environmental principles in its products and/or services, can help reduce the overall impact of a product.

Why it matters

As pollution from 'point' sources such as factories is addressed, a growing component of the overall load on natural resources comes from 'diffuse' sources, associated mainly with the use or disposal of products.

Companies that think proactively about these issues and ensure that products and services are designed with the entire life-cycle in mind are likely to avoid the negative impacts and potential costs of remediation or compensation, as well as reputational damage. Such products may also be able to attract a premium by legitimately claiming to be environmentally friendly.

Future trajectory

The focus of sustainability has shifted slowly from process improvements to products and services and this is likely to sharpen further as international efforts intensify to combat climate change and improve the impact of business on society. The development of environmental products and services by new businesses will present competition to existing suppliers which will also intensify activity in this area. Emerging markets are likely to continue to play an important role in the development of these markets.



Wind farm, India



Natura laboratory



Natura, formed in 1969, sells cosmetics, personal hygiene products, perfumes and nutritional supplements throughout Latin America.

Sales in 2001 were 1.66 billion reais (\$630 million), an increase of 14% over the previous year. At the beginning of 2002 Natura employed 3,100 people directly, and had 286,000 sales consultants in Brazil.

Natura believes that investing in the quality of all its relationships is fundamental to creating a united enterprise, attracting and maintaining professional talent, establishing constructive dialog with communities and achieving consistent economic results.

In 2000 it became a signatory to the UN Global Compact and also began to produce an annual 'balanço social' (corporate social responsibility report) in accordance with the Global Reporting Initiative guidelines. Natura works hard on sustainability with its own workforce and in its supply chain.

There is an initial induction process for each employee in which the beliefs, values and objectives of the company are explained. Suppliers are visited at least six times per year by quality assurance staff. They monitor economic performance, compliance with labor laws, health and safety, and working conditions.

Environmental initiatives

The Natura Ekos line of hygiene and beauty products was launched in 2000, based on natural Brazilian flora extracted in a sustainable manner by local people. In partnership with Imaflora, an NGO which operates on FSC principles, Natura has also certified floral assets to guarantee that they are extracted in a sustainable manner.

Other environmental initiatives include supporting environmental restoration projects in the 650 hectare Fazenda Bulcão and of the Pomar project which promotes restoration of polluted areas on the banks of the Pinheiros River. Natura also partners with TV Culture, the public broadcasting station of São Paulo, on the Biodiversity Brazil project which includes production of documentaries and other programs about biodiversity in Brazil.

Social initiatives

Natura's Social Action Management identifies and develops social projects. For example, since 2000 product labels are printed at Laramara, an institution which cares for visually impaired people.

The company has also developed a program with the Abrinq Foundation, an NGO that promotes the rights of the child, called 'Seeing is Believing'. The proceeds from a line of special products support the development of educational projects involving 3,600 schools and 768,000 children in Brazil. A total of 9 million reais (\$3.4 million) has been invested since the beginning of the program in 1995.

An amount equal to 10% of shareholder's dividends is invested in social programs each year.

Business benefits

Natura believes it has benefited from:

- increased skills and motivation (human capital);
- improved ability to attract and keep employees;
- increased brand value & reputation, demonstrated by a high ranking in assessments by Ethos and the *Good Citizenship Guide*, prepared by *Exame* and *Carta Capital* magazines;
- consumer loyalty and willingness to pay a price premium – an annual study of Natura consumers has found that the company's social responsibility is regarded as its most important attribute;
- better evaluation from financial institutions.

Challenges

It is necessary to embed sustainability throughout the business, influencing the whole production chain, engaging people and integrating sustainability into management systems.

This can cause short-term disruption. For example, in 2000 Natura learned of an illegal supply of bark from the 'candeia' tree which provides an important extract. The company decided to suspend the purchase of this item until the suppliers proved the product was totally legal.

The challenges also reach beyond the company's own operations to increasing fair trade practices in the supply chain.

2.8 The best opportunities in summary

This chapter has highlighted the key opportunities and benefits identified by some companies from action on sustainability. The substantial body of real-life cases behind this analysis demonstrates clearly that sustainability action can deliver against the 'triple bottom line' which considers social, environmental and economic benefits. Many more examples are on the website at www.sustainability.com/developing-value.

As explained at the start of this chapter, the links between the six elements of business success and the seven sustainability factors create the business case matrix. The matrix shows the strength⁴³ of the evidence we have found for each pair of business / sustainability factors (rather than the strength of the impact, which we have not attempted to measure). The matrix below summarizes the linkages. It answers the question: How much evidence is there for a business benefit from a specific sustainability action?

The dark orange cells identify the strongest evidence. Companies are clearly realizing the business benefit described down the left side of the matrix by taking the sustainability action identified across the top. For example, a company making improvements in working conditions is very likely to achieve greater labor productivity. These seven dark orange cells are the connections featured in the earlier part of this chapter.

The light orange cells, which fill the bulk of the matrix, represent links where there is evidence of business benefits, but the evidence is not as strong as the previous seven clear winners. For example, we found evidence of improved access to capital from all sustainability factors but there was no single factor with overwhelmingly strong evidence. Meanwhile, although we have not discussed the light orange cells in detail in this report, these are the areas where the business case may have the greatest potential to strengthen in the future. Examples of companies already experiencing benefits in these areas can be found in the database on the website. Six cells are uncolored. In these areas, such as cost savings from environmental products, we did not find any evidence of business benefits, although in all cases there are other benefits from the sustainability factor.

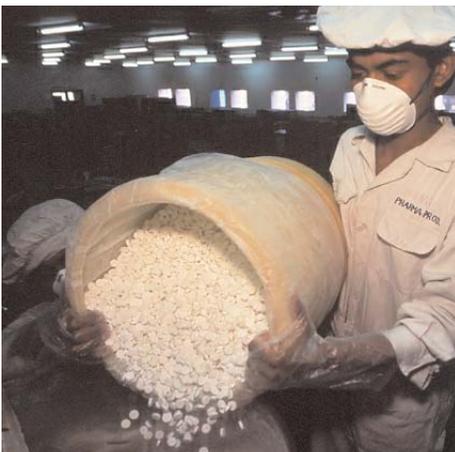
The lack of evidence does not necessarily mean that companies cannot achieve these benefits. It may be that the benefits are more difficult to measure or have not been measured. On the other hand, if these sustainability actions do not yield business benefits, then these might represent areas for governments and other players (see Chapter 5) to assess and redesign framework conditions and incentives to strengthen the business case.

The business case matrix illustrates our overall conclusions, although there are significant variations. Some benefits were more marked in some regions than others. The results also varied depending on the type and size of company, and the industry sector it operates in. These differences suggest that companies need to consider their own circumstances when deciding which sustainability opportunities to explore. These contrasts are explored further in Chapter 3.

It is also important to note that the business case is not static. As expectations and demands from stakeholders grow, along with environmental and social needs, the business case will evolve. A few years ago the environmental and social agenda was widely thought to be a fringe movement. But today companies are taking these concerns on board as their customers, investors and employees are examining their sustainability performance along the whole value chain. The future will see this agenda become mainstream and provide competitive advantage to companies which incorporate sustainability into their business strategies.

Limitations

The matrix shows where businesses can help to achieve their objectives by taking action which also furthers sustainable development. The grading of the cells in the matrix, illustrated by the color codes, indicates how confident we can be of the connection between the two dimensions. It does not give any indication of how significant the business benefit is likely to be, nor have we attempted to judge the scale of the sustainability benefit, because it depends on the case. It also does not show which connections will be stronger in future, but rather is based on the present experiences of companies. Future trends are discussed, however, throughout Chapter 2 and in Chapter 5. We hope that others will be inspired to use the data we have gathered to investigate the links in greater depth, and that businesses will explore how the connections fit their respective cases.



Pharmaceutical factory, India

The business case matrix		Sustainability factors						
		Governance & engagement		Environmental focus		Socio-economic development		
		Governance & management	Stakeholder engagement	Environmental process improvement	Environmental products & services	Local economic growth	Community development	Human resource management
Business success factors	Revenue growth & market access	Strong	Some	Strong	Some	Strong	Some	Some
	Cost savings & productivity	Some	Some	Strong	No	Some	Some	Strong
	Access to capital	Some	Some	Some	Some	Some	Some	Some
	Risk management & license to operate	Some	Strong	Some	Some	Some	Some	No
	Human capital	No	Some	No	No	Some	Some	Strong
	Brand value & reputation	Some	Some	Strong	No	Some	Some	Some

Figure 3 The business case matrix



The nature of this research also means that we have not gathered negative evidence. In other words, there may be cases where companies have made environmental process improvements, for example, which have resulted in cost increases. It could also mean that an activity had no immediate (or short-term) tangible benefit, or that nobody thought of observing the link to revenues, for example.

There can be no guarantees that a company will achieve a business benefit even by taking action which has produced the highest scores in the matrix. The evidence shows only that these opportunities exist. It is up to each company to find its own way of capitalizing on the opportunities which are relevant to its particular circumstances, as external conditions are important. Businesses must also see how certain activities are linked in their own company e.g. transparency, communications, partnership with suppliers. In Chapter 4 we provide some tools for companies to begin developing their own business case.

In context

It is important to put sustainability-focused management in context. It does not offer a magic recipe for success. It can contribute and add to success, but will not offset poor business practices or compensate for bad decisions in conventional aspects of marketing, production or financial control. Nor should business activity be seen as the solution to a country's sustainable development dilemmas. Business can contribute to sustainable development — and benefit in return — but governments and other actors are key, as we highlight in Chapter 5.

Our research has been concerned with examples of ordinary companies doing business in a more or less ordinary way. These companies are not paragons of virtue and the fact that we have identified some sustainability benefits does not mean they are doing everything right. In most cases they have not followed what might be called a 'sustainability strategy' but have acted in a piecemeal fashion.

It is likely, however, that the long-term benefits of strategic actions will outweigh the short-term benefits from tactical fixes. As Eve Anneke, executive director of **Spier Holdings** in South Africa observed, ⁴⁴ 'A sustainable approach asks people to think differently and make a fundamental leap in perspective. We find that when people are able to see the difference, their perspective changes.'

Answering the skeptics

We have found comprehensive evidence of the potential opportunities for business benefits from sustainability actions. Critics, however, raise several objections to corporate sustainability. We address them here:

'Sustainability is a trade barrier designed to make it more difficult for emerging countries to compete internationally.'

Corporate sustainability is primarily a strategic response to a changing external environment. It is underlying shifts in public opinion on the importance of environmental, social and governance issues which drive new opportunities and risks. In some cases, public opinion leads to changes in government regulations and policies, which may have the effect of raising standards and changing the criteria for trading partners. This may in some cases be a sustainability-related risk for developing country exporters. But the risk to these exporters does not lie in companies' focus on sustainability; instead it is a focus on sustainability which is often the best way for firms to mitigate that risk. The risks and opportunities targeted by most corporate sustainability strategies and programs are real — and require active management. Success brings improved access to markets and finance, helping build supply chain partnerships.

'Sustainability will add unnecessary costs which many companies simply cannot afford.'

It is a matter of investment, not cost. Like any investment, companies must find the resources and assess the paybacks. But this research has uncovered many cases where the paybacks have been swift and substantial, and it has shown that addressing these issues is more likely to help companies identify cost reductions than add to their costs.

'Sustainability interferes with the proper working of markets and distracts companies from their primary responsibility, which is to provide goods and services profitably.'

Sustainability is a response to evolving market pressures. Industrial and retail customers want to know that the goods they buy have been produced responsibly, with minimum environmental impact and optimum gains to the communities affected. Sustainability is a new way of thinking about business. It will become a basic characteristic of many goods and services, just as price and quality are.

'Sustainability is nothing more than philanthropy.'

The hundreds of examples on our website www.sustainability.com/developing-value demonstrate that sustainability is concerned with the core of a company's operations — the way workers are recruited and treated, dealings with suppliers and customers, and the impact of the products in use. These are central business issues. Philanthropy can be a part of sustainability, but it is not a central part.

'Companies are being asked to follow an agenda set by over-powerful NGOs.'

Sustainability is not about bowing to NGO demands. But NGOs represent many important stakeholders and it is critical to understand their interests and concerns. Many companies have found benefit from actively partnering with them. Business policies remain the prerogative of owners and managers but there needs to be a dialogue so that all parties understand the thinking and constraints of the others.

For all these reasons, and the evidence from over 240 cases, we believe sustainability offers a positive agenda for businesses in emerging markets all over the world.

Box 9
'The right thing to do?'

Some people feel sustainability action is a fundamental responsibility and there should be no need for a business case. This is reflected in business people saying they took initiatives simply because it was 'the right thing to do'. Looking for the business benefit as a justification can therefore be regarded as amoral. It implies that unethical behavior is acceptable if it pays, and that doing right is inappropriate if it damages profits. It is the kind of position which led the business world to oppose the abolition of slavery and the introduction of decent working conditions during the industrial revolution in the developed world.

The moral case argues that principle must precede profit, even if the two are not opposed. Profit is a necessary outcome, but the purpose needs to be rooted in something more substantial, such as the satisfaction of a societal need.

The reason why companies do not deliberately kill or poison people is not because it is bad for business, but simply because it is bad. Bribery, lying and polluting are not acceptable, regardless of whether they will be detected and therefore result in financial damage. The result is that companies must do right because it is right, not because it pays. Principle, not profit, should be the point of departure.

We do not dispute the assertions made by proponents of the moral argument. Our response is that it applies to fundamental principles, but there are many areas of corporate activity that are not matters of morality. The basic principles are usually enshrined in law – and certainly in United Nations declarations. But sustainability goes beyond legal minimums. Issues such as training and childcare, environmental innovation or responding to community concerns are not solely matters of morality. But they are areas where investment can help business success – and aid sustainability.

This box draws on the views of **Sir Geoffrey Chandler**, founder-chair of the Amnesty UK Business Group and former senior executive with Shell.⁴⁵



Bamboo transportation, Indonesia

Sustainability in Brazil



Car factory worker, Brazil

The concept of sustainability or corporate social responsibility emerged as a significant force in Brazil during the 1990s. But the seeds were planted already during the 1980s in a sequence of social and political events which definitively changed the attitude of citizens, including business community.

During the 1980s the country went through a process of re-establishing democracy. This was marked by vast participation of the people, culminating in a new constitution and direct elections for president in 1989.

The impeachment of the president, only two years after his election, was imposed by a national commitment against corruption. Citizen participation and civil society organizations continued to grow during the 1990s, fuelled by the Rio Summit which propelled environmental issues to the top of the world agenda, but also the campaign against hunger. This was led by Betinho (an intellectual and social leader responsible for many initiatives against poverty and hunger, ethics in politics and HIV patients' rights) and supported by an enormous group of organizations of all kinds, including business leaders, from all over the country.

This tide of concern for environmental and social issues began a fundamental change in attitudes in the Brazilian business world. The social movements brought together free trade unions, political parties, environmental organizations, ethical bodies and associations promoting the rights of consumers, women and children.

The series of changes in the business world have developed and become more prominent over the last ten years. Many business institutions were created to deal with themes such as economic and environmental sustainability, community and societal development, and corporate responsibility (such as the Ethos Institute – Business and Social Responsibility). These organizations are led by business men and women who actively take part in different social movements.

Spending on social projects has also grown substantially. The Institute for Applied Economic Research (IPEA) reported that in the last few years companies spent nearly \$4.5 billion reais (\$1.7 billion) per year in social investment, beyond spending required by law. This figure is comparable with the federal government's spending on social services and assistance.

The IPEA found that two-thirds of the companies in the Southeast of Brazil (the most industrialized region in the country) have community projects. Half of these businesses are small companies.

The growth of interest in sustainability in Brazil can also be demonstrated by the growth of the Ethos Institute. It began in 1998 with 11 associate companies, and by the beginning of 2002 nearly 600 companies are associated with Ethos. Their turnover amounts to more than a quarter of the country's GNP. These companies want to support the movement and get information about ethics, transparency, employment conditions, consumer relations, supplier involvement, community activity, the environment and government/society relations.

There are three main motivations for corporate sustainability:

- The need to adapt to the international market – the Brazilian business community is marked by a large number of branches of multinational and export companies which are aiming at developed markets.
- The desire to bring about swift and significant improvements in poverty and the country's extreme social differences.
- Concern to maintain natural and human resources for future generations.

The main challenge faced by companies is to develop a balanced style of management that maintains a focus on cost control, high standards of quality and other aspects of competitiveness, but also aims for sustainable growth in accordance with the demands of civil society. Many Brazilian companies are getting involved in sustainable aspects but are still centered on the issues of cost and quality.

A second challenge is training managers and professionals who will work in these companies in the new sustainability scenario. That is also a challenge for the teachers and trainers of the professionals of the future.

We can identify already increasing company interest in reporting on social and environmental activities – a few companies already report following the Global Reporting Initiative or similar guidelines – and a greater engagement with projects around public issues and social development.

A view of the development of corporate sustainability in one country, contributed by Ethos Institute, Brazil.

www.ethos.org.br