

The New Competitive Advantage: Creating Shared Value

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This presentation draws on ideas from Professor Porter's books and articles, in particular, *Competitive Strategy* (The Free Press, 1980); *Competitive Advantage* (The Free Press, 1985); "What is Strategy?" (*Harvard Business Review*, Nov/Dec 1996); and *On Competition* (*Harvard Business Review*, 2008). No part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any means—electronic, mechanical, photocopying, recording, or otherwise—without the permission of Michael E. Porter. Additional information may be found at the website of the Institute for Strategy and Competitiveness, www.isc.hbs.edu.

The Role of Business in Prosperity

- Only business can **create prosperity**

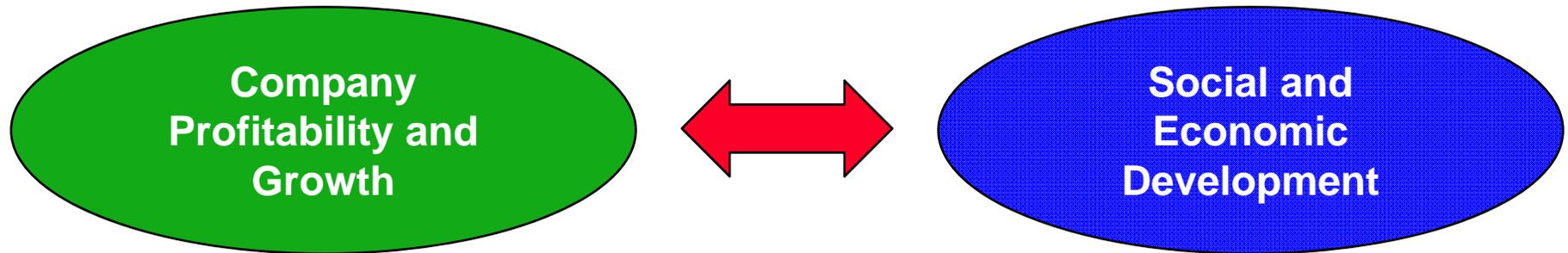
BUT

- Companies are increasingly perceived to be prospering **at the expense of the broader community**
- Business increasingly is seen as **a major cause of social, environmental, and economic problems**
- Government and civil society often attempt to address societal issues **at the expense of business**



- Despite growing corporate social responsibility (CSR) activities, the **legitimacy of business** has fallen

Business and Society: Why the Disconnect?

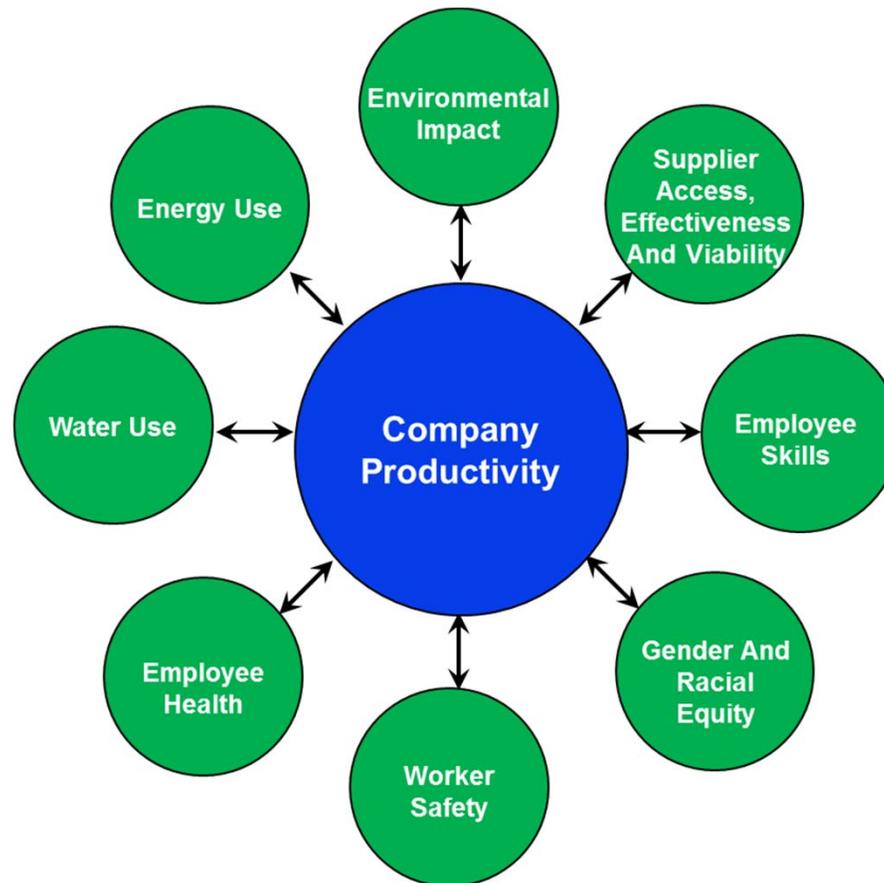


- Many companies have adopted a **narrow model** of economic value creation
 - Maximizing shareholder value with shortening **time horizons**
 - Meeting **conventional** and sometimes **artificial** needs of **conventional** customers
 - **De-skilling** jobs to reduce wages
 - **Downsizing, outsourcing, relocating,** and **offshoring**
 - Enforcing **price cuts** on suppliers
 - Societal issues are treated as **outside** the scope of business



- Huge **societal needs** go unmet
- **Growth** and **innovation** in business have suffered

Creating Economic Value and Societal Needs



- **Social** deficits create **economic** costs and **market** opportunities
- **External** conditions shape **internal** company productivity
- There is a growing **congruence** between economic value creation and societal objectives

The Concept of Shared Value

Shared Value: Corporate policies and practices that **enhance the competitiveness** of a company while simultaneously **advancing social and economic conditions** in the communities in which it operates

- Create **economic value** by creating **societal value**
 - What is good for the community is good for business
- All profit is **not equal**. Profit involving shared value enables society to advance more rapidly and allows companies to grow faster

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- The pursuit of shared value represents the next evolution of **capitalism**
- Concern with **societal issues** will be a defining characteristic of the post-crisis era
- Incorporating societal issues into strategy and operations is **the next major transformation** in management thinking

Misconceptions About Creating Shared Value

Creating Shared Value is **NOT**:

- **Philanthropy**
- **Giving back**
- **Personal values**
- **Ethics**
- **Harm reduction**
- **(Just) sustainability**
- **Triple bottom line**
- **Balancing stakeholder interests**
- **Sharing created value**

Levels of Shared Value

- Reconceiving customer **needs, products, and markets**
- **Redefining productivity** in the value chain
- Enabling **local cluster development**

Reconceiving Products and Markets

- Design products and services to **address societal needs**
 - E.g., environmental impact, safety, health, education, nutrition, living with disability, housing, financial security
- Open **new markets** by serving unmet needs in underserved communities
 - Often requires **redesigned products** or different **distribution methods**
- Meeting such needs spurs **self-reinforcing** economic growth

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- Businesses have the potential to be more effective than governments and NGOs in **marketing** solutions to social problems
 - Shared value offers new opportunities for **differentiation, innovation, and growth**
 - A new generation of **social entrepreneurs** is capturing these opportunities, often faster than mainstream businesses

Creating Shared Value in Products

Intuit

- **Intuit Health Debit Card** allows small employers who cannot afford health insurance to provide pre-tax healthcare support to their employees
 - Card automatically recognizes healthcare expenditures vs. other kinds of spending
 - Unspent funds roll over year to year
- **SnapTax** provides low-income consumers with access to tax preparation services over the phone and enables rapid refunds
 - **15 minutes for \$15**, electronic filing included
 - Data extracted from **mobile phone photos** of W-2s via optical character recognition
 - **Debit card** option for direct deposit of refunds for unbanked households
 - **Simple IRA option** to enable use of refund for retirement savings

Creating Shared Value in Products and Markets

Novo Nordisk Diabetes Products in China

Physician Training

- **Diabetes training programs** together with governments, NGOs, and opinion leaders to promote the latest thinking among physicians on diabetes prevention, screening, treatment, and patient communication
- Targeting smaller cities
- 220,000 sessions to date

Patient Education

- “**Diabetes bus**” program to raise patient awareness and provide on-site advice, NovoCare telephone hotline allows patients to reach specialists with questions. NovoCare Club provides ongoing updates to members.
- Patient education focuses on prevention, lifestyle changes, and effective use of insulin products
- 280,000 patients educated to date



- Since 1997, this program is estimated to have reduced healthcare costs in China by \$700 million through reducing diabetes related complications
- Novo Nordisk sales have increased by an estimated \$114 million

Creating Shared Value in Products and Markets

DeBeers

- DeBeers led the development of the Kimberley Process, a **certification process** for conflict-free diamonds
- Companies and governments must meet extensive requirements for certification, including an audit trail that can be traced back to the original diamond mine
- All DeBeers diamonds are Kimberley certified
- DeBeers also launched the Diamond Development Initiative to improve working and social conditions for artisanal diamond miners that are most vulnerable to exploitation

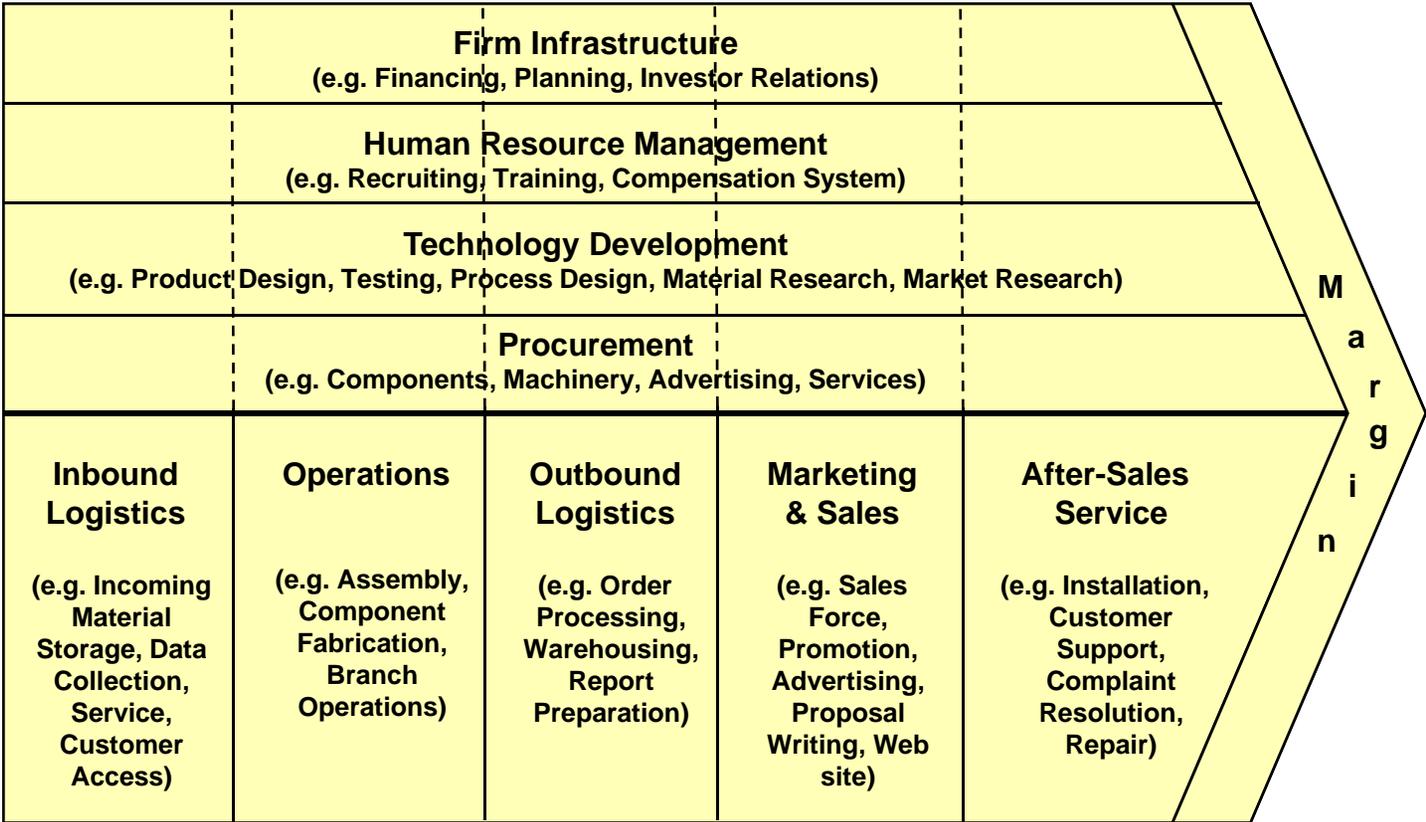


- Conflict diamonds are now less than one percent of the global market, down from fifteen percent in the 1990's
- Certification adds a **social dimension** to the product
- DeBeers has been able to **improve consumer acceptance** of diamonds while better linking diamond sales to **country prosperity**

Finding Product and Market Opportunities to Create Shared Value

- Redefine the business around **unsolved customer problems or concerns**, not traditional product definitions
- Think in terms of **improving lives**, not just meeting consumer needs
- Identify customer groups that have been **poorly served** or **overlooked** by the industry's products
- Start with **no preconceived constraints** about product attributes, channel configuration, or the economic model of the business (e.g., small loans are unprofitable)

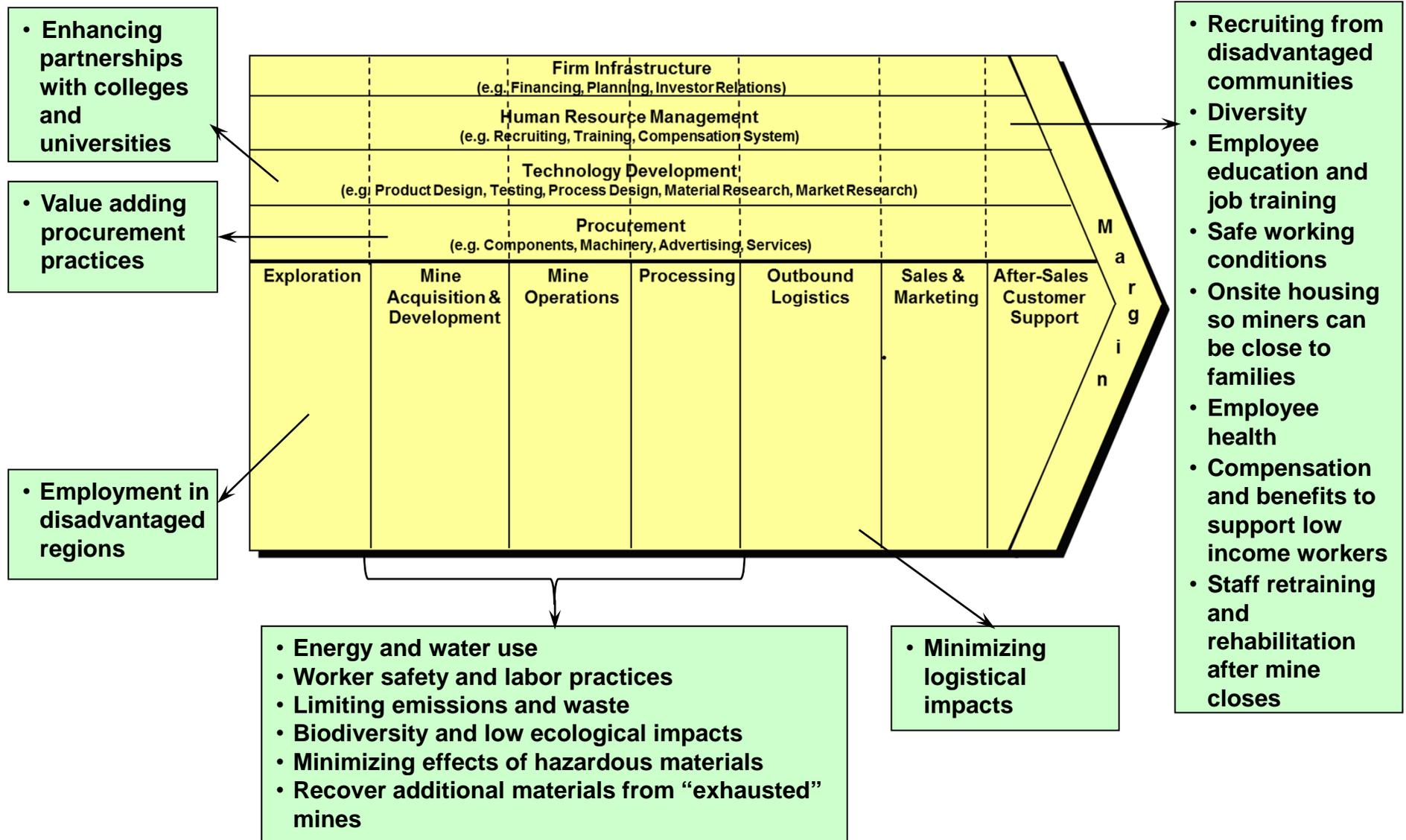
Redefining Productivity in the Value Chain



- Resource use
- Energy use
- Logistical efficiency
- Employee productivity
- Location of facilities and the supply chain

Identifying Opportunities for Shared Value in Mining

The Value Chain



Local Cluster Development

- A strong local cluster with capable local suppliers and institutions **improves company productivity**
 - e.g., greater supply chain efficiency, lower environmental impact, and better access to skills
- **Companies**, working collaboratively, can catalyze major improvements in the local cluster and business environment
- Local cluster development **strengthens the link** between a company's success and community success

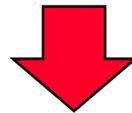


- What suppliers are **inefficient** or **missing locally**?
- What **institutional weaknesses** or **community deficits** create internal costs for the firm?

Local Cluster Development

Consumer's Choice Coffee (Louisville, KY)

- Manufactures and distributes **specialty coffee and other beverages**
- Located in an industrial park in the **economically disadvantaged Park Hill Corridor of Louisville**, with direct access to the freeway and proximity to the airport and UPS shipping facility
- Started the **Park Hill Business Association (PHBA)** to draw other manufacturers, suppliers, and distribution firms to the area, now with 45 members
- PHBA businesses have **pooled their resources** to address security concerns; shaped a long-term strategic plan for regional transportation; and catalyzed green infrastructure improvements in the area



- Consumer's Choice has grown to \$10 million in revenue and 30 employees
- The “one stop shop” of multiple food service companies in business park has expanded the customer base
- The Park Hill food cluster has created more than 100 new jobs in the area with an average annual salary of \$43,710
- There are 13 active food and beverage processing investment projects in the pipeline for the area that could create 400 more jobs with a combined capital investment of \$21.3 million

Local Cluster Development

Anglo-American

- Anglo American has established Anglo Zimele, a South African enterprise investment fund, for **mining-related small and medium-sized businesses**
- As of 2010, the fund had invested in 509 businesses, which collectively employed 9,514 people with annual revenues of \$215M

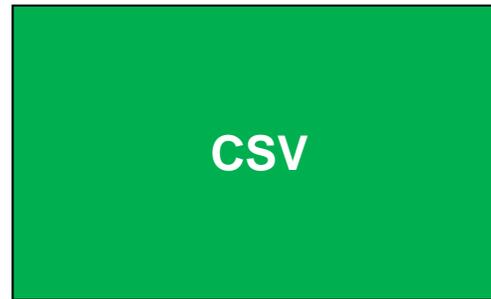
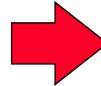
Community value

- 10,000 new jobs created
- Spillover effects of these new businesses in their communities
- Significant increase in income for SME employees and owners

Economic value

- Anglo-American has created reliable, high-quality local suppliers
- Building local suppliers reduces transaction costs and improves service levels and quality

Moving to Shared Value



- **Values:** “doing good”
- Good citizenship, philanthropy, and sustainability
- **Discretionary**
- **Separate** from profit maximization
- Agenda **externally determined**
- Impact is **limited** by the corporate footprint and CSR budget

• Example: Fair trade purchasing

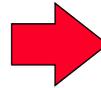
- **Value:** economic and societal benefits relative to cost
- **Joint** company and community value creation
- Integral to **competing**
- **Essential** to profit maximization
- Agenda is **business specific**
- Mobilizes the **entire company** budget

• Example: Transforming procurement to increase quality and yield

In both cases, **compliance** with laws and ethical standards and reducing harm for corporate activities are **assumed**

Moving to Shared Value

Novartis

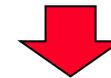


- Donate drugs to lower-income populations
- Same products, but free or at a discounted price
- Provides product access for affected individuals



- Reduced revenue at the same cost

- Arogya Parivar: Implementing a new drug distribution channel for low-income populations
- New quantity, packaging, patient education, and distribution
- Improvement in local healthcare delivery infrastructure
- Learning about customer behavior and new business models



- Expanded revenue and profitable business model

Measuring Shared Value

Economic Value

- Profitability
- Revenue
- ROI
- Category growth

Societal Value

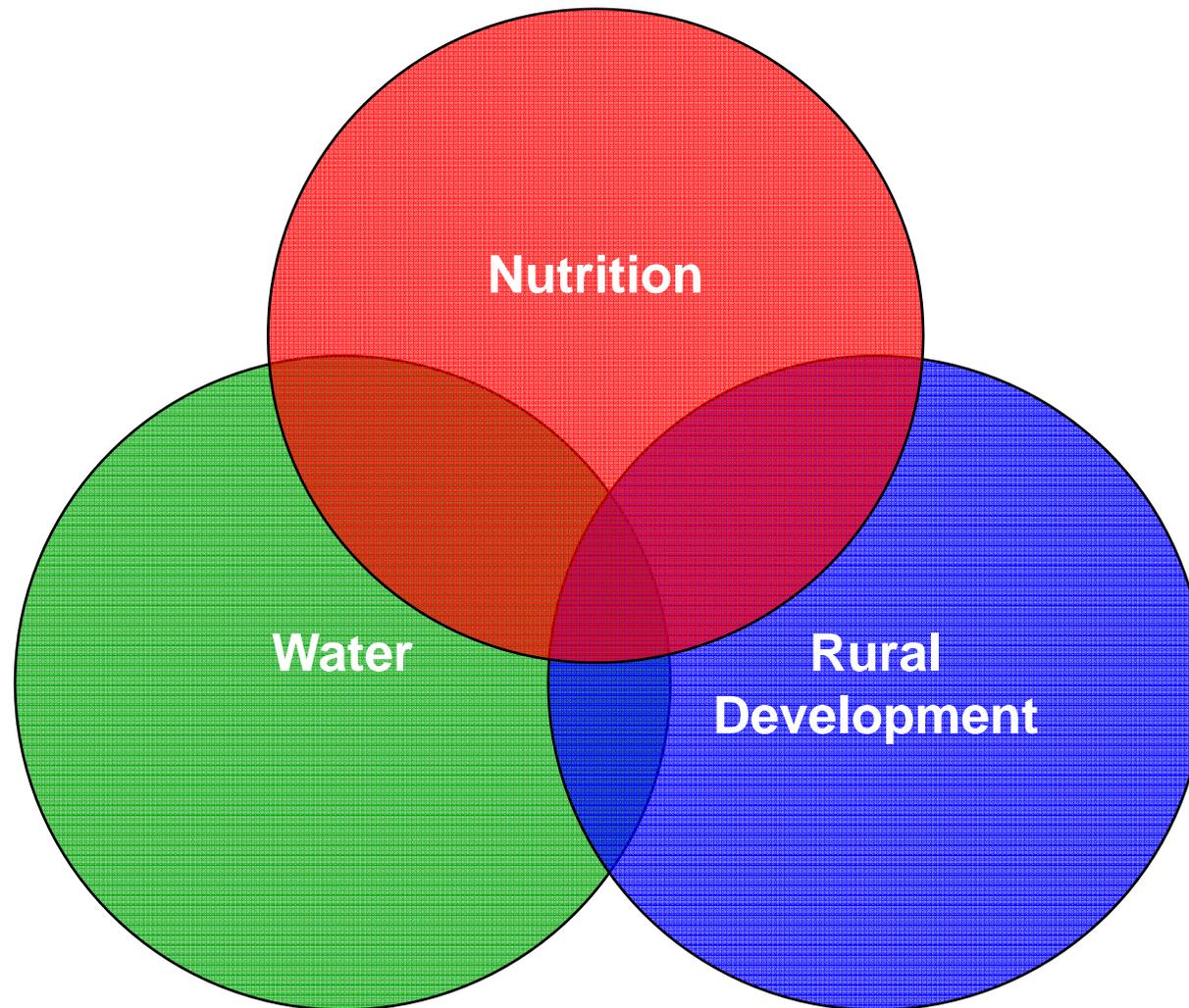
- Specific societal benefits achieved



- Fundamental to shared value is **linking** economic and social measures

Creating Shared Value: Deciding Where to Concentrate

Nestlé



- Opportunities to create shared value are inevitably **tied closely** to a company's particular businesses

Creating Shared Value

Nestle Nespresso

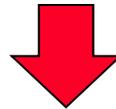
Implementing shared value in sourcing premium coffees from farmers in Costa Rica, Guatemala, Colombia, and Ghana

- Reconfiguring the value chain
 - Reconceiving **procurement**
- Upgrading the cluster
 - Supporting local **cluster development** in coffee growing regions, including establishment of cluster institutions
 - **Partnering** with stakeholders

| Shared Value | | |
|---------------------|--------------------------------|------------------------------------|
| <u>Farmers</u> | <u>Community</u> | <u>Nespresso</u> |
| → Better yields | → Environmental sustainability | → Stable supply |
| → Better prices | → Economic development | → Better quality |
| → Better processing | | → Reinforces strategic positioning |

Adding a Social Dimension to Strategy

- Shared value opens up new **needs**, new **markets**, and new **value chain configurations**
- This creates **new strategic positions**, and new opportunities for **extending existing positions**



- Companies should incorporate a **social dimension** to their value proposition
- Shared value can **reinforce** and even **anchor** a company's strategy
- The social dimension of strategy can be **more sustainable vs. competitors** than conventional cost and quality advantages

Shared Value and Strategic Positioning

Whole Foods Markets

Value Proposition

- Natural, fresh, organic, and prepared foods and health items with excellent service at premium prices
- Cater to specialized nutritional requirements (gluten allergies, vegan, etc.)
- Educated, middle class, and affluent customers who are passionate about food and a healthy lifestyle

Distinctive Activities

- Well-lit, inviting supermarket store formats with appealing displays and extensive prepared foods sections
- Produce section as “theater”
- Café-style seating areas with wireless internet for meals and meetings
- Each store carries local produce and has the authority to contract with the local farmers. Company provides low-interest loans and microcredit if needed
- Information and education provided to shoppers along with products
- High touch in-store customer service via knowledgeable, flexible, and highly motivated personnel
- Flat compensation structure
- Own seafood procurement and processing facilities to control quality (and price) from the boat to the counter
- Heavy emphasis on environmental sustainability in all activities.
- Emphasis on supporting community development



- Successful strategies in the future will embody a significant **shared value dimension**

Shared Value and Strategic Positioning

Intrepid Travel

Value Proposition

- Sustainable small-group travel
- Unique real-life experiences involving significant interaction with the local communities
- Cost-conscious, adventurous, socially aware travellers looking for authentic experiences

Mission

“Intrepid’s core purpose is to enrich people’s lives by creating unique, interactive travel experiences. We provide fun, affordable and sustainable travel that is profitable for Intrepid and beneficial to local communities.”

Distinctive Activities

- Smaller groups allows for frequent use of local public transport, supporting local infrastructure and reducing environmental impact
- Smaller groups allow stays at local hotels and homestay opportunities as well as dining at local restaurants
- Some trips involve community volunteer projects where travellers help build local infrastructure
- Significant training of local tour guides and other local businesses such as hotels to improve quality and efficiency
- Projects such as Kilimanjaro Porters Assistance Project outfits 300+ porters per month with climbing gear and has trained 10,000 porters in first aid, conversational English, money management, and HIV/AIDS awareness since 2004
- Cooperation with Victoria University to study the impact of small group travel on sensitive rural communities



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The Purpose of Business

- There is an opportunity **to transform thinking and practice** about the role of the corporation in society
- Shared value gives rise to **far broader approaches** to economic value creation
- Shared value thinking will drive the next wave of **innovation, productivity enhancement, and economic growth**
- Businesses **acting as businesses**, not as charitable givers, are arguably the most powerful force for addressing many of the pressing issues facing our society
- A transformation of business practice around shared value will give **purpose** to the corporation and represents our best chance to **legitimize business again**