

The Role of Business in Society: Creating Shared Value

Professor Michael E. Porter
Harvard Business School

*Dutch Sustainable Trade Initiative
Video Conference
New York, NY
December 15, 2011*

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 Society

- Only business can **create prosperity**
- Healthy businesses need a **healthy community**

BUT

- There is a **growing awareness** of major societal challenges
- 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 citizenship activities, the **legitimacy of business** has fallen

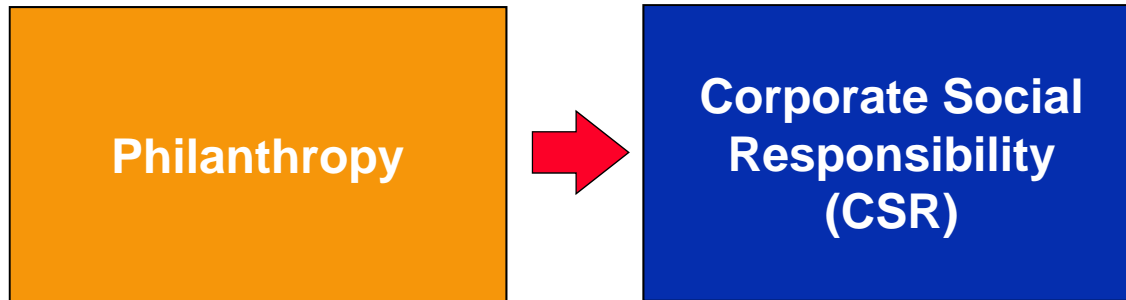
The Role of a Company in Its Communities



Philanthropy

- Donations to worthy social causes

The Role of a Company in Its Communities



- Donations to worthy social causes

- Good corporate citizenship and compliance with community standards
- “Sustainability”

The Role of a Company in Its Communities



The Concept of Shared Value

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

- Create **economic value** by creating **societal value**
 - What is good for the community is good for business
- Use **capitalism** to address social problems
- All profit is **not equal**. Profit involving shared value enables society to advance and companies to grow faster

The Concept of Shared Value

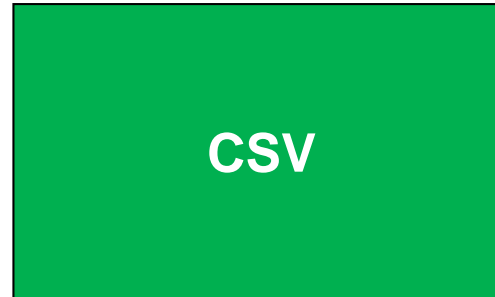
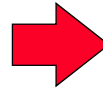
Shared Value: Corporate policies and practices that **enhance competitiveness** of the company while simultaneously **advancing social and economic conditions** in the communities in which it sells and operates

- Create **economic value** by creating **societal value**
 - What is good for the community is good for business
- Use **capitalism** to address social problems
- All profit is **not equal**. Profit involving shared value enables society to advance and companies to grow faster



- 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
- Shared value thinking represents the next evolution of **capitalism itself**

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

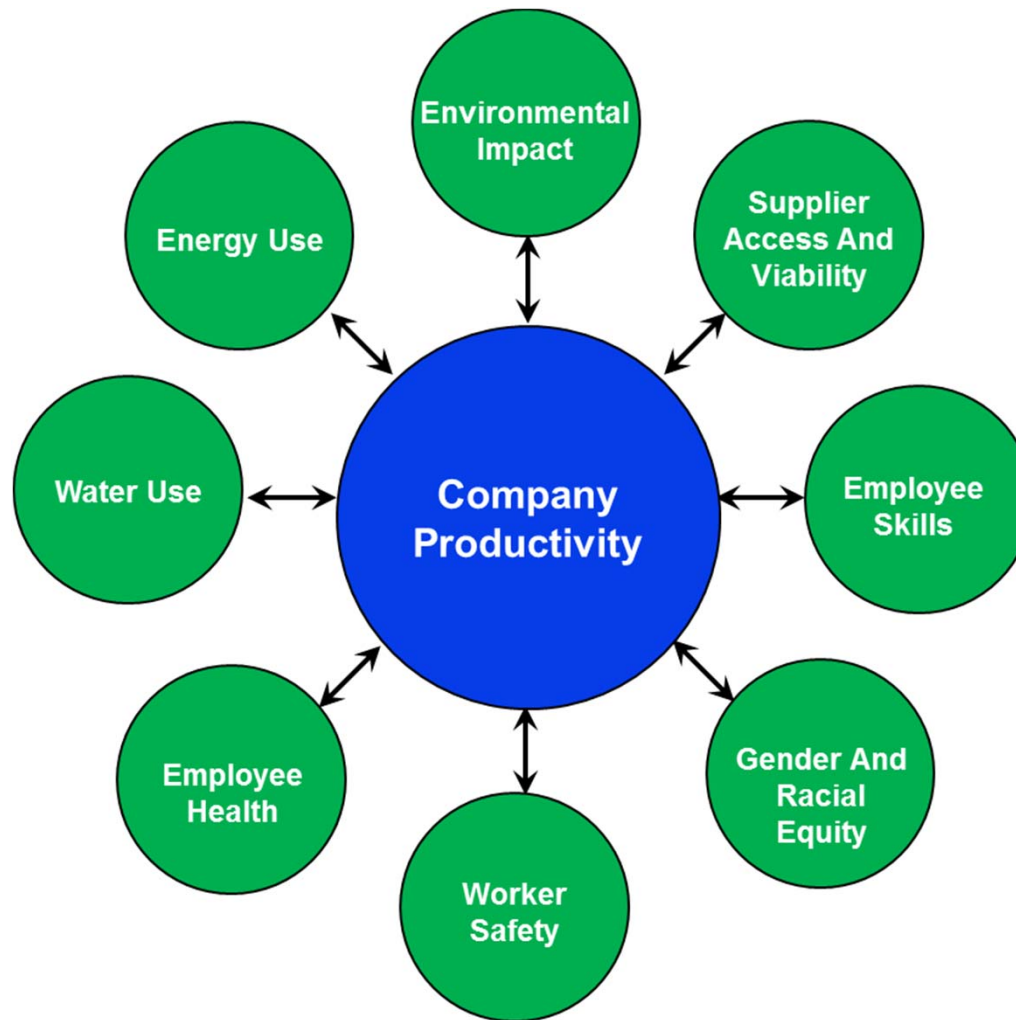
- **Value:** economic and societal benefits relative to cost
- Integral to **competing**
- **Essential** to profit maximization
- Agenda is **business specific**
- Mobilizes the **entire company** budget

Example: Fair trade purchasing

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**

Societal Needs and Economic Value Creation



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

Levels of Shared Value

- Reconceiving customer **needs, products, and markets**
- **Redefining productivity** in the value chain
 - How the organization conducts its business
- 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**
- Businesses have the potential to be more effective than governments and NGOs in **creating** and **marketing** solutions to community problems



- New needs and new markets open up opportunities to **differentiate, innovate,** and **grow**
- A new generation of **social entrepreneurs** is capturing these opportunities, often faster than mainstream businesses

Creating Shared Value in Products

Dow Chemical Insect Control

The Spinetoram™ Family of insect control products are derived from a **biological organism** that provides control of a broad spectrum of insect pests in a variety of crops

- Natural degradation through UV light and soil microbes
- Low solubility in water
- Favorable toxological profile
- Carries lowest human hazard label
- Organic version available



- Ability to be applied at **lower rates** than conventional insecticides
- **Low impact** on beneficial insects
- **Double-digit growth** since launch in 2010

Creating Shared Value in Products and Markets

Novo Nordisk in China

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

“**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 revenues** have increased by an estimated **\$114 million**

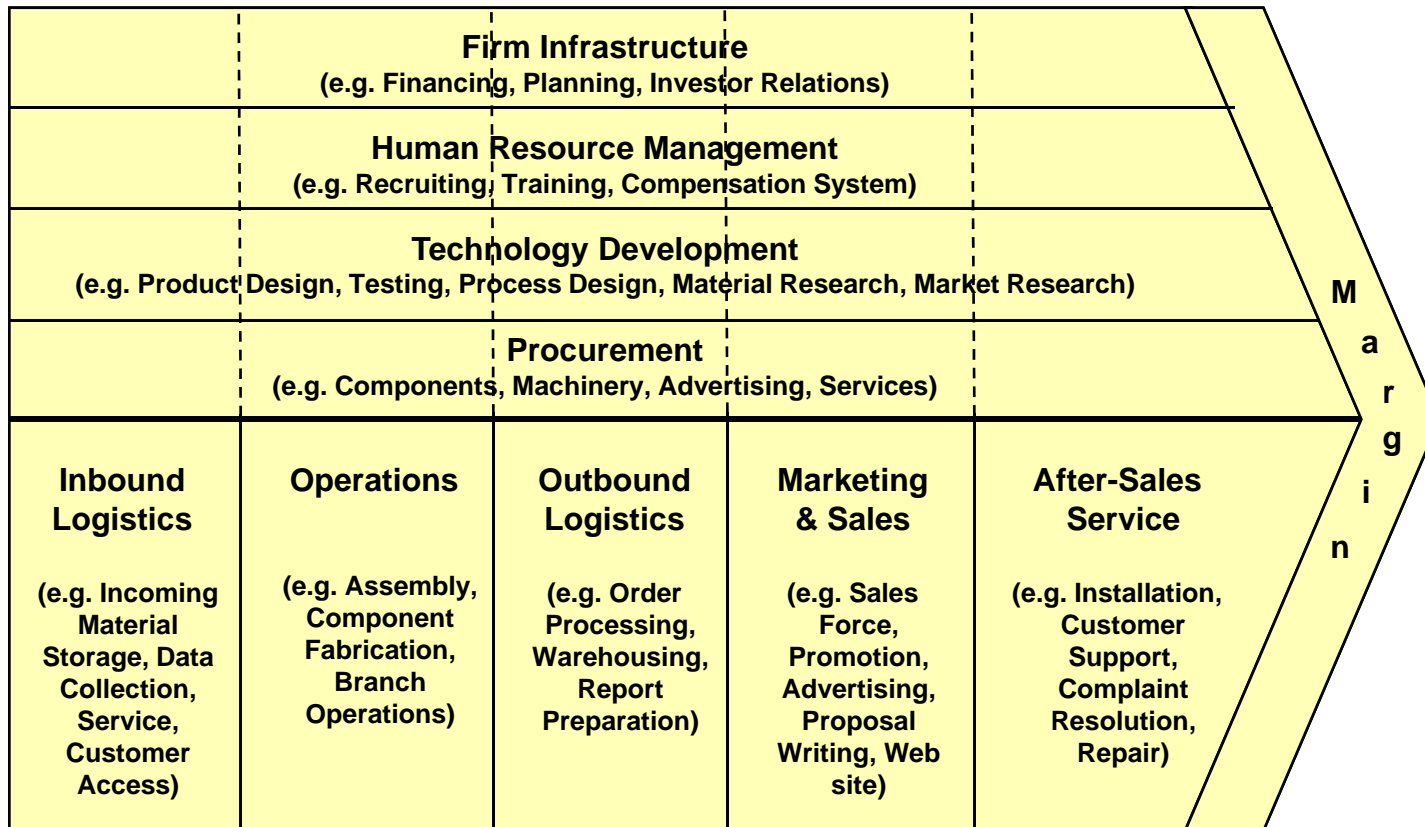
Discovering Product and Market Opportunities to Create Shared Value

- Redefine the business around **unsolved customer problems or concerns**, not traditional product definitions
 - Or the customer's customer
- 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)



- Opens up **new opportunities** to customer segmentation and marketing

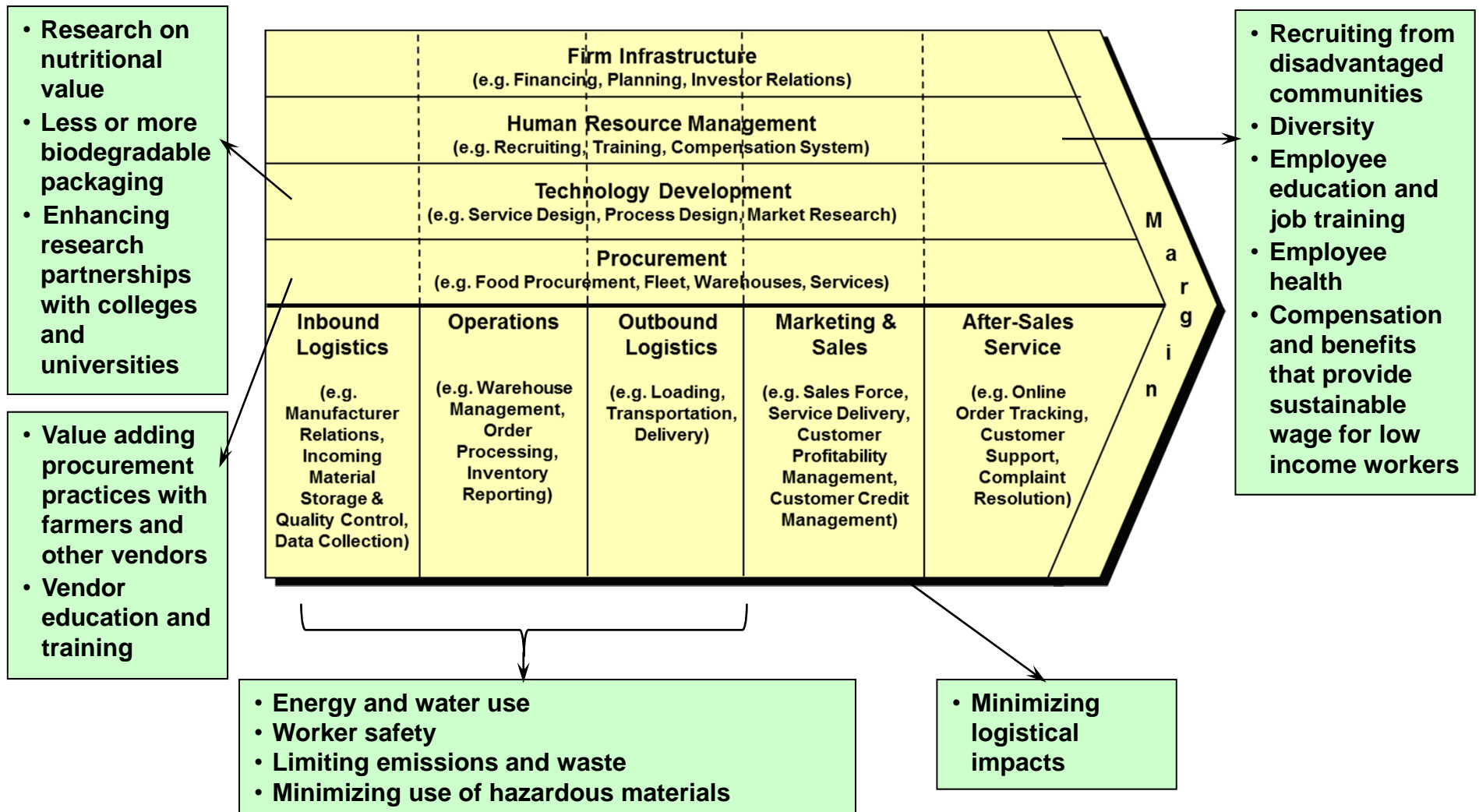
Redefining Productivity in the Value Chain



- Purchasing
- Energy use
- Resource use
- Logistical efficiency
- Employee productivity
- Location of facilities / supply chain

Identifying Opportunities for Shared Value in Food Services

The Value Chain



Cluster Development in the Company's Major Locations

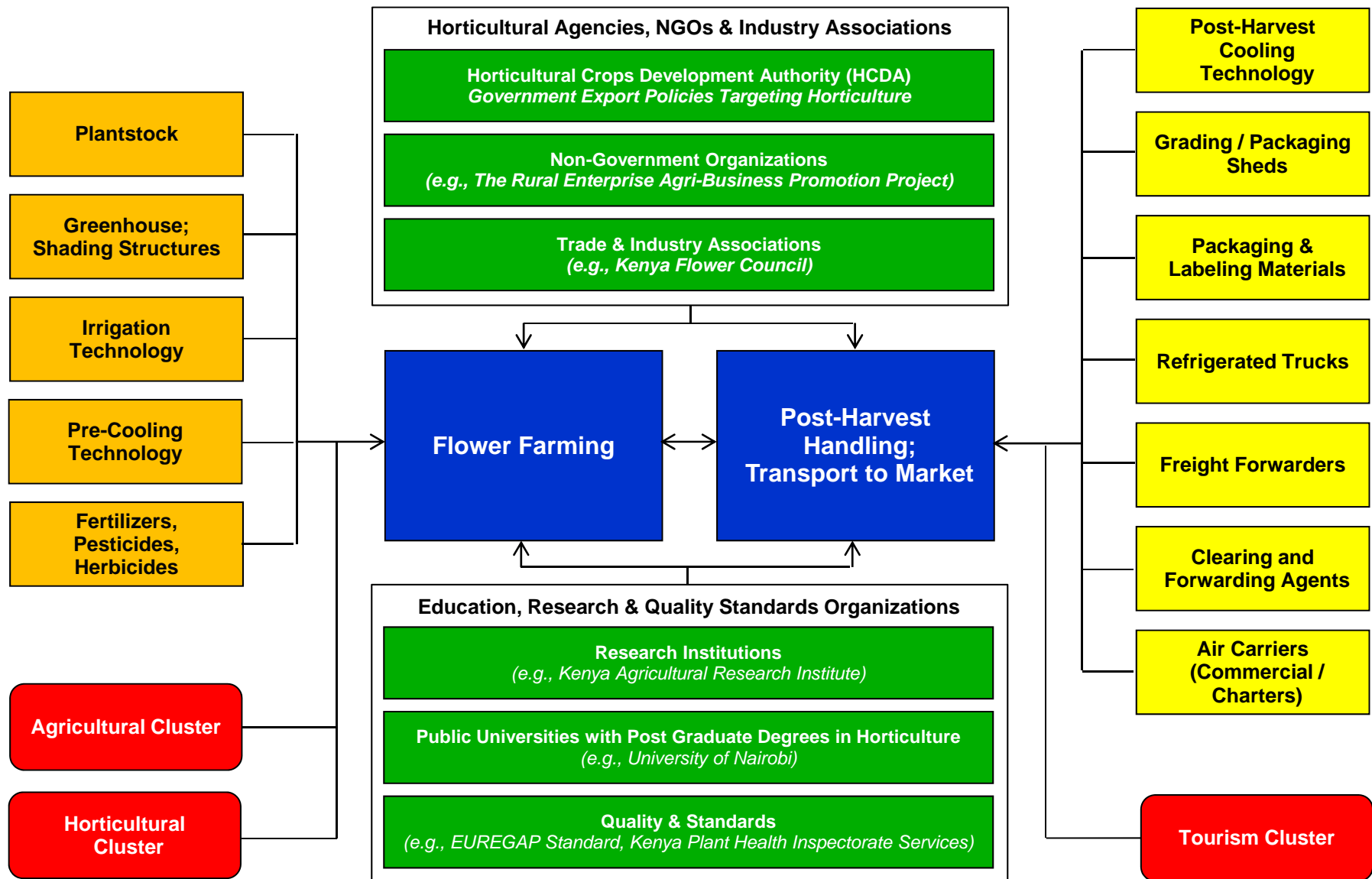
- A strong local cluster improves **company growth and productivity**
 - Local suppliers
 - Supporting institutions and infrastructure
 - Related businesses
- **Companies**, working collaboratively, can catalyze major improvements in the cluster and the local business environment



- Local cluster development **strengthens the link** between a company's success and community success

State of Cluster Development

Kenya's Cut Flower Cluster



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** in South Africa
- As of 2010, the fund had invested in **509 businesses**, which collectively employed 9,514 people with annual revenues of \$215 million

Economic value

- Anglo-American has created reliable, high-quality **local suppliers**
- Local suppliers reduce transaction costs and improve **service levels** and **quality**

Community value

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

Integrating Shared Value Approaches

Nespresso

- Implementing shared value in **sourcing** premium coffees from farmers in Costa Rica, Guatemala, Colombia, and Ghana
- Upgrading the cluster
 - Supporting local **cluster development** in coffee growing regions, including establishment of cluster institutions
 - **Partnering** with stakeholders

Shared Value

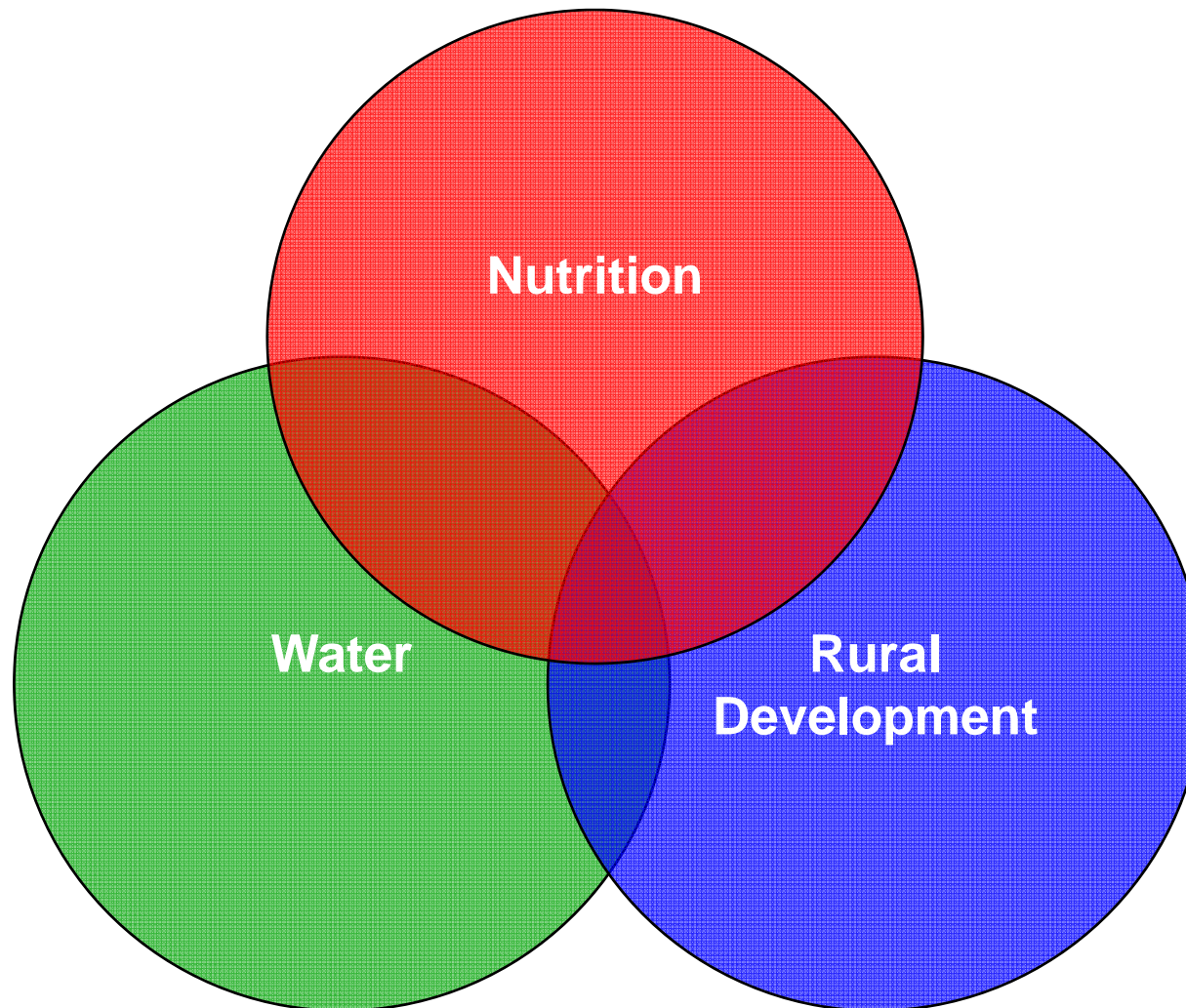
<u>Farmers</u>	<u>Community</u>	<u>Nespresso</u>
<ul style="list-style-type: none">• Better yields• Better prices• Better processing	<ul style="list-style-type: none">• Economic development• Environmental sustainability	<ul style="list-style-type: none">• Stable supply• Better quality• Reinforces strategic positioning



- The three levels of shared value are often **mutually reinforcing**

Creating Shared Value: Deciding Where to Concentrate

Nestlé



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

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 positioning**



- 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 if needed
- Nutrition 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, sustainability 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**

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 growth**, 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**

Backup

Integrating Shared Value Approaches

Nespresso

- Nespresso's Real Farmer Income (RFI)TM program focuses on creating shared value in **sourcing premium coffees** from more than **40,000 farmers** around the world
 - RFI comprises of **more than a dozen pilot projects**
- As part of the pilot project in **Jardin, Antioquia (Columbia)**, Nespresso worked with local farmers and multiple other stakeholders to **centralize coffee milling operations**

Economic value

- Percent of coffee meeting Nespresso's AAA **quality standards** improved from **50%** to **97%** in the first operating year
- **Economies of scale** associated with consolidated milling operations

Community value

- **Farmer income increased by 30%** due to lower rejection rate and higher sale price
- **Water utilization reduced by 60%** due to centralization of milling
- Installation of water treatment capacity ensured **cleaner and safer water supply** for downstream communities