

The New Competitive Advantage: Creating Shared Value

Professor Michael E. Porter
Harvard Business School

*CSV Forum:
Practical Wisdom for Creating Innovation
Tokyo, Japan
December 4, 2012*

The ideas drawn from “Creating Shared Value” (*Harvard Business Review*, Jan 2011) and “Competing by Saving Lives” (FSG, 2012). 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. For further materials, see the website of the Institute for Strategy and Competitiveness, www.isc.hbs.edu, and FSG website, www.fsg.org.

The Role of Business in Society

- Only business can **create prosperity**
- Healthy businesses need a **healthy community**
- There is an ever **growing awareness** of major societal challenges
- Government and NGO's alone **lack sufficient resources and capabilities** to fully meet these challenges

BUT

- More of the public perceives business as prospering **at the expense** of the society
- Despite growing corporate citizenship activities, the **legitimacy of business** has fallen



- We need a **new model**

The Role of Business in Society

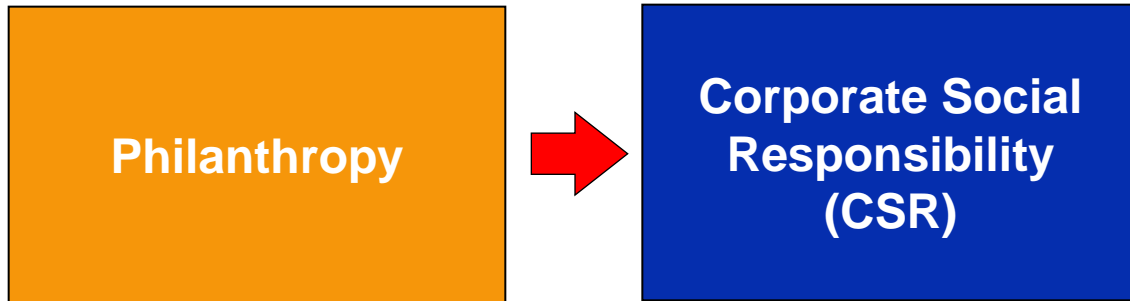
Evolving Approaches

Philanthropy

- Donations to worthy social causes
- Volunteering

The Role of Business in Society

Evolving Approaches



- Donations to worthy social causes
- Volunteering

- Compliance with community standards
- Good corporate citizenship
- “Sustainability”

The Role of Business in Society

Evolving Approaches



The Concept of Shared Value

What Shared Value is NOT

- Sharing the value **already created** (philanthropy)
- Acting based on strong **personal values** and **ethical standards**
- **Balancing** stakeholder interests
- Avoiding **harm** and protecting **reputation**

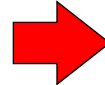
What Shared Value IS

- Using **capitalism** to address social problems
- Addressing social problems tied **directly** to the business
- Creating solutions that are **scalable** and **self-sustaining**

Moving to Shared Value in Pharmaceuticals

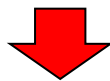
Novartis

CSR



CSV

- **Donate drugs** to lower-income populations
- **Same products**, but free or at a discounted price
- Reach patients through **existing** health systems



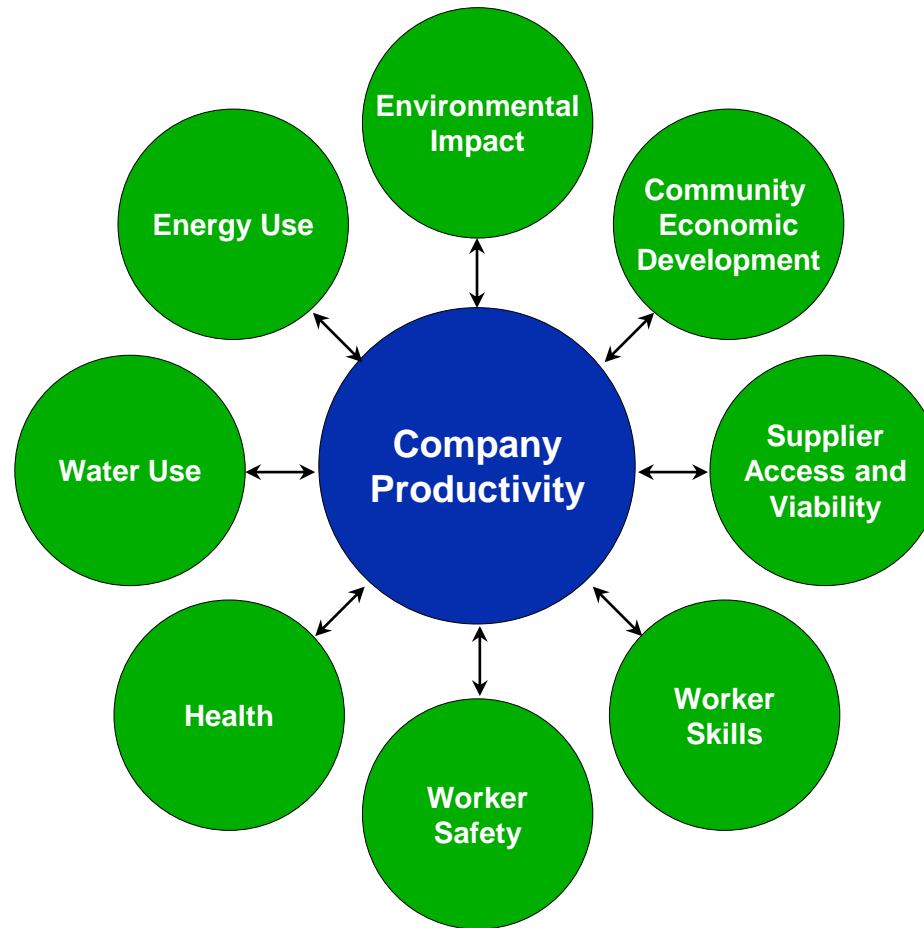
- **Lower revenue** at the same cost

- Implementing a new drug **business model** for low-income populations (Arogya Parivar)
- New quantity, packaging, patient education, and distribution
- Improvement in local healthcare delivery infrastructure
- Learning about non-traditional customer behavior and new business models



- **Higher revenue** and **profitability**

Societal Needs and Economic Value Creation



- **Social** deficits create **economic** cost
- **“Externalities”** shape **internal** company productivity
- Social needs represent the **largest market opportunities**

Levels of Shared Value

I: Reconceiving **needs, products,** and **customers**

- Meeting **societal needs** through products
- Addressing **unserved** or **underserved customers** in the industry

II: **Redefining productivity** in the value chain

- Changing practices in the value chain to drive productivity through **better utilizing resources, employees,** and **business partners**

III: Enabling **local cluster development**

- Improving the **available skills, supplier base,** and **supporting institutions** in the communities in which a company operates to boost productivity, innovation, and growth

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 toxicological profile
- Carries lowest human hazard label

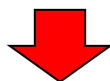


- Applied in **lower quantities** than conventional insecticides
- **Low impact** on **beneficial insects**
- **Double-digit revenue growth** since launch in 2010

Creating Shared Value in Products and Markets

Novo Nordisk in China

- **Product design** that reflects Chinese patient demographics and culture
- **Diabetes training programs for physicians** in partnership with government, NGOs, and opinion leaders to promote the latest thinking on diabetes prevention, screening, treatment, and patient communication
 - The program has **trained 55,000 physicians** to date, each treating approximately 230 patients
- New types of **diabetes education programs for patients** focusing on prevention, lifestyle changes, and effective use of insulin products



- Novo's market share in China increased from **0% to 63%**, and China became the company's third largest market with revenues of \$935 million in 2011

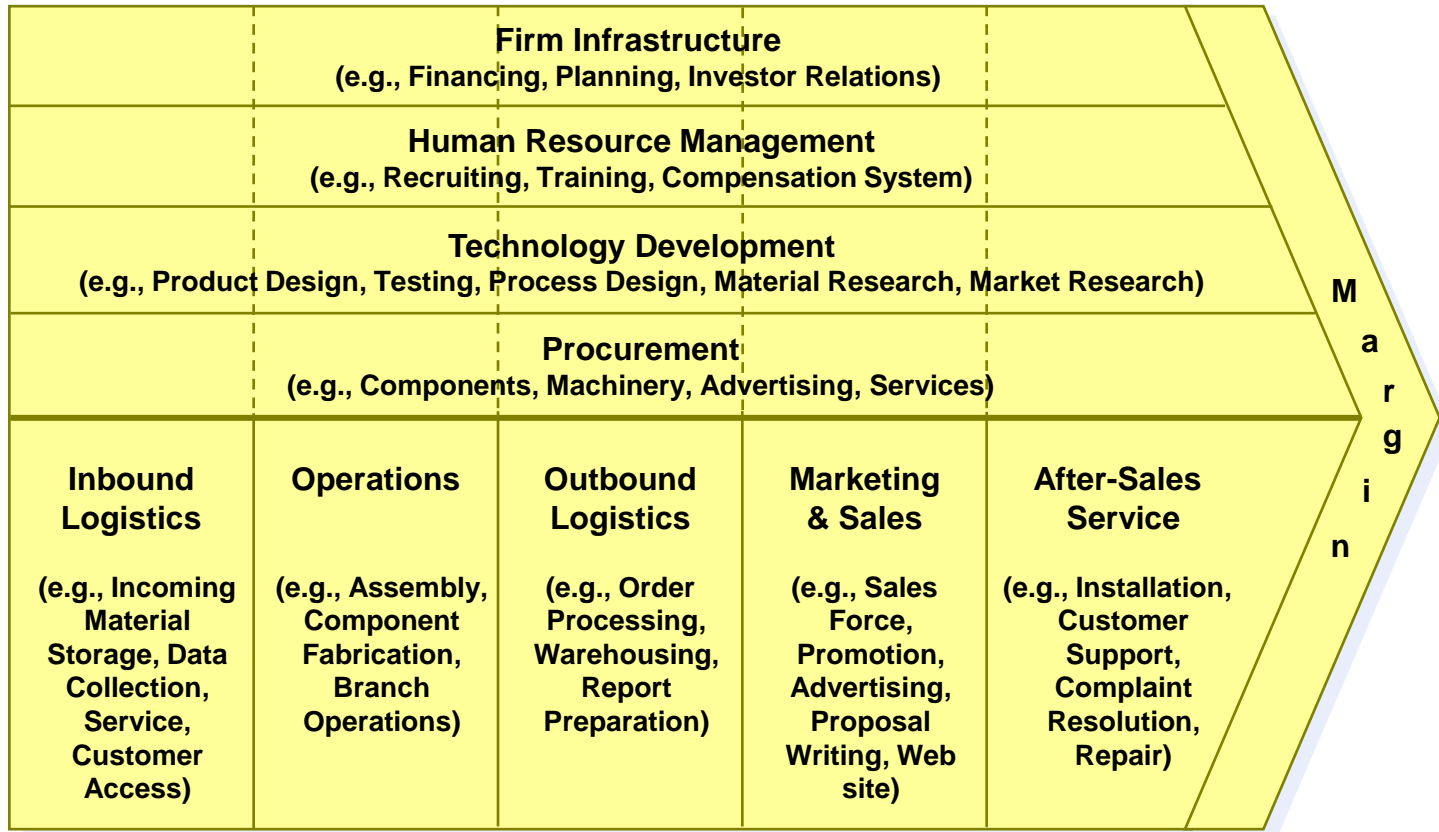
Creating Shared Value in Products and Markets

- Redefine the business around **unsolved customer problems or concerns**, not traditional product definitions
- Identify customer groups that have been **poorly served** or **overlooked** by the industry's products
- Think in terms of **improving lives**, not just meeting customer needs
- 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** for customer segmentation, marketing, innovation, and growth
- Businesses have the potential to be more effective than governments and NGOs in **creating** and **marketing** solutions to community problems

Redefining Productivity in the Value Chain



- Shared value **purchasing**
- **Energy** and **resource** efficiency
- Minimizing **logistical content**
- Strengthening **local distribution** channels
- Improving employee **health and safety**
- Enhancing the productivity of **lower income** employees and improving their wages

Improving the Business Environment in the Company's Major Locations

- Companies, working individually and collaboratively, can catalyze major improvements in the **local business environment**
- Building a **strong local cluster** improves company productivity and growth
 - E.g., Supporting institutions and infrastructure
 - Related businesses



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

Strengthening the Local Business Environment

Roles of Business

Improving skills

- Create or expand an **apprentice program**
- Create or expand a **training program**
- Partner with a **community college, technical school, or university**

Upgrading supporting industries

- Identify and increase sourcing from capable **local suppliers**
- **Mentor local suppliers** to upgrade their capabilities

Supporting innovation and entrepreneurship

- Participate in **research collaboratives** in company's field
- **Invest in or incubate promising startups** related to company's business

Collaborating on regional business environment improvement

- Participate in a **regional competitiveness initiative** in your region

Bolstering regional cluster development

- Participate in a **cluster competitiveness initiative** in your field

Locating in the U.S.

- **Move activities back to the U.S.** that can be productive here

Local Cluster Development

Coca-Cola Brazil

- Coca Cola Brazil has established **Coca-Cola Coletivo**, a program designed to **increase the employability** of low income youth in Brazilian Favelas
- Through partnerships with local NGOs, Coca-Cola Brazil's Coletivo initiative trains local youth for eight weeks in **retailing, business development, and entrepreneurship**
- Coca-Cola Coletivo also **pairs youth with a local retailer** to get their first job experience, which, in turn, enables retailers to improve their operations with trainee assistance

Economic value

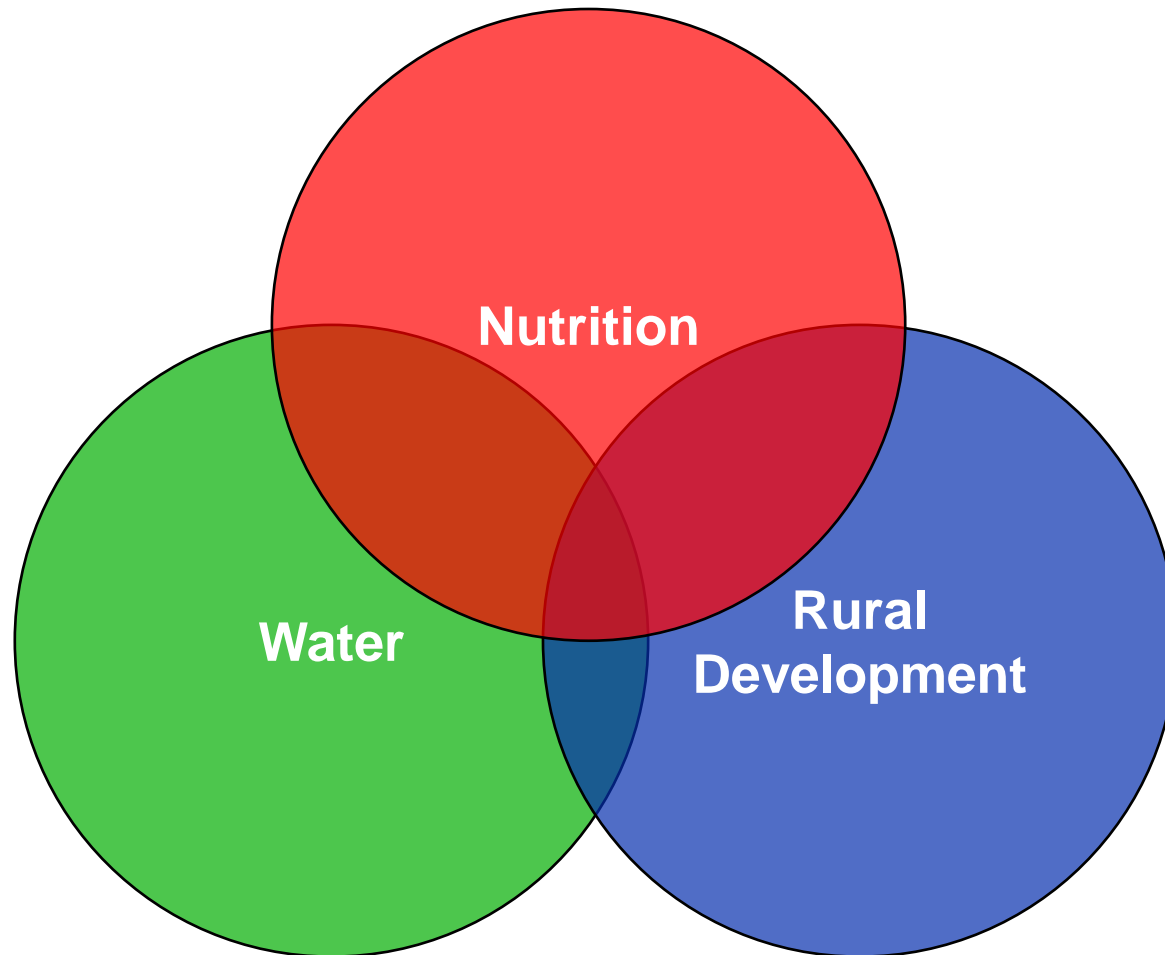
- Through improved retailer operations, Coca-Cola Brazil **increased sales of its products**
- The program also **increased Coca-Cola's market penetration** among the emerging lower-middle income segment

Community value

- Coca-Cola Coletivo graduates gain employment that **raises household income** by 50% on average
- The program operates **160 Coletivos**, training **65,000 youth** per year

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 in Banking

I: Reconceiving customer **needs**, **products**, and **markets**

- Serve **unbanked** and **under-banked** consumers
- **SME** lending and business services
- **Real estate** lending with community multiplier effects
- Financing **affordable housing**
- **Financial instruments** that advance environmental and social progress (e.g., loans repaid with energy savings)

II: **Redefining productivity** in the value chain

- Local / value-added **procurement**
- **Hiring** and **training**
- **Energy** and resource efficiency

III: Enabling **local cluster development**

- **Financial literacy** education
- Leveraging **facility locations as anchors**
- **Skill development** programs in partnership with universities, technical schools or community colleges to improve the pipeline of prospective employees in shortage areas
- Leadership in **regional competitiveness improvement**

New Stakeholder Roles and Relationships

- Shared value thinking is driving **new relationships** between companies, philanthropists, NGOs, and government in addressing social issues

Traditional Roles

- Philanthropists** • Donate to charitable causes
- NGOs** • Receive grants to provide social services
- Governments** • Tax business and regulate business practices; operate social programs
- Companies** • Donate to charitable causes or operate ESG programs



New Roles

- Partner with companies and NGOs to catalyze shared value initiatives
- Enable implementation of new shared value business models
- Partner with companies and NGOs to make platform investments and support shared value strategies
- Partner with NGOs and government to initiate and scale shared value strategies

Adding a Social Dimension to Strategy

- Shared value opens up new **needs**, new **markets**, new **value chain configurations**, and new **ways of thinking** about the business
- This creates new opportunities for **strategic positioning** and new **competitive advantages**
- Companies should incorporate a **social dimension** in their value proposition
- Adding social dimensions makes strategy more **sustainable vs. competitors** than conventional cost and quality advantages

Shared Value and Strategy

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

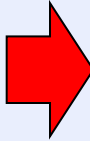
Distinctive Activities

- 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



- Whole Foods is the most **economically successful** food retailer in North America
- Successful strategies in the future will embody a significant **shared value dimension**

Purpose Based Strategic Positioning

| | <u>Traditional Positioning</u> | | <u>New Positioning</u> |
|----------------------|--------------------------------|--|--|
| Nestlé | • Food | | • Nutrition |
| Nike | • Shoes |  | • Health and Wellness |
| Thermo Fisher | • Leader in Serving Science | | • Making the World Healthier, Cleaner, and Safer |

- A **broader sense of purpose** not only opens up **new opportunities** for growth and profitability, but also **motivates** and **attracts** employees, consumers, business partners, shareholders, and the public

The Purpose of Business

- Our purpose in business is to **create shared value for society**, not economic value for its own sake
- Businesses **acting as businesses**, not as charitable givers, are arguably the most powerful force for addressing many of the pressing issues facing our society
- Shared value will give rise to **far broader opportunities** for economic value creation
- Shared value thinking will drive the next wave of **innovation, productivity, and economic growth**
- A transformation of business practice around shared value will give **purpose** to the corporation and represents our best chance to **legitimize business again**