

## BUILDING LINKAGES FOR COMPETITIVE AND RESPONSIBLE ENTREPRENEURSHIP

Innovative partnerships to foster small enterprise, promote economic growth  
and reduce poverty in developing countries

Jane Nelson

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The report forms part of a series of publications illustrating new models of multi-sector partnership and collective corporate action that are fostering small enterprise, promoting economic growth and reducing poverty in developing countries.

Other titles in the series currently include:

- **Viet Nam: Lessons in Building Linkages for Competitive and Responsible Entrepreneurship.**
  - **Tanzania: Lessons in Building Linkages for Competitive and Responsible Entrepreneurship.**
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# BUILDING LINKAGES FOR **COMPETITIVE AND RESPONSIBLE ENTREPRENEURSHIP**

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**Jane Nelson**

United Nations Industrial Development Organization (UNIDO)

Mossavar-Rahmani Center for Business and Government, John F. Kennedy School of Government, Harvard University

# Foreword by Dr. Kandeh K. Yumkella

Director-General, UNIDO



The role of industry in fighting poverty and achieving progress towards the Millennium Development Goals (MDGs) is of critical importance. I am convinced that the path to sustained poverty reduction is to create wealth by empowering the private sector to invest within an enabling policy and regulatory framework established by government. There can be no sustained poverty reduction without capability building, productivity growth and the development of competitive production structures. In this regard, industry has the potential to contribute to many of the MDGs, through generating employment, raising income and providing essential products for the poor such as processed food, pharmaceuticals, shelter, fertilizers, irrigation and essential low-priced consumer products. It is also important to emphasize the significance of domestic entrepreneurship in developing countries and the need to reduce the widespread informality of economies. The challenge presents itself at two levels: first the need to dynamise economic development in a bottom-up process, especially through small enterprise development, and secondly, the need to engage global business players in effective linkages and broader partnerships for development.

In accordance with its mandate, UNIDO is actively engaged in promoting entrepreneurship and private sector development in developing countries and transition economies through the provision of policy advice and institutional capacity-building services. These include measures to integrate small and medium enterprises from these countries into global value chains and enable them to achieve compliance with quality and social standards prevailing in international markets. Recognizing the diversity of challenges that need to be overcome to achieve these objectives, and appreciating that many of these fall beyond the core competencies of the Organization, UNIDO has vigorously pursued a policy of building partnerships with other entities within the UN system, the private sector, academia and civil society. In doing so, it has sought to generate complementarities and increased coherence in the services provided by these partners, and thereby to enhance the developmental impact of these services.

The project with the Kennedy School of Government leading to the preparation of this publication, and the associated country case studies, is an example of this quest for partnerships. Through this joint effort we hope to create awareness on the importance of building effective linkages for the promotion of entrepreneurship in developing countries, and to disseminate the information we have jointly gleaned on the various approaches that may be adopted to this end. Cited within these documents are numerous examples of linkages with a broader range of development partners aimed at the achievement of more substantive developmental objectives. I sincerely hope and believe that this publication will provide a stimulus for further partnership-building between development-minded organizations and corporations for the shared objective of fighting poverty and achieving the MDGs.

Foreword by Professor John Gerard Ruggie,  
Director, Mossavar-Rahmani Center for Business and Government, Harvard University,  
and UN Special Representative on Business and Human Rights



**M**ore now than at any time in recent memory, there is an urgent need for cooperation between governments, business and civil society to find shared solutions to global challenges. After almost two decades of unprecedented economic expansion and tumultuous change, an apprehensive public around the world is coming to appreciate a renewed need to reconcile robust and efficient markets with society's demand for equitable outcomes, social legitimacy, and public trust. And we have learned that the most effective route toward that goal is through the active combination of “smart” government, a socially responsible private sector, and an engaged civil society.

Corporate Social Responsibility may be seen as a voluntary effort on the part of the private sector to realign the efficiency of markets with the shared values and purposes that societies demand, and that markets themselves require to survive and thrive. One area where responsible business practices can play a particularly important role is in reducing poverty through the creation of jobs, income-generating opportunities and livelihoods for the poor. In particular, new types of public-private partnership and business linkages between large corporations and small enterprises offer great potential to increase economic opportunity, productivity and growth. Numerous initiatives are being experimented with around the world, but we need more rigorous analysis on what works and what does not, and how to scale-up the more effective interventions to achieve greater impact.

This is the focus of our joint research project with UNIDO, which analyses different models of public-private partnership and collective corporate action that support competitive and responsible small enterprise development. Through this research we aim to share examples of what we consider to be the most promising mechanisms, and make recommendations for increasing their scale and effectiveness. We welcome this opportunity to work with our colleagues in UNIDO to advance policy-relevant research concerning some of society's most challenging problems at the interface of business and government.



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# EXECUTIVE SUMMARY

“Increasing economic growth rates is essential – but it is not enough. The quality of growth – its sustainability, composition and equity – is equally important.”<sup>1</sup>

Increasing economic opportunity, productivity and growth offers some of our best hopes for reducing poverty. As the Organisation for Economic Cooperation and Development (OECD) has commented, however, “Increasing economic growth rates is essential – but it is not enough. The quality of growth – its sustainability, composition and equity – is equally important.”<sup>1</sup> Crucial elements of such growth include creating jobs, income-generating opportunities and livelihoods for the poor. In particular, this involves improving the access of small enterprises<sup>2</sup> to finance, skills, technology, information, responsible business practices, legal rights and markets. In many developing countries achieving this goal requires effective partnerships and intermediaries that are able to address the market failures, governance gaps and institutional constraints that currently exclude or disadvantage most small entrepreneurs from accessing these public goods and business opportunities. Such partnerships are also essential in helping small enterprises to upgrade and integrate into broader production networks and value chains and to improve their labour and environmental practices, which in turn can help to raise productivity and employment levels.

These partnerships include brokerage mechanisms, business linkage initiatives, hybrid commercial and social business models, innovative financing instruments, enhanced enterprise support services, and new types of alliances between companies, trade associations, governments, donors, academic institutions and non-governmental organisations. They offer great potential for promoting enterprise development, reducing poverty and helping to spread more competitive and responsible business practices along the value chain between large and small-scale firms. Yet such partnerships are relatively new and untested. They are currently few in number and disconnected from each other at the global and national levels. As such, they are limited in scale and effectiveness.

*Building Linkages for Competitive and Responsible Entrepreneurship* provides a framework for categorising six of these different models of multi-sector partnership and collective corporate action. It illustrates examples of existing initiatives and offers recommendations for increasing their scale and effectiveness.

## PART I: A GROWING CONSENSUS ON DEVELOPMENT AND POVERTY REDUCTION

The report looks first at the growing consensus on development and poverty reduction that has emerged around frameworks such as the Millennium Development Goals (MDGs) and National Poverty Reduction Strategies. It highlights five core components in development thinking and practice that underpin this emerging consensus. These are:

- 1) *The centrality of economic growth* – Economic growth, which ensures participation of the poor and takes measures to protect environmental sustainability, is increasingly recognised as an essential and powerful force in the fight against global poverty – both in terms of its potential to generate direct improvements in standards of living and to support broader social progress.
- 2) *The foundation of good governance* – There is recognition that good governance, supported by effective institutions, forms another fundamental pillar for sustained development and poverty reduction.
- 3) *The shared responsibility of governments as development partners* – There is greater acceptance that both developing country governments and donor governments must share responsibility and take mutual leadership for creating the necessary enabling environment – at both national and global levels – for achieving development goals.
- 4) *The active participation of the poor* – The assets, capabilities and voices of the poor themselves are now accepted as being essential in creating effective approaches to poverty reduction, with civil society organisations often playing a key role as interlocutors and advocates.
- 5) *The importance of private sector development, especially small enterprise* – There is strong emerging evidence of the crucial importance of a diversified, productive, profitable and responsible private sector – ranging from large multinationals and domestic corporations, to small, medium and micro-enterprises in both rural and urban communities. The vital role of small enterprises as key producers, employers, distributors, innovators and wealth creators is increasingly recognised. UNIDO argues that, “Crucial to the process [of overcoming poverty and inequality] is the development of a vibrant private sector, in which small and medium enterprises (SMEs) play a central part. SMEs make up over 90 per cent of businesses worldwide and account for between 50 and 60 per cent of employment. However, their importance in the development process goes beyond their strength in number. There is a rich body of research on the development contribution of small enterprises.”<sup>3</sup>

## PART II: THE EMERGENCE OF CSR AND MULTI-SECTOR PARTNERSHIPS

Part II of the report reviews the emergence of two other trends over the past decade, both of which have crucial implications for the achievement of more competitive and responsible entrepreneurship and pro-poor industrial development:

- 1) Corporate social responsibility (CSR); and
- 2) New types of multi-sector partnership and collective action.

Over the past decade the concept of CSR has moved beyond the boundaries of public relations, traditional philanthropy, compliance and defensive 'do-no-harm' strategies, although all of these remain important, to focus additionally on competitive strategies aimed at creating new value for the company and society.

Over the past decade the concept of CSR has moved beyond the boundaries of public relations, traditional philanthropy, compliance and defensive 'do-no-harm' strategies, although all of these remain important, to focus additionally on competitive strategies aimed at creating new value for the company and society. This process has added to the strategic choices that companies can make in managing risks and costs, harnessing new opportunities, engaging with stakeholders, ensuring corporate accountability, and investing in innovation and upgrading.

The report reviews the following trends, critiques and challenges in the emerging area of corporate social responsibility and public-private partnerships:

- 1) *CSR strategies at the enterprise level* – Four CSR strategies that companies can employ at the level of the individual firm are: compliance with regulations and voluntary norms, principles and codes; control of risks, negative impacts, costs and liabilities; community investment and philanthropy; and creation of new market and social value through the development of new products, services, processes, markets and alliances.
- 2) *The link between CSR and governance* – The emerging CSR agenda has implications not only for corporate governance, strategy and risk management at the firm level, but also for governance more broadly at the global and national levels. In many cases CSR is a corporate response to dealing with governance gaps and failures on the part of government.
- 3) *Critiques of CSR* – There are a number of well-argued critiques of CSR that need to be addressed if responsible business practices are to become the norm rather than the exception. These include arguments that CSR is in fact irresponsible in the face of legal requirements for companies to maximize shareholder value; that the 'business case' and drivers for CSR are too weak to ensure wide adoption in the absence of regulations; and that CSR as currently promoted excludes small enterprises and supports a 'northern' agenda that often penalises developing economies.
- 4) *The case for CSR and responsible competitiveness* – Research is being undertaken by a number of scholars and practitioners to test both the micro-level 'business case' for CSR at the level of individual firms and the macro-level 'national competitiveness case' for CSR at the level of national economies. Although still at an early stage, this research offers some support for the proposition that CSR can fuel both corporate and country competitiveness.

At the level of the individual firm in particular, there is a growing body of evidence that effective CSR strategies help cut risks and costs and harness business opportunities and benefits – as outlined below.

CSR-RELATED COSTS, RISKS, BENEFITS AND OPPORTUNITIES	
<p><b>Potential costs and risks of ‘getting it wrong’:</b> Unacceptable ethical, social and/or environmental performance may <i>destroy or undermine</i> a company's financial value.</p> <ul style="list-style-type: none"> <li>• Corporate failure and liquidation</li> <li>• Criminal charges and imprisonment of corporate officers</li> <li>• Litigation costs</li> <li>• Government fines, increased regulatory supervision and greater compliance burdens</li> <li>• Higher costs of capital and insurance premiums</li> <li>• Problems with stock exchange listings, unsuccessful public offers and inability to attract investment capital</li> <li>• Lost customers</li> <li>• Higher operating costs and/or inefficiencies</li> <li>• Reputation damage through media exposés, consumer boycotts, lawsuits, activist campaigns</li> <li>• High employee turnover and low employee morale and engagement</li> <li>• Poor quality control</li> <li>• Opportunity costs due to distraction, time spent on litigation, crisis management and compliance burdens</li> <li>• Inward, compliance-oriented focus, poor executive-board relations, and risk-averse, hostile and suspicious corporate culture</li> <li>• Accelerated depletion of intangible assets such as innovation and good relationships and lost competitive-edge.</li> </ul>	<p><b>Potential benefits and opportunities of ‘getting it right’:</b> Good ethical, social and environmental performance and/or leadership on a specific issue can <i>protect or enhance</i> a company's financial value.</p> <ul style="list-style-type: none"> <li>• Improved risk management, better risk profile and credit ratings</li> <li>• Avoidance of costly regulation</li> <li>• Better access to capital through greater investor confidence, access to socially responsible investment funds, lower insurance premiums and more favourable credit terms</li> <li>• Reduced operating and resource costs</li> <li>• Improved process efficiency and effectiveness</li> <li>• Enhanced intangible assets, such as good reputation, brand equity, product and service quality, successful innovation, increased employee motivation and productivity, positive stakeholder relationships</li> <li>• Better organisational functioning, through creation of a more integrated performance-driven culture, greater cross-boundary linkages and employee learning and motivation</li> <li>• Easier to attract and retain talented employees and loyal customers</li> <li>• More attractive as a reliable strategic partner</li> <li>• Recognition as a neighbour of choice by local community leaders and public authorities</li> <li>• Increased differentiation of existing product and service offering</li> <li>• Greater opportunities for innovation and for new product, service and market development</li> <li>• Competitive advantage, through lower costs, differentiated products, or new products, services and customer solutions.</li> </ul>

Sources: Jackson, Ira and Nelson, Jane. *Profits with Principles: Seven strategies for delivering value with values*. Currency/Doubleday, 2004, page 46. Adapted from Nelson, J. *Business as Partners in Development*. International Business Leaders Forum, UNDP and the World Bank 1996; Nelson, J. *Building Competitiveness and Communities*. International Business Leaders Forum, UNDP and the World Bank, 1998; and Nelson, J, and Zadek, S. *Partnership Alchemy*. Copenhagen Centre, 2000.

The greatest and most sustainable contribution that any company can make to development is through carrying out its core business activities in a productive, profitable and responsible manner, building business linkages and creating other 'economic multipliers' in host countries and communities. The key goals should be to minimise any negative impacts that may arise from the company's activities and to increase and leverage positive impacts.

5) *CSR and the development agenda* – There is growing interest in the link between CSR and the achievement of the Millennium Development Goals. Research by the International Business Leaders Forum, World Bank and UNDP has identified three key spheres of influence through which responsible business practices can contribute to development and poverty reduction:<sup>4</sup>

(i) **Core business activities** – The company's operations, investments and relationships in the boardroom, the workplace, the marketplace and along the value chain. The greatest and most sustainable contribution that any company can make to development is through carrying out its core business activities in a productive, profitable and responsible manner, building business linkages and creating other 'economic multipliers' in host countries and communities. The key goals should be to minimise any negative impacts that may arise from the company's activities and to increase and leverage positive impacts.

Some of the ways in which companies can create positive value for host countries and communities through their core business activities include the following:<sup>5</sup>

- Producing safe and affordable products and services
- Generating income and investment
- Creating jobs
- Developing human resources
- Building local business linkages
- Spreading responsible business standards
- Supporting technology development and transfer
- Establishing physical and institutional infrastructure.

(ii) **Social investment and philanthropic activities** – Aimed at mobilising not only money, but also the company's people, products and premises to help support and strengthen local communities and non-profit partners.

(iii) **Policy dialogue and advocacy activities** – Efforts by companies, either individually or collectively, to support more systemic change and to participate in relevant public policy dialogues and advocacy platforms with both developing country governments and donor governments.

These three key spheres of influence are illustrated on page 8. They can also be envisaged as a company's 'development footprint' – the extent of which will vary depending on the company, industry sector and situation in question.

An interesting development has been the emergence of what Ashoka, the World Economic Forum and others are describing as 'hybrid' or 'blended value' approaches. These are essentially business models, practices or partnerships that combine the company's core competencies and commercial acumen with social investment, philanthropy and/or public finance.<sup>6</sup> Such approaches are being used to support projects that may not currently meet commercial hurdle rates, but have

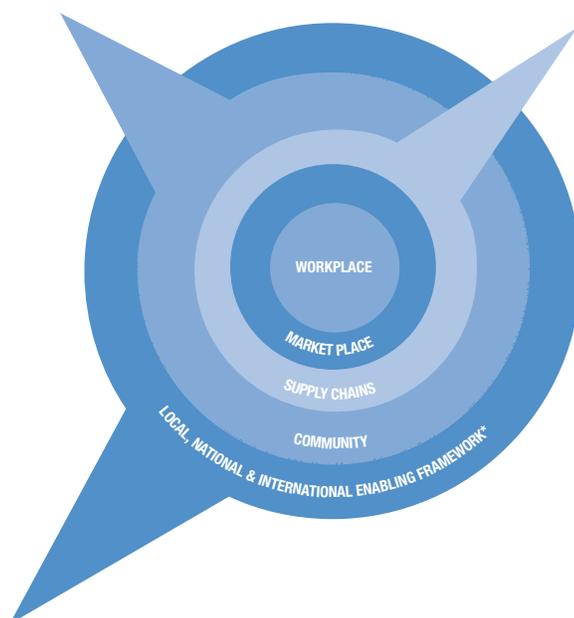
the potential of becoming commercially viable over the longer term, while explicitly addressing a development or social need. They are often carried out in partnership with other actors, such as other companies, NGOs and/or donors – and are one of the innovative partnership models for supporting business linkages that are profiled in Section V of the report.

## SPHERES OF BUSINESS IMPACT AND INFLUENCE

### SOCIAL INVESTMENT AND PHILANTHROPIC ACTIVITIES

Companies can mobilise core competencies and resources such as money, products, skills, premises and people to help support or strengthen local communities by:

- **Supporting enterprise development, education, training, youth development, environmental, and health and nutrition projects in local communities**
- **Building managerial, technical, financial and governance capacity of local community leaders, social entrepreneurs, technical specialists and their organisations**



### CORE BUSINESS ACTIVITIES

The research and development, sourcing, manufacture, marketing, distribution, pricing, end-use, and disposal of many products and services can contribute to international goals in a number of ways. At a minimum these activities should be carried out in a way that complies with the law, manages risks, and minimizes negative social and environmental impacts, while remaining profitable. They can also create positive value for host communities and countries by:

- **Producing safe and affordable products and services**
- **Generating income and investment**
- **Creating jobs**
- **Developing human resources**
- **Building local businesses**
- **Spreading responsible international business standards and practices**
- **Supporting technology development and transfer**
- **Establishing physical and institutional infrastructure**

### POLICY DIALOGUE AND ADVOCACY ACTIVITIES

Companies can take individual and/or collective action to influence the enabling environment, build public capacity, promote good governance and support more systemic change at the local, national or global level by:

- **Supporting effective implementation of international norms relating to human rights, labour rights, bribery and corruption, and the environment**
- **Sharing business skills, know-how, technology and resources with government to help improve public capacity and service delivery in key economic, education and health areas**
- **Helping government to attract and retain foreign investment and to access foreign markets**
- **Advocating for fair trade and effective aid**
- **Engaging in multi-stakeholder dialogues around complex public problems such as corruption, healthcare, education, security, climate change etc.**

\* Enabling framework = regulations, legislation, fiscal incentives, voluntary guidelines and codes of conduct, public opinion, institutional structures, financing mechanisms, research, training and capacity-building, media etc.

Sources: Nelson, J. *Building Partnerships*. United Nations and International Business Leaders Forum, 2002 and Nelson, J. *Business as Partners in Development*. International Business Leaders Forum, UNDP and the World Bank, 1996.

6) *CSR and linkages between large and small enterprises* – One of the most obvious and surprisingly untapped ways that large companies can support development objectives in the countries and communities in which they operate is through spreading economic opportunity through a variety of small enterprise development, training and business linkage initiatives.<sup>7</sup>

Depending on the industry sector and the company's business model, such initiatives can be supported through all three spheres of company influence, as outlined below. Many of these lend themselves to collective business initiatives and other innovative types of cross-sector partnership explored in more detail in Part V of the report.

## LINKAGES BETWEEN LARGE AND SMALL ENTERPRISES

### CORE BUSINESS ACTIVITY

- Procurement
- Agricultural outgrowers schemes
- Manufacturing subcontracting
- Outsourcing non-core functions and services
- Distribution and retail
- Franchising and leasing
- Financial services provision
- Utilities services provision – energy, water, technology

### SOCIAL INVESTMENT AND PHILANTHROPY

- Offering basic business training
- Technical and vocational training
- Volunteering management time
- Donating premises, equipment, discards, cut-offs
- Innovative community financing
- Funding research and development
- Enterprise education in schools

### PUBLIC POLICY ADVOCACY for small enterprises

- Business associations directly advocating for SME-related policies
- Business engagement in national Poverty Reduction Strategy processes

Source: Adapted from Nelson, J. *Business as Partners in Development*. International Business Leaders Forum, UNDP and the World Bank, 1996.

The creation of effective linkages between large companies and small enterprises can offer clear benefits to all the parties involved. According to Peter Brew, Director of Corporate Practices and Policy at the International Business Leaders Forum, “Effective business linkages between multinational corporations and small-scale enterprises can create clear mutual benefits. They help to transfer world-class technology and spread international business standards, creating more competitive, productive and quality-driven business sectors in many countries. They develop the pool of local skills, create market growth opportunities, and decrease procurement and other input costs for multinational companies. They help to build trust with local business communities and government bodies and to ensure a ‘license to operate’.”<sup>8</sup>

7) *The case for partnerships and collective action* – The growth in the corporate responsibility agenda over the past decade has been matched by a marked increase in new types of non-traditional alliances aimed at addressing public problems and development challenges. These new alliances are either between companies themselves – what we refer to in the report as collective corporate action – or between organisations in the public, private and civil society sectors – commonly referred to as public-private, cross-sector, multi-sector or multi-stakeholder partnerships. Some are global in scope, others national or local. Many are focused on addressing a particular development challenge, although some aim to tackle a range of inter-related issues.

In a world beset by market failures, governance gaps and institutional constraints, the case for such alliances can be made at both the national and global level, and from the perspective of both public and private actors, in terms of:<sup>9</sup>

- Improved Effectiveness – greater leverage, scale and systemic impact
- Greater Efficiency – minimising duplication and optimising resource use
- Increased Legitimacy – greater participation, consultation and accountability.

There are two key strategic options for companies aiming to strengthen their contribution to development and to achieve greater scale and systemic impact through engaging in alliances with others:

- (i) **Collective corporate action** – Companies can address certain development challenges by engaging in collective corporate action. Such action can often be achieved through representative business organisations, such as Chambers of Commerce, Organisations of Employers, or trade and industry groups. It can also be achieved through more targeted business leadership groups with a specific development goal or social mandate, such as national business councils for sustainable development, national business coalitions to tackle HIV/AIDS, or as focused on in this report, collective business linkage initiatives to support enterprise development.
- (ii) **Multi-sector partnerships** – Another strategy, with relevance at the global, national or local level, is for companies to participate in formal alliances with key development actors in other sectors – government bodies, donor agencies, NGOs etc. Such alliances vary widely in the formality and rigour of their governance and operational structures, as well as in their focus and purpose. Some are structured as consultation mechanisms, others as operational and delivery mechanisms. Some aim to set standards and improve public and private governance systems, while others aim to mobilise financial and other resources from different sectors. As with collective business action, such multi-sector partnerships can also play a crucial role in supporting competitive and responsible small enterprise development as outlined in Part V of the report.

Looking at the establishment of business linkages between large and small companies, UNIDO's Wilfried Luetkenhorst argues, "...large corporations usually cannot justify bearing alone the expense of upgrading entire local productive systems, which is often required to reduce capability gaps. Also, the benefits of such efforts cannot be completely appropriated at the firm level, thus assuming significant elements of a public goods character. ...Hence there is a case for an intermediary to intervene and complement market mechanisms in creating sustainable business linkages. Any such linkage programme initiated by an impartial broker will need to adopt a sector-wide approach, strengthen existing service institutions, work with local partners, and arrange for world-class expertise to be delivered to SME suppliers."<sup>10</sup>

The development contribution of collective corporate action and multi-sector partnerships comes from their ability to confer greater legitimacy and/or enable greater effectiveness and efficiency than any one of the participants could achieve on its own. But they are not a panacea. These alliances can have high transaction, operational and reputation costs. They may also face substantial governance and accountability challenges. Despite these challenges, they can be a valuable addition to a portfolio of strategies used by companies, governments and NGOs to strengthen the development impact of business.

Alliances can have high transaction, operational and reputation costs. They may also face substantial governance and accountability challenges. Despite these challenges, they can be a valuable addition to a portfolio of strategies used by companies, governments and NGOs to strengthen the development impact of business.

### **PART III: OVERCOMING CHALLENGES TO COMPETITIVE AND RESPONSIBLE ENTREPRENEURSHIP**

Part III reviews some of the key challenges to achieving more competitive and responsible business practices in small enterprises and how these can be overcome. It focuses on the following three broad areas of action:

- 1) *Improving access to finance, business services and legal rights* – Initiatives to improve the access of small enterprises to appropriate products, services and legal and institutional support – with the goals of developing high-potential 'opportunity entrepreneurs' who have the prospect of becoming major job creators and wealth generators and also supporting informal sector entrepreneurs to move into the formal sector in rural and urban communities.
- 2) *Upgrading and integrating small enterprises into value chains* – Initiatives that support small enterprises to upgrade their products, processes and functions and to improve their levels of quality, productivity and innovation – with the aim of enabling them to build successful linkages with large domestic companies and foreign investors and to integrate into broader production networks and value chains.
- 3) *Implementing responsible business practices in small enterprises* – Initiatives that support small enterprises to implement ethical, social and environmental practices – with the goal of helping them to better manage risks and costs; further improve quality, productivity and innovation; and harness new business opportunities and relationships.

## PART IV: THE IMPORTANCE OF PUBLIC POLICY MEASURES

Part IV reviews the important role of good government and effective public policy interventions in supporting competitive and responsible enterprise development. It focuses on the role of public policy in:

- 1) *Creating an enabling framework for private sector development in general* – Establishing a sound investment climate, addressing both macro-stability and micro-economic and regulatory impediments to the mobilisation of domestic capital and the attraction and retention of foreign capital, and investing in physical, social and institutional infrastructure.
- 2) *Supporting small enterprise development* – Ensuring that framework conditions, consultation structures and delivery mechanisms for finance and business development services enable rather than exclude small enterprises, helping informal enterprises move into the formal economy and high-potential entrepreneurs upgrade into broader value chains.
- 3) *Fostering responsible business practices* – Implementing the necessary policies, regulations, funding mechanisms, market incentives, training, and standardisation and certification programmes to either require or encourage the adoption of sound labour and human rights standards, environmental practices and anti-corruption measures – in small enterprises as well as large companies.
- 4) *Improving aid effectiveness* – Improving the effectiveness of bilateral and multilateral aid through increasing national ownership; aligning aid more closely with national development strategies, institutions and procedures; improving harmonisation between donor agencies; managing for results; and ensuring greater mutual accountability for development results.

## PART V: MULTI-SECTOR PARTNERSHIPS AND COLLECTIVE ACTION MODELS

Part V defines and illustrates six key models of multi-sector partnership or collective corporate action that harness a combination of market-driven and public policy approaches to support more competitive and responsible small enterprise development. They are summarised on page 14:

- 1) *Individual company value chains and 'hybrid' business models*
- 2) *Collective business linkage initiatives*
- 3) *Enhanced trade and industry associations*
- 4) *'Blended value' financing mechanisms*
- 5) *Institutionalised enterprise support services*
- 6) *Multi-stakeholder public policy structures.*

All six models are positioned on a spectrum between purely commercial business-to-business (B2B) linkages and fully government-funded services. They are not mutually exclusive. Indeed, they should be viewed as inter-related components of a vibrant enterprise ecosystem, all of them essential for building more sustained and equitable patterns of economic growth.

Some of these partnerships are driven by the private sector, others initiated by donors and government bodies – but all share two common characteristics. First, they harness a combination of commercial and philanthropic funding or private and public resources. Second, they pursue a combination of direct economic self-interest and broader development objectives. They illustrate new models of doing business that also focus on achieving broader development goals. In some cases they illustrate new models of governance and policy making, which emphasise proactive public sector engagement with the private sector and civil society organisations.

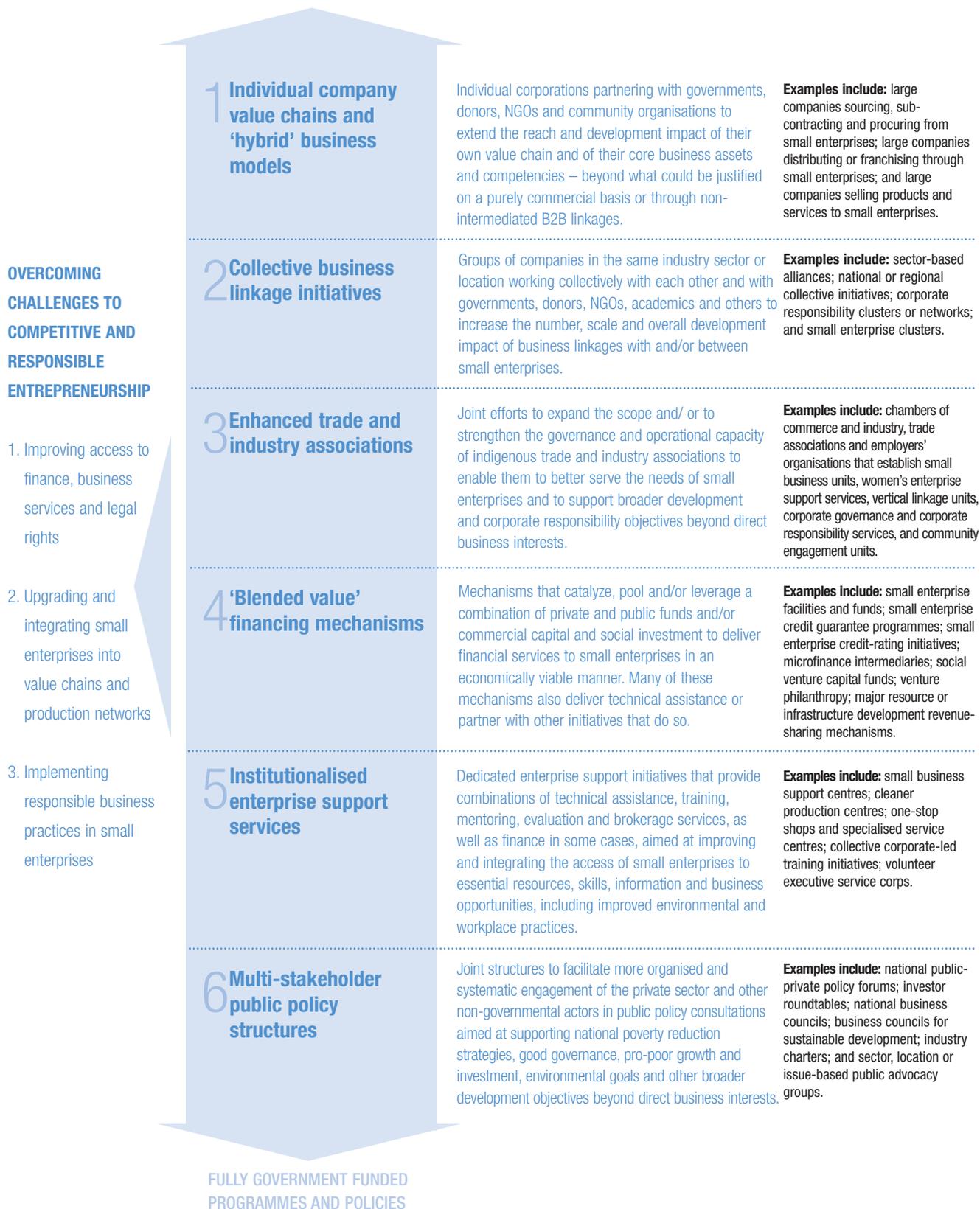
The first two models of partnership and collective action are the most market-driven. They focus on building direct business linkages between large companies and small enterprises that explicitly and systematically aim – in addition to being profitable – to transfer competitive and responsible business practices along corporate value chains and to optimise the development impacts of any these linkages.

The next three models of partnership and collective corporate action focus primarily on delivering essential products and services directly to small enterprises – in particular finance, skills and information. In most cases they employ both private and public resources and they pursue both commercial and social objectives. The relative balances vary from case to case, often driven by the nature of the initiating organisation or managing partner.

The sixth and final model is focused on influencing the broader enabling environment in which competitive and responsible small enterprises can flourish.

**MULTI-SECTOR PARTNERSHIP AND COLLECTIVE ACTION MODELS TO SUPPORT COMPETITIVE AND RESPONSIBLE ENTREPRENEURSHIP**

FULLY COMMERCIAL, BUSINESS-TO-BUSINESS (B-2-B)



The report provides brief summaries of a number of innovative new models in each of these six categories, which include the following:

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#### **EXAMPLES OF MULTI-SECTOR PARTNERSHIPS AND COLLECTIVE ACTION MODELS TO SUPPORT COMPETITIVE AND RESPONSIBLE SMALL ENTERPRISE**

Viet Nam Business Links Initiative – Tanzania's Private Sector Initiative – UNDP's Growing Sustainable Business Initiative – Thai Business Initiative for Rural Development – Mexican Supplier Development Programme – Information Technology Industry Global Supply Chain Initiative – Instituto Ethos, Brazil – TechnoServe – UNIDO's Indian Automotive Partnership – Business Action for Africa – DFID's Business Linkage Challenge Fund – GTZ's Public-Private Partnership Programme – USAID's Global Development Alliance – Investment Climate Facility for Africa – IFC's Enterprise Facilities – Shell's Africa Venture Capital Fund – Acumen Fund – Angola Enterprise Programme – E&Co – Youth Business International – Ethical Trading Initiative – UNIDO/UNEP National Cleaner Production Centres – Atyrau Business Centre, Kazakhstan – Penang Skills Development Centre, Malaysia – Saudi Japanese Automobile High Institute – Endeavor – National Business Initiative, South Africa – Alexandria Business Association, Egypt – Tanzania National Business Council – Philippines Business for Social Progress – Uganda Small Scale Industry Association – Viet Nam Business Forum – Tanzania Investors Roundtable

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*Building Linkages for Competitive and Responsible Entrepreneurship* offers a conceptual framework and brief examples of these different types of multi-sector partnership and collective business models. It is supported by a series of country case studies which analyse some of these models of partnership in more detail and illustrate some innovations in public policy and donor coordination that are promoting competitive and responsible entrepreneurship.

The challenges of expanding economic opportunity and reducing poverty remain daunting, but there is much to be optimistic about. There are already numerous potential solutions. Ongoing efforts are needed to evaluate what works and to replicate and scale those initiatives that are likely to be most effective. Better governance and accountability on the part of both donor and developing country governments will be essential to achieving this. Such governance and accountability will also be important on the part of corporations, trade unions and non-governmental organisations. At the same time, leaders in the public, private and civic sectors will need to become better innovators and risk-takers, willing to experiment with new models and approaches that span traditional boundaries. All of these leaders will need to learn from and work with the millions of men, women and young people living and working in low-income urban and rural communities, many of them as self-employed entrepreneurs who are not asking for charity but rather seeking opportunity.



# I A GROWING CONSENSUS ON DEVELOPMENT AND POVERTY REDUCTION

## Our common global agenda

“Globalisation, so far from being the cause of poverty and other social ills, offers the best hope of overcoming them.”

Over the past two decades, the forces of political change, globalisation and technical innovation have ushered in an era of increased prosperity and political freedom for millions of people worldwide. For the first time in human history over half the world’s population lives under democratically elected governments. Close to four billion people have made the transition from living in centrally planned to market-oriented economies. This process has resulted in a large-scale transfer of assets to the private sector and has led to the emergence of new business models, new industries, increased financial flows, expanded global value chains and cross-border transactions between more countries and regions.

With the appropriate conditions – in particular, good governance and efficient markets – these trends have resulted in increased wealth creation, economic growth and higher living standards. The former UN Secretary-General Kofi Annan has commented: “Globalisation, so far from being the cause of poverty and other social ills, offers the best hope of overcoming them.”<sup>1</sup> The economist Martin Wolf argues in his book *Why Globalisation Works*, “Never before have so many people – or so large a proportion of the world’s population – enjoyed such large rises in their standard of living.”<sup>2</sup>

Yet, the benefits and costs of globalisation have not been evenly spread. Millions of people around the world still lack access to the economic opportunities and basic services that would help to lift them out of poverty. They lack sufficient income from wage employment or self-employment to provide basic nutrition, health and education for their families. They are often excluded from economic decision-making and access to productive assets and resources. Many operate in the informal sector – a legal ‘twilight zone’ severely limiting their access to affordable credit and risk management tools and their recourse to property rights and other forms of legal protection. Risks are high and they are particularly vulnerable to natural and economic disasters, to the impacts of corruption and bad governance and to the costs associated with inefficient markets and market externalities. They live in a survival economy with limited opportunities for benefiting from improved productivity and competitiveness, and minimal chance of achieving the sustained economic dynamism, income generation and wealth creation that are essential for reducing poverty.

In an interdependent world, long-term prospects for human progress and economic prosperity are seriously challenged by this persistent poverty, which is both driven by and exacerbates inequality, insecurity and instability.

Consider just five of the key contradictions and leadership challenges faced by the international community and national leaders:<sup>3</sup>

*Supporting people 'left-behind' by economic and technical change* – While economic restructuring, outsourcing and the emergence of new technologies are creating jobs and unprecedented wealth for people with the necessary skills and education, there is often failure to adequately address the economic insecurity and training needs of those who are being 'left-behind' – in both developed and developing economies. One result has been a widening of inequality both within and between nations related in large part to relative skills and technical capacities. In his book, *The Wealth and Poverty of Nations*, Professor David Landes notes that, "...the current pattern of technological diffusion and catch-up development will press hard on the haves, especially the individual victims of economic regrouping, while bringing "goodies" and hope to some of the have-nots, and despair, disappointment, and anger to many of the others."<sup>4</sup> In some cases these are inevitable short-term or transitional trade-offs and tensions that can be addressed through sound public policy interventions. In other cases they are a result of bad policies that directly exclude particular groups, regions or countries from access to new skills, technologies and economic opportunities. Regardless of the drivers, their political and economic implications are often severe and cannot be ignored.

*Levelling the 'playing-field' for small entrepreneurs* – While small-scale, start-up entrepreneurs in OECD countries usually have access to clearly defined legal and property rights, efficient and affordable registration processes, and reasonably priced and accessible financing and business development services, their counterparts in low income countries are severely constrained by deficiencies in all of these areas. The World Bank's *Doing Business in 2004* survey, for example, estimates that: "It takes 2 days to start a business in Australia, but 203 days in Haiti and 215 days in the Democratic Republic of the Congo. There are no monetary costs to start a new business in Denmark, but it costs more than 5 times income per capita in Cambodia and over 15 times in Sierra Leone. ...A simple commercial contract is enforced in 7 days in Tunisia and 39 days in the Netherlands, but takes almost 1,500 days in Guatemala."<sup>5</sup>

"It takes 2 days to start a business in Australia, but 203 days in Haiti and 215 days in the Democratic Republic of the Congo. There are no monetary costs to start a new business in Denmark, but it costs more than 5 times income per capita in Cambodia and over 15 times in Sierra Leone."

The personal and financial risks that an aspiring entrepreneur must take in a developing country put him or her at a disadvantage from the outset. This is before one takes into account lower skill levels and training, inadequate physical and institutional infrastructure, out-dated technology, lack of quality awareness, an absence of capital, and other impediments to upgrading business processes and products, increasing productivity, and integrating effectively into global value chains.

Not surprisingly, the development contribution of such enterprises is compromised. Alan Patricof and Julie Sunderland drawing on World Bank research argue that, “In high-income countries, the SME sector has been estimated to contribute more than 50% to GDP, not to mention being the engine of new job creation and a source of as much as half of the innovation in these economies. In low-income countries, however, the contribution of the SME sector to GDP has been estimated at 16% and, in most African countries the SME sector has been estimated at less than 10%. This absent segment of companies that are undergoing the risky but creative process of growing from small to medium-sized to large could explain much of the weakness in the overall economic growth of developing countries.”<sup>6</sup>

Referred to by many development and business experts as the “missing middle”, this group of companies is essential to increasing productivity, employment and income generation. While the dramatic growth in microfinance over the past decade is playing a vital, if yet still insufficient role in supporting the smallest of small enterprises, failure to adequately support the ‘missing middle’ – those enterprises that fill the spectrum between micro-enterprises and larger companies – is a serious impediment to development.

*Tackling youth unemployment* – While much-needed attention is being focused on the looming pensions and healthcare crises resulting from aging populations in most developed economies, the economic and political risks associated with the ‘youth bulge’ in many developing countries have all too often been ignored, although the *World Development Report 2007* has focused on youth for the first time. Over the next decade, about 1.2 billion young people will enter the global labour market – the largest entry pool in history. Experts predict, optimistically, that no more than 300 million new formal sector jobs will be created during the same period. Furthermore, approximately 70% of young people in developing countries are not in school past age 14. In parts of the Middle East and Africa over 50% of the population is under the age of 25.

As Rick Little, co-chair of the UN’s Youth Employment Network argues, “We cannot ignore the implications of a generation of young people without job prospects, opportunity or hope. Providing them with access to employment, livelihood opportunities, credit and business coaching will be absolutely essential to securing a more peaceful and prosperous future for all.”<sup>7</sup>

*Harnessing technology for social and environmental progress* – While advances in science and technology have vastly improved the quality of life and longevity of millions of people and at the same time driven lucrative new industries and business models, the international community has failed to find effective solutions – either through public or commercial funding – to many preventable diseases and malnutrition, or to key drivers of environmental degradation, in particular climate change, water scarcity and biodiversity loss. All of these technically solvable

problems impose a particularly strong burden on the poor and are in turn further exacerbated by poverty. None of them is likely to be solved without approaches that combine the delivery of public goods with elements of market mechanisms and market disciplines.

*Improving global governance* – While effective governance becomes ever more important, the national ‘policy space’ or flexibility of individual government action in many countries is being narrowed down by forces of globalisation. At the same time, effective global policy approaches are still embryonic at best – especially those that include increasingly influential non-state actors as well as nation states in their governance and implementation structures.

“The imbalanced system of global rule making is particularly problematic for the sustainability of globalisation itself. Rules that favour global market expansion have become more robust and enforceable – intellectual property rights, for example, or trade dispute resolution through the World Trade Organisation. But global rules intended to promote equally valid social concerns, be they labour standards, human rights, environmental quality or poverty reduction, have not kept pace.”

Professor John Ruggie, Director of the Kennedy School’s Center for Business and Government and former Assistant Secretary-General at the United Nations, notes that, “The imbalanced system of global rule making is particularly problematic for the sustainability of globalisation itself. Rules that favour global market expansion have become more robust and enforceable – intellectual property rights, for example, or trade dispute resolution through the World Trade Organisation. But global rules intended to promote equally valid social concerns, be they labour standards, human rights, environmental quality or poverty reduction, have not kept pace.”<sup>8</sup>

### **No easy answers, but growing consensus**

It is reasonable to argue that on a collective basis the international community already has the necessary technologies, financial resources, entrepreneurial acumen and human ingenuity to create the wealth and technical solutions that are required to address the challenges outlined above. What are needed are more effective institutions, more efficient market mechanisms and more accountable approaches to mobilising and allocating resources. To achieve this, new types of market-driven partnerships, new funding instruments and new governance structures are required in order to harness the competencies and resources of *all* sectors – public, private and civil society.

Yet, the challenge is far from straightforward. Nancy Birdsall, President of the Center for Global Development, argues, “[There are] ...no simple solutions to making globalisation work for all. Yes, root out corruption and liberalise markets in poor countries. But do not rely on open markets alone, and watch out for the costs of open capital markets in particular. Yes, fix the global rules. But do not expect that this alone will do. The poorest countries are so far behind that they may not be able to compete on a level playing field – at least without help to build their human capital and improve their local infrastructure and institutions.”<sup>9</sup>

Despite the complexity and contradictions that beset the vision of achieving more sustainable and equitable economic growth, there is cause for cautious optimism. For the first time in over fifty years of international development efforts, an

increasingly clear framework is emerging on the roles and responsibilities of different development actors and the key types of intervention that are most likely to make a difference. Since 2000, several major development initiatives, reports and commissions have added increased momentum and impetus to this growing consensus. They include the following:

### The UN Millennium Declaration and Millennium Development Goals (MDGs)

In September 2000, 189 Heads of State and Government ratified the *UN Millennium Declaration*. The declaration is an unprecedented global commitment and one of the most significant United Nations documents of recent time. It brings together the conclusions and commitments made by governments in a series of major UN conferences throughout the 1990s, to offer a common and integrated vision for tackling some of the major development challenges facing the world.

The goals of poverty reduction and shared responsibility between donor and developing country governments lie at the core of the declaration. These goals were further endorsed at the 2002 International Conference on Financing for Development, which resulted in the *Monterrey Consensus* calling for a new partnership of rich and poor countries based on good governance and expanded trade, aid and debt relief, and at a series of G8 Summits.

One of the *UN Millennium Declaration's* most important outcomes has been the introduction of eight Millennium Development Goals (MDGs), to be achieved between 1990 and 2015. They are focused on:

- Halving extreme poverty and hunger
- Achieving universal primary education
- Promoting gender equality
- Reducing under-five mortality by two-thirds
- Reducing maternal mortality by three-quarters
- Reversing the spread of HIV/AIDS, malaria and TB
- Ensuring environmental sustainability
- Developing a global partnership for development, with targets for aid, trade and debt relief.

These goals have become the defining framework for international development. The Millennium Project's 2005 report to the UN Secretary-General, *Investing in Development*, described them as, "the most broadly supported, comprehensive, and specific poverty reduction targets the world has ever established, so their importance is manifold."<sup>10</sup>

They are generally accepted, if not yet fully integrated into policies and practices, by most donor and developing country governments and major multilateral institutions in the UN system, the World Bank Group, the IMF, and OECD. Leading non-governmental organisations and companies are also increasingly using them as a frame of reference. As the former Director-General of UNIDO,

Carlos Magariños, has commented, “I see the MDGs as an organising principle for the international system, offering programmatic coherence for the UN’s activities, particularly at country-level, and constituting the basis for an integrated, multi-sectoral approach to development. ...they provide an opportunity to achieve a demonstrable coming together of the system’s various organisations around common objectives, wherever possible pooling resources, engaging in collaborative programming, and devising innovative alliances and partnerships to deliver results.”<sup>11</sup>

A results-oriented emphasis on measurable indicators is one of the MDGs’ key advantages and innovations. In devising the MDGs, the United Nations Development Programme worked with the World Bank, the IMF, the OECD, and other UN departments, funds and programmes, to agree on a set of concise goals, backed by numerical targets, quantifiable indicators, and an annual reporting framework to monitor progress. The eight MDGs are backed-up by 18 targets and over 40 indicators, as outlined in Appendix I.

The UNDP has been tasked with MDG measurement and reporting at the country-level. The aim is to use country reports not only to monitor and manage progress and to improve research and analysis, but also to raise public awareness and provide citizens, the media, non-governmental groups and others with the information needed to press their governments. To date, over 20 countries have issued such reports.

At the same time, the World Bank and the IMF are cooperating on the production of an annual *Global Monitoring Report*. According to this report, progress towards the MDGs has been slow and uneven across regions. Some parts of the world, most notably China, South East Asia and India, have shown impressive advances in reducing poverty, but others, such as parts of Latin America, many small island economies, and notably most of Africa, have experienced either limited progress on the goals, or in some cases absolute declines in average living standards. In many cases, the achievement of sustained economic growth has been a key factor in differentiating the leaders from the laggards.

The World Bank and the IMF estimate that most African countries, for example, would need to double their average annual growth rates to 7% in order to halve poverty by 2015. This goal can never be achieved without better governance, growth-oriented policies, and much greater support for private sector development and entrepreneurship. While the challenge may appear daunting, the existence of these results-oriented MDGs gives governments and their citizens, for the first time, a framework and a set of globally accepted and comparable statistics with which to assess progress.

## National Poverty Reduction Strategies

The *UN Millennium Declaration* and MDGs were pre-dated by a World Bank and IMF-led effort to require the preparation and implementation of national poverty reduction strategy papers (PRSPs) by developing country governments.

The World Bank and IMF's Development Committee first endorsed PRSPs in September 1999, as a requirement for low-income countries receiving funding from the International Development Association (IDA) and Enhanced Structural Adjustment Facility (ESAF). Today the approach is increasingly used as a framework for accessing other sources of donor funding and is becoming the principal national policy tool used by a growing number of governments in their efforts to achieve the MDGs. Several key principles underpin the development of PRSPs. These are outlined in Box 1 and reflect similar significant shifts in development thinking and practice as those embodied in the MDGs:

### **BOX 1: KEY PRINCIPLES UNDERPINNING POVERTY REDUCTION STRATEGY PAPERS**

Poverty reduction strategy papers are produced according to five principles:

- 1** They are country-driven, involving broad-based participation by civil society and the private sector as they are produced.
- 2** They are directed toward achieving results and focused on outcomes that would benefit the poor.
- 3** They recognize that tackling poverty requires a comprehensive approach because poverty is more than just a lack of income. Poor people also suffer a lack of opportunity, security and voice in decisions that affect their lives.
- 4** They are partnership-oriented in that they encourage the coordinated involvement of bilateral, multilateral and non-government organisations in the country's poverty reduction programme.
- 5** They are based on a long-term perspective for poverty reduction.

Source: World Bank Group. [www.worldbank.org](http://www.worldbank.org)

## The New Partnership for African Development (NEPAD) and the African Peer Review Mechanism

Leaders in developing countries themselves have also driven new collaborative approaches to poverty reduction in recent years. One notable example has been the development of NEPAD, which is championed by African leaders and calls for a programme for action that aligns well to both the MDGs and PRSPs.

A key innovation established through NEPAD has been the African Peer Review Mechanism (APRM), through which African governments agree to open their governance policies and practices to review by their peers from neighbouring countries. The mechanism is still at an early stage of implementation and its ability to influence fundamental improvements in governance remains to be extensively tested. The fact that it is a voluntary mechanism limits its potential effectiveness, as illustrated by the decision of Zimbabwe's government not to participate in the

process. It does, however, provide a useful new approach to mutual accountability and learning.

Although the mechanism focuses on governance issues, UNIDO has argued that it could also be extended to “provide an incentive for African countries to learn from each other in terms of private sector development policies. Along these lines, the APRM can be utilised to create competition in policy reforms, as well as informing potential investors and breaking widespread perceptions about Africa’s investment environment.”<sup>12</sup>

### Expert-led commissions and reports

In addition to collaborative frameworks such as the MDGs, PRSPs and NEPAD, a series of expert-led commissions during 2004 and 2005 proposed a similar integrated vision and set of results-driven recommendations to reducing poverty. Notable examples include:

- The UK Government’s Commission for Africa, and its report *Our Common Interest*, which was launched in 2005.
- The report of the UN Secretary-General, *In Larger Freedom: Towards Development: Security and Human Rights for All*, published in 2005.
- The UN Millennium Project and its report, *Investing in Development*, which was issued in 2005, along with a series of sector task-force reports.
- The UN Secretary-General’s Commission on the Private Sector and Development, and its final report *Unleashing Entrepreneurship: Making Business Work for the Poor*, which was issued in 2004.
- The UN Secretary-General’s High-Level Panel on Threats, Challenges and Change, and its final report *A More Secure World: Our Shared Responsibility*, which was issued in 2004.
- The World Economic Forum’s *Global Governance Initiative*, which consisted of six expert groups in the areas of peace and security, human rights, environment, education, poverty and hunger, and health, and issued reports in 2004, 2005 and 2006, providing rankings of the world community’s progress in each of these areas.

These new development frameworks and recent global commissions and reports all reflect similar fundamental changes in the thinking and practice of international development. They all emphasize critical foundations such as economic growth, good governance, effective institutions and efficient markets that have not received sufficient attention by the international development community in the past 20 years. And they all focus on the vital role of a much more diverse group of actors than ever before, ranging from governments to non-governmental organisations, and from large multinational corporations to small-scale entrepreneurs and farmers.

Together, these five core components of development provide a solid foundation for increasing people's access to the economic opportunities and basic services that help to promote enterprise development, create jobs and livelihoods, increase productivity and competitiveness, generate more equitable wealth creation, and overcome extreme poverty.

To a lesser or greater extent, they all emphasize five critical components of development that are likely to be of growing importance in achieving more equitable and sustainable patterns of economic growth and tackling global poverty in the 21st century. These are outlined in the following pages:

- 1. The centrality of economic growth**
- 2. The foundation of good governance**
- 3. The shared responsibility of governments as development partners**
- 4. The active participation of the poor**
- 5. The importance of private sector development**

Together, these five core components of development provide a solid foundation for increasing people's access to the economic opportunities and basic services that help to promote enterprise development, create jobs and livelihoods, increase productivity and competitiveness, generate more equitable wealth creation, and overcome extreme poverty. Each of them has been extensively analysed, debated and researched elsewhere. The following pages offer a brief overview.

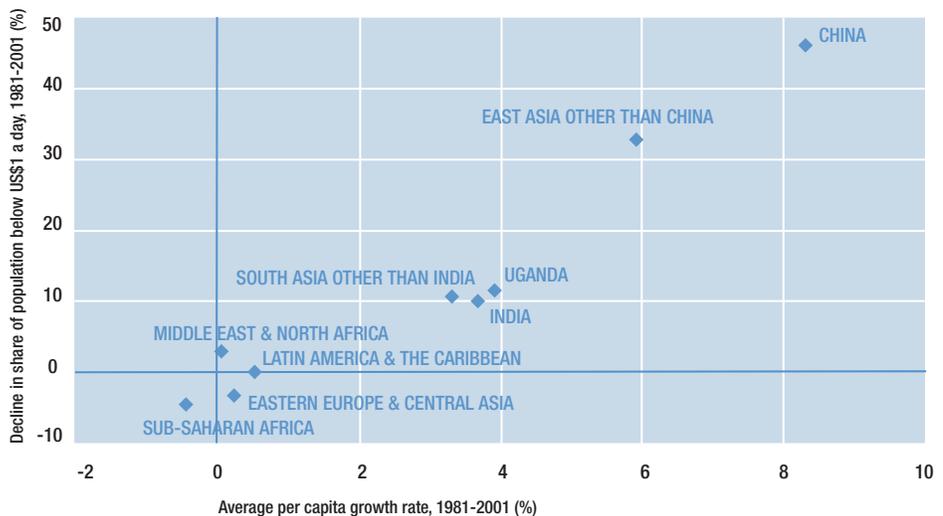
# 1 The centrality of economic growth

There is convincing evidence that sustained economic growth, accompanied by measures to ensure participation of the poor and to protect the environment, is an essential and powerful force in the fight against global poverty.

Although debate continues on the role that economic growth plays in improving the quality of peoples' lives, there is convincing evidence that sustained economic growth, accompanied by measures to ensure participation of the poor and to protect the environment, is an essential and powerful force in the fight against global poverty.

The following graph illustrates the association of economic growth with reductions in poverty in selected regions of the world between 1981 and 2001.

**FIGURE 1: POVERTY REDUCTION IS CLOSELY ASSOCIATED WITH GROWTH**



Source: *World Development Report 2005: A Better Investment Climate for Everyone*. World Bank, 2004.

Countries that have delivered sustained economic growth in recent decades, most notably China and other Asian countries, have achieved dramatic improvements in living standards and lifted millions of people out of poverty – albeit not without ongoing challenges of income inequality between regions and environmental degradation. Those countries that have failed to achieve such growth have a dismal record in reducing poverty.

The World Bank makes the case, “The importance of growth for reducing poverty cannot be overstated. Poor people typically benefit from rising aggregate incomes and suffer from economic contractions. Major improvements have also occurred in the non-income dimensions of poverty in recent decades. ...But progress has been uneven and massive challenges remain.”<sup>13</sup>

Professor Ricardo Hausmann, Director of Harvard’s Center for International Development argues, “The fundamental difference between poor countries and

rich countries is that poor countries have low income and rich countries have high income. If you want to transform poor countries into richer countries then incomes need to grow, so economic growth is central to that. In the poorest countries in the world, workers are 1/70th as productive as workers in the richest countries in the world. And this is a relatively new phenomenon. When Adam Smith wrote about the wealth of nations, the poorest country in the world was only four times poorer than the richest country in the world. That has gone from four-to-one to seventy-to-one.”<sup>14</sup>

While sustained economic growth is essential for tackling poverty, the quality of growth is also a key factor.

The OECD’s Development Assistance Committee (DAC) has commented, “Vigorous, sustained economic growth in the private sector creates jobs and incomes for the poor. It also generates public revenues to finance social development and social protection programmes and to strengthen the institutional framework and physical infrastructure for efficient markets. ...But even rapid and durable growth can leave people behind. Only about half the increase in incomes of the poorest fifth of the population comes from GDP growth. The other half comes from the quality of growth – from its composition, distribution and sustainability.”<sup>15</sup>

“...for output growth to contribute to poverty alleviation, it must translate into incomes for the poor. For wage labourers and salaried workers, the quantity of employment and the rate of pay are crucial. For the self-employed, productivity and returns are important, influenced by technology, inputs and prices. Employment is thus the key link between output growth and poverty alleviation.”

The UN’s Commission on Private Sector and Development, concluded in a similar way, “...for output growth to contribute to poverty alleviation, it must translate into incomes for the poor. For wage labourers and salaried workers, the quantity of employment and the rate of pay are crucial. For the self-employed, productivity and returns are important, influenced by technology, inputs and prices. Employment is thus the key link between output growth and poverty alleviation.”<sup>16</sup>

Likewise, Professor Benjamin M. Friedman, argues in his book *The Moral Consequences of Economic Growth*, “Economic progress needs to be broadly based if it is to foster social and political progress. That progress requires the positive experience of a sufficiently broad cross-section of a country’s population to shape the national mood and direction.”<sup>17</sup> In situations where economic growth results in a rising standard of living for the majority of citizens, Professor Friedman argues that its impact is not only limited to a higher material standard of living, but also, “...more often than not fosters greater opportunity, tolerance of diversity, social mobility, commitment to fairness, and dedication to democracy.”<sup>18</sup>

In short, to have any long-term hope of being sustained, efforts to accelerate economic growth must take into account wider considerations of human development and environmental sustainability, as well as the challenges of raising productivity levels, upgrading quality and technology, and integrating into global value chains.

Having said that, without economic growth and the public revenues as well as the private wealth that such growth generates, aspirations to fund human and environmental progress are doomed to failure. As the multi-sector Commission for Africa reported, “Africa is the poorest region in the world. Over the last 30 years, on average, its people have seen virtually no increase in their incomes. Across countries and within countries over time the message is clear: without economic growth, Africa cannot make substantial reductions in poverty.”<sup>19</sup>

There is a long way to go, in Africa as well as other low-income countries. Mark Malloch Brown, the former UN Deputy Secretary-General and UNDP Administrator, has commented, “Economic progress has in many places stalled. Growth is anaemic and not overcoming a structural unemployment driven by reduced agricultural opportunities, urban migration, and above all, a demography that is putting hundreds of millions of young job seekers into the employment market. Simply put, we are failing to meet the challenge of higher economic growth.”<sup>20</sup>

What is required to reverse this situation? As in other areas of development, there has been an important transition in thinking and approach over the past few decades.

The Commission for Africa captures this transition, “Economists have long seen growth in terms of the accumulation of physical and human capital, on the one hand, and the productivity with which factors of production – land, labour and capital – are used, on the other. The collapse in African growth post-1973 is blamed on a collapse in both. The last decade has seen a shift of attention towards still more fundamental questions. Why do some countries see more rapid accumulation and higher rates of productivity growth than others? What enables a country to sustain growth, once it has been ignited? The answers have focused on institutions – particularly those relating to governance, including peace and security and the economic framework – and on geography – particularly the impact of Africa’s distinctive tropical, largely landlocked geography on agriculture and transport costs. Both governance and geography shape the incentives, opportunities and constraints on the private sector – from small firms to big firms – and the level of productivity and innovation in the economy.”<sup>21</sup>

But, as the Commission emphasizes, “Neither governance nor geography is destiny. There are many ways a nation can act to improve its governance and many ways outsiders can help. ...Problems of geography can also be overcome or reduced by investments in infrastructure, good governance, and regional cooperation to stop political borders becoming economic barriers.”<sup>22</sup>

There is clearly no one-size-fits-all approach to ensuring economic growth. Patterns of growth, market concentration and opportunities for small enterprises will obviously vary for different countries and sectors. Natural resource

beneficiation, for example, as well as agribusiness, manufacturing, and services, such as banking, telecommunications, transportation, tourism, health and education, all offer some degree of opportunity for domestic enterprises, including small enterprises. But the specific policies, investment strategies, institutional structures and types of partnership between the public and private sectors that are needed are likely to vary in each case. So too is the balance between public intervention and market-driven approaches.

Carlos Magariños states that, “Most – if not all – of the countries that have succeeded in achieving economic development and translating it into social progress did so by combining sound macroeconomics with market-oriented reforms, good governance with reliable institutions, and the proper interaction between incentives and the supply of public goods, so as to balance economic dynamism with social inclusiveness. Most of them, far from adopting one-size-fits-all models, developed their own approaches.”<sup>23</sup>

Professor Hausmann comments, “I think there has been too much guidance and not enough experimentation. I think there’s too much of an attempt to have a ‘one-size-fits-all’ approach to development, one formula, a single conventional wisdom, and that has not been terribly helpful. We need more country focus; we need less focus on how to make aid effective and more focus on how to make policies in countries effective.”<sup>24</sup>

In summary, the achievement of sustained economic growth is increasingly accepted as an essential prerequisite for reducing poverty. The crucial challenges are:

- How to identify and overcome the constraints to such growth on a country by country basis; and
- How to ensure that it benefits the poor and does not degrade the environment.

Governments, in both donor and developing countries, have a crucial role to play in addressing these challenges, but so do the private sector and the poor themselves. The different roles and responsibilities of government, the poor and the private sector are outlined in the following sections.

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## 2 The foundation of good governance

The Millennium Development Goals and other recent development frameworks, commissions and reports strongly emphasise the crucial importance of good governance. The concept of governance used to focus almost exclusively on what governments do. In today's world this concept is no longer limited to the role of governments, although this role remains essential. It is increasingly focused on:<sup>25</sup>

- Balancing rights, responsibilities and resources between different levels of government (local, national and international) and between different sectors (government, the private sector and civil society); and
- Creating more participatory, 'hybrid' structures of governance that involve the public, private and/or civic sector all taking a more active responsibility in ensuring good governance and accountability.

The following definition from UNDP offers a sense of this more dynamic, complex and multi-stakeholder concept of governance and Box 2 outlines five essential characteristics of good governance:<sup>26</sup>

*Governance is the set of values, policies and institutions by which a society manages economic, political and social processes at all levels through interaction among the government, civil society and private sector. It is the way in which a society achieves mutual understanding, agreement and action.*

*Governance comprises the mechanisms and processes through which citizens and groups articulate their interests, mediate their differences and exercise their legal rights and obligations. It is, in other words, the framework of rules, institutions and practices that sets limits and provides incentives for individuals, organisations and businesses.*

### BOX 2: CHARACTERISTICS OF 'GOOD GOVERNANCE'

Research by the World Bank, UNDP and OECD all point to the following common characteristics of good governance.

**Legitimacy** – derived from the degree of democracy and other forms of participation beyond the ballot box, which give citizens a voice in decision-making and ensure that political, social and economic priorities are based on broad consensus in society. It calls for an inclusive and consultative approach to decision-making.

**Administrative competence** – the managerial and organisational abilities to formulate policies, raise and allocate resources, and deliver public services in an effective, efficient and equitable manner.

**Credibility** – discipline and consistency in policy implementation to build public confidence and trust.

**Accountability and transparency** – effective institutional checks and balances, transparent decision-making processes, lack of corruption, an open media and public access to information.

**Respect for the rule of law and human rights** – implementation of a predictable, fair and non-corrupt legal environment, supported by an independent judiciary and adherence to the UN Charter on Human Rights.

SOURCE: Adapted from World Bank, UNDP, and OECD sources

## Tackling governance failures

Different types of ‘governance failure’ can severely hinder achievement of development goals and limit the ability of entrepreneurs and businesses to survive, let alone increase their productivity and competitiveness. Four examples of governance failure are summarized briefly in the following pages. Although governments in both donor and developing countries have the core responsibility for addressing these governance failures, civil society and the private sector can also play a role.

- **Bad governance** – This relates to governments that are repressive and/or corrupt. Usually non-democratic, at a minimum they put their own interests above those of their citizens and in all too many cases actively undermine the human rights, economic opportunities and aspirations of the people they are governing. Wealth is usually highly concentrated, rent seeking is common, and allocation of productive resources is characterised by cronyism, inequity and lack of transparency. All too often, such governments are impervious to peer pressure or calls for fundamental reform by external donors, investors, and opposition politicians and activists, even if such exist. Localised or national conflict, human rights abuses, political intimidation, lack of public goods and market failures are often features of their regime. Corruption is usually widespread and endemic. Even when they are forced to leave office, such governments leave behind a failed state apparatus or severely weakened public capacity and public trust: conditions that are difficult for even the best-intentioned successors to overcome.
- **Weak governance** – This relates to governments that lack the necessary institutional capacity and financial, human, structural or physical resources to effectively serve the needs and aspirations of their citizens. Often this is the result of more responsible leaders succeeding one or more generations of bad governance and needing to overcome years of underinvestment in public services, corruption, and degradation of institutional and physical infrastructure – and in some cases facing the challenge of rebuilding a failed state after periods of conflict and political turmoil.

“Strong institutions, and the closely related issue of efficient political administration, are essential to effective development. ...It is easy for outside observers to debate more concrete issues, such as tariff rates, budget deficit targets, or approaches to bank supervision. But acquiring the ability to do things in effective, directed, coherent ways is central to successful development and it is extremely difficult to figure out ways to build that capacity.”

The importance of institutional capacity has received increasingly strong attention over the past decade. Economist Lawrence Summers cites this as one of the key development lessons of the 1990s, “Strong institutions, and the closely related issue of efficient political administration, are essential to effective development. ...It is easy for outside observers to debate more concrete issues, such as tariff rates, budget deficit targets, or approaches to bank supervision. But acquiring the ability to do things in effective, directed, coherent ways is central to successful development and it is extremely difficult to figure out ways to build that capacity. ...I support the idea that building such capacity requires strengthening linkages, supporting institutions, and learning to transcend what governments can do by working through all the institutions of society.”<sup>27</sup>

Donors have a particular responsibility and opportunity to support weak, but responsible governments in building-up the necessary resources and strengthening the institutions needed to better serve their citizens. Achieving high rates of economic growth will also be essential for such governments to accumulate the public assets and institutional capacity needed to progress. Although institution building is primarily a function of governments and donors, the private sector can play an important role, especially in the area of strengthening economic and financial institutions.

- *Major macroeconomic imbalances* – There are well-documented examples of governments over the past decade, such as those of Argentina, Zambia and Nigeria, that have implemented poor fiscal and monetary policies resulting in destruction of national wealth and increased poverty for large numbers of citizens. Over the long term, no country can generate and sustain growth if it maintains serious macroeconomic imbalances.
- *Lack of political will* – This type of governance failure relates to governments in both developed and developing countries that may be relatively well-resourced and accountable, but are influenced by special interest groups and/or lack the political will when it comes to tackling certain major economic and social challenges. Examples include: failure to remove market distortions to pro-poor growth such as agricultural and other subsidies; failure to prioritize investments in economic, education and health infrastructure in national budgets; failure to limit non-productive public interventions or military spending; and failure to address crucial environmental and economic challenges in areas such as energy policy and natural resource development. Depending on the issue, ‘lack of political will’ can often be addressed through pressure, encouragement or support from other governments and/or business associations or citizen-led activist groups.

Multilateral and bilateral government institutions can play an important role in supporting improvements in the quality of national and global governance. At the country-level, the opportunity for influence and impact is likely to be much greater as one moves along the spectrum from bad governance to weak governance, poor macroeconomic policies, and lack of political will.

### **What is the role of the private sector?**

The role of the private sector in influencing the quality of governance – either national or global – is more sensitive. Even when companies act through representative trade and industry associations, many question the mandate and legitimacy of business to influence national governance, let alone to shape international governance frameworks, norms and standards. There is no doubt, however, that many companies and business associations do influence political and governance processes. Such private sector actions can either undermine or promote good governance. The challenge for responsible companies is to ensure that they

engage in public policy debates and governance issues in an accountable and where possible transparent manner.

At a minimum, companies should aim to *ensure that their own operations do not actively underpin or exacerbate situations of bad governance*. Anti-corruption programmes and corporate responsibility initiatives such as the UN Global Compact, Extractive Industries Transparency Initiative, Equator Principles, Kimberley Process, and Fair Labor Association, as well as a plethora of voluntary corporate codes of conduct and accountability mechanisms have emerged over the past decade to help companies and their stakeholders to address this challenge.

The private sector can also help to *strengthen weak governance* resulting from inadequate public capacity and low administrative and institutional capability. This is especially the case in terms of helping to build or strengthen essential economic institutions, such as effective financial markets, legal systems, and accounting and quality management standards, but business can also help to strengthen social infrastructure and public capacity in areas such as health and education.

In South Africa, for example, over 100 domestic and foreign companies have joined forces through the National Business Initiative to help build the capacity of local government authorities and to improve the quality of education delivery and management, as well as being active in supporting job creation efforts in the tourism sector. Elsewhere in Africa and Asia, there is a growing number of other examples where companies and business networks are helping to improve management and information systems in public health and education facilities and supporting local governments in more effective service delivery. Such efforts represent one of the greatest untapped opportunities for companies to harness their core competencies and operational capacities and networks to contribute to the achievement of development goals.

Business associations and leadership networks can play both an advocacy role and in some cases directly support government efforts to implement *good macroeconomic policies and management*. Companies can also become engaged in advocacy and lobbying efforts to *address lack of political will* when it comes to government failures to prioritise and allocate resources to crucial development needs. In the lead up to the 2005 G8 Summit, for example, the Initiative for Global Development mobilised over 100 American business leaders to publicly call on the government to ‘make the elimination of extreme global poverty a priority’. At the same time, some of the UK’s largest companies came together to launch Business Action for Africa – aimed at mobilising public awareness, political support and private resources for African development. Among other issues, they led a media campaign calling on OECD governments to support successful negotiation of the Doha Trade round and in particular to tackle agricultural subsidies. Within developing countries themselves, more business groups are

starting to engage proactively with their governments in the development of national growth and poverty reduction strategies, as outlined in more detail in Section V.

In summary, good governance is one of the essential foundations on which sustained economic growth and poverty reduction are based. As part of the emerging corporate social responsibility (CSR) agenda, outlined in Section II, companies and business associations are playing a more proactive and influential role in shaping and strengthening governance structures.

There is no doubt, however, that the major responsibility for avoiding bad governance, strengthening weak governance, ensuring sound macroeconomic policies, and building political will rests with governments themselves – both at the national and global level.

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### 3 The shared responsibility of governments as development partners

The concept of shared responsibility and a new partnership between donor and developing country governments lies at the heart of the Millennium Development Goals, the Monterrey Consensus, National Poverty Reduction Strategies and the New Partnership for African Development.

The specifics of what ‘shared responsibility’ mean in practice will vary between different countries and donors, but three core themes are worth noting:

- (i) *‘National ownership’ – the growing emphasis on developing country governments taking the leadership role in devising their own development strategies and being in charge of and accountable for their implementation.*

This marks a dramatic shift from the more paternalistic and directive approach that characterised flows of aid in the immediate post-colonial era and during the Cold War. As outlined earlier, National Poverty Reduction Strategies are becoming the central national policy and planning tool for most developing countries.

Although not always made explicit, pro-poor growth policies are increasingly central to these national strategies. Some countries have made a commitment to economic growth more explicit and have started to use the term National Poverty Reduction and Growth Strategy.

There is also increasing attention to the integration of MDG targets and private sector development goals into these strategies. At the same time, greater emphasis is being placed on establishing public-private consultation mechanisms and other

participatory structures to proactively engage the private sector, civil society and the poor in shaping such strategies. Some of the innovative new mechanisms that are emerging in this area are outlined in Section V.

Another innovative mechanism for ensuring greater developing country responsibility and accountability is the African Peer Review Mechanism, already outlined in an earlier section. This has potential to be used as a methodology beyond its current focus on governance to also benchmark and promote good practices in private sector and enterprise development.

In their *2004 Global Monitoring Report*, the World Bank and IMF list four areas of responsibility that they consider to be priorities for developing country governments in accelerating progress towards the MDGs:<sup>28</sup>

- Improving the enabling climate for private sector activity;
- Strengthening capacity in the public sector and improving quality of governance – which they consider to be the biggest challenge for many countries, with the most serious shortcomings being in the areas of transparency, accountability and control of corruption;
- Scaling up investments in infrastructure and ensuring its effectiveness – especially in the areas of water, sanitation, and transport; and
- Enhancing the effectiveness of service delivery in human development – especially in the areas of education, health and social assistance services.

For many developing countries, one of the greatest challenges is prioritizing the allocation of scarce resources – both financial and administrative – among these often competing demands. While an integrated and comprehensive approach to the above list of priorities is desirable, in practice few developing country governments have the capacity and resources to implement such an approach. As such, these are all areas where donor assistance, and where appropriate private sector and civic engagement, can make a valuable contribution even if developing country governments maintain overall control of and accountability for the process.

*(ii) Donor action on aid, trade and debt – growing public pressure and political momentum around the responsibility of developed country governments to prioritize poverty reduction*

Over the past five years there has been a substantial increase in civil society campaigns, media coverage, public awareness and political pressure calling on donor governments to place greater priority on and allocate more resources to tackling global poverty. A particular emphasis has been placed on the areas of aid, trade and debt. Non-governmental organisations have become increasingly sophisticated and strategic in working together, influencing public opinion and engaging in dialogue around key political forums, ranging from G8 Summits to

United Nations Summits and World Bank and IMF meetings. In recent years, global campaigns such as Jubilee 2000, Make Poverty History and LiveAid have mobilised millions of citizens around the world to lobby their politicians and governments for debt relief, increased aid and fair trade.

“History tells us that the most successful cures for poverty come from within. Foreign aid can help, but like windfall wealth, can also hurt. It can discourage effort and plant a crippling sense of incapacity. ...what counts is work, thrift, honesty, patience, tenacity. To people haunted by misery and hunger, that may add up to selfish indifference. But at bottom, no empowerment is so effective as self-empowerment.”

It should be noted that there is still debate over the relative importance of increased aid and trade when it comes to supporting economic growth and reducing poverty in developing countries. In many cases they may be necessary, but not sufficient. In some cases they may have a detrimental impact. Professor David Landes argues in his book *The Wealth and Poverty of Nations*: “History tells us that the most successful cures for poverty come from within. Foreign aid can help, but like windfall wealth, can also hurt. It can discourage effort and plant a crippling sense of incapacity. ...what counts is work, thrift, honesty, patience, tenacity. To people haunted by misery and hunger, that may add up to selfish indifference. But at bottom, no empowerment is so effective as self-empowerment.”<sup>29</sup> Professor Dani Rodrik concurs, “Foremost among [the clear lessons of the last five decades of economic development] is that economic development is largely in the hands of poor nations themselves. Countries that have done well in the recent past have done so through their own efforts. Aid and market access have rarely played a critical role.”<sup>30</sup>

Writing for *Foreign Affairs* magazine, Rodrik, Nancy Birdsall, President of the Center for Global Development and Arvind Subramanian, Division Chief of the IMF’s research department, argue, “If rich countries truly aim to help developing countries achieve lasting growth, they must think creatively about the development agenda. If aid is increased and delivered more efficiently and trade inequities are addressed, then the two traditional pillars of development will yield rewards. But these rewards should not be overestimated. Indeed, other courses of action – such as giving poor nations more control over economic policy, financing new development-friendly technologies and opening up labour markets – could have more significant benefits. It is time to direct the attention of the world’s wealthiest countries to other ways of helping the poorest – ways that have been for too long neglected.”<sup>31</sup>

The ‘shared responsibility’ issues for developed country governments identified by the World Bank and the IMF’s 2004 *Global Monitoring Report* are as follows:<sup>32</sup>

- Sustaining stable and strong growth in the global economy – including efforts to ensure the “...orderly resolution of fiscal and external imbalances, especially the large U.S. external current account deficit.”
- Ensuring a successful, pro-development and timely outcome to the Doha Round.
- Providing more and better aid.
- Improving policy coherence for development.





In 2006, the former UN Secretary-General Kofi Annan established a High-Level Panel on System-Wide Coherence to explore ways of improving coordination among United Nations agencies and activities in the areas of development, humanitarian assistance and the environment. Co-chaired by the Prime Ministers of Pakistan, Mozambique and Norway, the panel issued its recommendations in November 2006 in a report entitled *Delivering as One*.<sup>36</sup>

The panel held consultations with stakeholders around the world to undertake a thorough assessment of the strengths and weaknesses of the UN system. It summarized these strengths and weaknesses as follows:

*“We commend the UN as the indispensable force driving forward the discourse on human development; by defining and creating a global consensus behind the MDGs and the other internationally agreed development goals; by playing a leading role in developing the concept of sustainable development; by responding rapidly to humanitarian disasters; and by mobilizing international action for the protection of the environment. The UN system also continues to play an essential role as a convenor, in setting norms and standards and in advising countries on their implementation at global, regional, national and local levels.*

*However, we have also seen how the UN’s work on development and environment is often fragmented and weak. Inefficient and ineffective governance and unpredictable funding have contributed to policy incoherence, duplication and operational ineffectiveness across the system. Cooperation between organizations has been hindered by competition for funding, mission creep and by outdated business practices ...If implemented, the recommendations could deliver better focus on performance, efficiency, accountability and results within the UN system and enhance the role and voice of developing countries.”<sup>37</sup>*

At the core of the recommendations is a proposal for better coordination at field level by adopting the One UN Country Programme – one leader, one programme, one budget, and where appropriate one office. Where partner governments are in support, the aim of this approach is to ensure that all UN programme activities are consolidated at the country level and managed by an empowered UN Resident Coordinator. This exercise is currently being piloted in eight countries: Albania, Cape Verde, Mozambique, Pakistan, Rwanda, Tanzania, Uruguay, and Viet Nam.

As with many initiatives aimed at greater coordination and cooperation among donors, a key challenge is translating these commitments into the allocation of new resources or reallocation of existing resources by the national legislative and executive bodies of the donor governments. Much remains to be done in this area, but there are some encouraging signs of progress.

Some examples of new types of donor coordination and partnership in these areas, focused on supporting small enterprise development, are profiled in Part IV.

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## 4 The active participation of the poor

Just as there is growing consensus that developing country governments must take the lead in determining their own nation's poverty reduction priorities and targets, there is also increased acknowledgement of the vital need to more directly engage and empower the poor themselves in this process. The poor need to be viewed not as a problem to be solved, but as problem-solvers, and not as a group that simply benefits *from* development, but as a group that participates *in* development. In the words of economist Hernando de Soto, 'The poor are not the problem, but the solution.'<sup>38</sup> A key factor in reducing poverty is the ability to directly raise the skills, employment, entrepreneurship and productivity of the poor within an overall context of economic growth and a favourable macroeconomic environment. Some of the key challenges and opportunities that need to be addressed in this process are as follows:

- Engage the poor directly in asset-building and income-generating opportunities either through increasing opportunities for entrepreneurship and self-employment or improving access to other forms of work and employment, and through providing legal title to the assets they already own.
- Work more directly with low-income communities in understanding their needs and their ability to pay for essential products and services, and in developing economically viable options for delivering these products and services.
- Ensure that the views and voices of the poor are more systematically integrated into policy-making and decision-making, for example through regular surveys, enabling increased participation and better representation of this group of citizens in public policy dialogues and project planning processes, supporting decentralisation of government services and community-level dialogue, encouraging gender equality, and ensuring more accountable institutions.
- Explore the potential for increasing labour mobility for low-income workers and harnessing the financial flows from Diaspora communities.

In short, governments, donors and private sector leaders should proactively encourage and facilitate the participation of low-income communities in finding their own solutions to poverty, while being realistic about what can be achieved in the absence of a sound macroeconomic setting and sustained economic growth. As Malcolm McPherson, Senior Fellow in Development at the Kennedy School of Government observes, "the poor simply do not have the levels of income, skills, assets or opportunities to make much of an impression on poverty levels or move forward against a backwash of weak economic growth. In conditions of generalized economic growth, however, supported by sound macroeconomic policies, there is no doubt that the poor can effectively harness opportunities and have an impact as producers and consumers. Growth obviously also provides opportunities for the rich, which is why income distribution may worsen as has happened in China."<sup>39</sup>

The following research and practical experimentation over the past decade has helped to change perspectives and improve understanding among the international development community of the needs, assets and capacities of low-income communities.

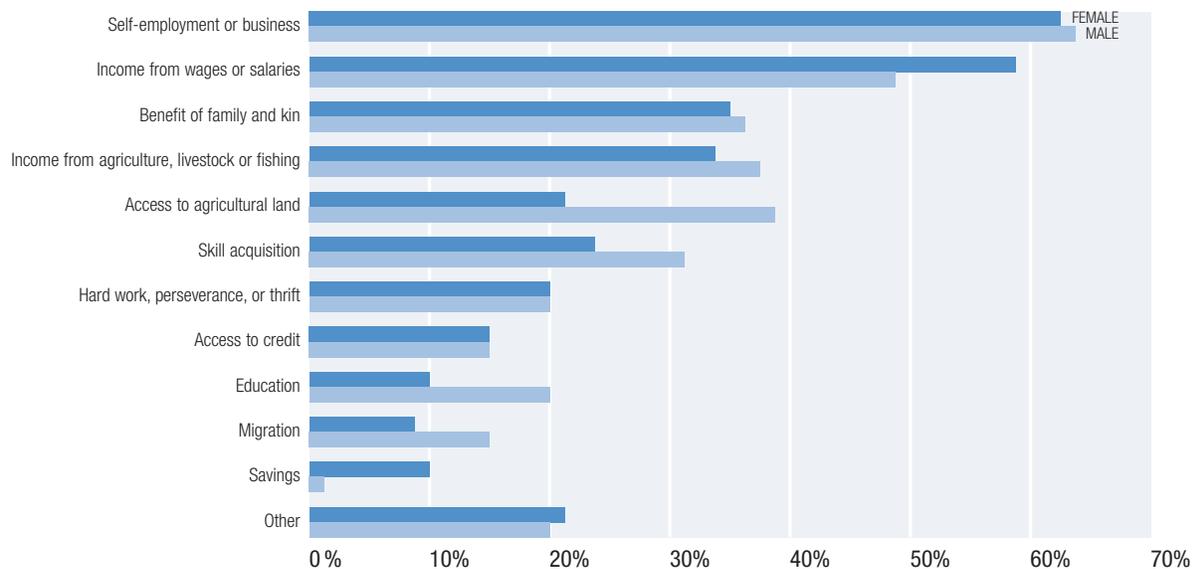
### Listening to and learning from the views of the poor

In 1999, for the first time in its history the World Bank undertook an ambitious global survey to listen to and learn from the perspectives of people living in poverty. The resulting report *Voices of the Poor* summarised the views of some 60,000 people in 60 countries. It found that “next to illness and injury, the scope for entrepreneurial activity and the availability of jobs is the most important factor determining the fate of poor people – for better or for worse.”<sup>40</sup>

“...next to illness and injury, the scope for entrepreneurial activity and the availability of jobs is the most important factor determining the fate of poor people – for better or for worse.”

The vast majority of these entrepreneurial activities and jobs will be in the small enterprise sector, many of them in the informal sector. Finding ways to harness the entrepreneurship and legalise and upgrade the enterprises that exist in the informal sector of many developing countries is one of the central challenges of alleviating poverty.

**FIGURE 4: SELF-EMPLOYMENT AND WAGE INCOME ARE THE WAYS OUT OF POVERTY**



Source: *World Development Report 2005: A Better Investment Climate for Everyone*. World Bank, 2004.

## Providing the poor with legal title to physical assets

The Peruvian-based Institute for Liberty and Democracy (ILD) and its president Hernando de Soto have earned international recognition for their research and advice on legal and institutional reforms in a number of developing and transition economies that have provided poor people with title to the assets they own. These reforms have helped to move large numbers of low-income families, small businesses and real estate holdings from the informal sector into the formal sector and economic mainstream. Although not without its critics, this work has also demonstrated that poor people own billions of dollars in physical assets, and usually have detailed extra-legal arrangements for protecting this ownership within their own communities. What they lack is the formal legal title that would enable them to convert these assets into bank loans and other forms of leverageable capital to start and run legally established enterprises that in turn would enable them to undertake transactions beyond their immediate communities and become more connected with regional economies and even global value chains.

ILD estimates, for example, that, “the total value of the real estate held but not legally owned by the poor of the Third World and former communist nations is at least \$ 9.3 trillion.”<sup>41</sup> In Egypt, ILD found that the poor had accumulated some \$245 billion worth of assets, including real estate and small enterprises, since the end of the Second World War. De Soto points out, “[this is] ... fifty-five times bigger than all foreign investment in Egypt over the last two hundred years, including the Suez Canal and the Aswan dam. Fifty times greater than all foreign aid received by Egypt. Thirty times greater than the Cairo Stock Exchange. So the poor are the solution. The problem is that they do not have a legal system that allows them to bring together capital, create new enterprises, leverage their assets, and cooperate on a global scale.”<sup>42</sup>

## Tapping the entrepreneurial potential among the poor

As illustrated throughout this report, growing recognition of the self-driven entrepreneurial and income-generating potential of low-income communities, given the right enabling conditions and increased access to financial products and business services, has been another major breakthrough in development thinking and practice during the past decade. Governments, donors and private institutions are focusing increased efforts on supporting direct business-to-business linkages between the poor themselves, for example through clustering, and creating direct business linkages between small enterprises and larger companies, for example through value chain relationships such as sourcing, franchising, and distributing – some innovative examples of which are profiled in Part V.

A related trend has been growing recognition of the potential of microfinance – loans, savings, insurance, transfer services and other financial products targeted at low-income clients to support both productive activities and consumption needs.

Over the past decade provision of financial services for the poor has started to shift from being highly marginal, heavily subsidised and/or purely philanthropic or publicly funded, to increasingly market-driven – with the potential for much greater scale, outreach and sustainability over the long-term.

2005 was designated by the United Nations as the Year of Microcredit. Analysing over 100 microfinance stories during this year, the World Resources Institute has observed, “...taken together these stories indicate that the ‘Year of Microcredit’ may well be remembered as the tipping point when providing financial services to the poor went from a charitable activity to a core investment strategy for both the financial and philanthropic sectors”.<sup>43</sup>

Recent improvements in regulatory and institutional frameworks, data collection, credit analysis, and distribution technologies aimed at lowering the cost of providing financial services to the poor, all offer cause for optimism, along with the growing engagement of strategic philanthropists and commercial banks.

There is still a long distance to travel and the eminent Advisors Group to the UN Year of Microcredit, warns that, “...rhetoric is certainly running ahead of action.”<sup>44</sup> Despite this valid ‘reality-check’, recent improvements in regulatory and institutional frameworks, data collection, credit analysis, and distribution technologies aimed at lowering the cost of providing financial services to the poor, all offer cause for optimism, along with the growing engagement of strategic philanthropists and commercial banks, some examples of which are profiled in Section V.

It is important to note, however, that even with legal title to their physical assets and access to finance, the poor often use their assets unproductively relative to the rich. One reason is their relative lack of human capacities and organizational skills to create the situations, whether markets or networks, that will markedly raise productivity. This highlights the need for comprehensive approaches to small enterprise development and poverty reduction that aim to integrate the accumulation of human capital with other forms of capital, be it natural, physical or financial capital.

### Accessing ‘the Fortune at the Bottom of the Pyramid’

Treating the poor as clients, rather than passive beneficiaries extends beyond the provision of microfinance. Management strategists C.K. Prahalad, Stuart Hart and Allen Hammond have led the way on pioneering work to demonstrate the potential buying power of the poor. They speak of the huge ‘multi-trillion dollar’ market potential of the four to five billion underserved people who live at the bottom of the world’s so-called ‘economic pyramid’ on less than \$2 a day; people who are both willing and able to pay for services such as water, energy, healthcare, housing, and basic consumer goods that are affordable and accessible.

Drawing on a growing number of examples where large domestic companies and multinational corporations have started to sell to these markets, they call on large companies to rethink conventional wisdom about capital efficiency, product development, distribution networks, business models and joint ventures in order to make a profit by serving the needs of the poor. They argue that companies can include the poor more directly – both as small business partners and consumers – in

“Collectively, we have only begun to scratch the surface of what is the biggest potential market opportunity in the history of commerce. Those in the private sector who commit their companies to more inclusive capitalism have the opportunity to prosper and share their prosperity with those who are less fortunate.”

“Greater opportunities for poor and less-skilled workers to move across borders, would, more than anything else, increase both the efficiency of resource allocation in the world economy and the incomes of the citizens of poor countries.”

business research and development efforts, in sourcing and supply chain management and in marketing, distribution and sales. Prahalad and Hart argue that, “Collectively, we have only begun to scratch the surface of what is the biggest potential market opportunity in the history of commerce. Those in the private sector who commit their companies to more inclusive capitalism have the opportunity to prosper and share their prosperity with those who are less fortunate.”<sup>45</sup>

### Encouraging labour mobility and remittances

Another evolving area of research on the poor and on poverty reduction relates to labour mobility and to the remittances that migrant labourers or the Diaspora from certain developing countries are sending back to their families, often in low-income communities. The World Bank’s *Global Economic Prospects 2006* estimates that international remittances received by developing countries have doubled in the past five years, reaching about \$167 million in 2005. Measuring the impact of remittances on poverty is difficult, but analysis of household survey data in countries such as the Philippines, Uganda, Ghana, Bangladesh and Guatemala suggests a positive association. A Bank survey of Filipino households, for example, “... shows the remittances they receive mean less child labor, greater child schooling, more hours worked in self employment and a higher rate of people starting capital intensive enterprises.” And in a Guatemala study, “... remittances reduced the level and severity of poverty, making up more than half the income of the poorest ten percent of families.”<sup>46</sup>

Although migration is ranked near the bottom of the list as a way to escape poverty in the 1999 *Voices of the Poor* survey, this probably reflects, at least in part, recognition of the severe constraints on labour mobility. Birdsall, Rodrik and Subramanian have argued that, “Greater opportunities for poor and less-skilled workers to move across borders, would, more than anything else, increase both the efficiency of resource allocation in the world economy and the incomes of the citizens of poor countries. ...a scheme for temporary work visas amounting to no more than 3% of the rich countries’ total labour force ...would easily yield \$200 billion annually for the citizens of developing countries. The returnees would also bring home far more benefits than their wages alone: experience, entrepreneurship, funds to invest, and an increased work ethic.”<sup>47</sup>

A key challenge is ensuring that such workers actually return home and do not simply add to the brain drain of professionals as well as labourers from many developing countries. Despite the risks and obstacles, this proposal suggests another innovative way of looking at the poor as active participants and decision-makers in the process of economic development and poverty reduction, not simply passive recipients.

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## 5 The importance of private sector development

One of the most dramatic shifts in development thinking and practice over the past two decades has been growing acceptance of the importance of the private sector. Private enterprise plays a role in creating the economic opportunity, growth and employment that will be essential for poverty reduction. It is also essential in shaping the enabling environment and has an impact on an increasing range of labour, human rights and environmental issues, in addition to economic outcomes.

Warrick Smith, Director of the World Bank's *World Development Report 2005*, observes, "Today, few informed commentators question that the private sector plays a critical role in growth and poverty reduction. The ideological debates of the past are giving way to more pragmatic discussions about how best to unleash and expand that contribution while preserving other social values."<sup>48</sup>

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### The contribution and impact of the private sector

The development role of the private sector is well captured by two seminal reports produced in 2004: the World Development Report: *A Better Investment Climate for Everyone*; and the Report of the UN's Commission on the Private Sector and Development: *Unleashing Entrepreneurship: Making Business Work for the Poor*.

The World Bank describes the private sector's impact as follows:<sup>49</sup>

*Private firms are at the heart of the development process. Driven by the quest for profits, firms of all types – from farmers and micro-entrepreneurs to local manufacturing companies and multinational enterprises – invest in new ideas and new facilities that strengthen the foundation of economic growth and prosperity. They provide more than 90% of jobs – creating opportunities for people to apply their talents and improve their situations. They provide the goods and services needed to sustain life and improve living standards. They are also the main source of tax revenues, contributing to public funding for health, education and other services. Firms are thus central actors in the quest for growth and poverty reduction.*

In the words of the UN Commission on the Private Sector and Development:<sup>50</sup>

*The Commission believes that any approach to private sector development – and the policy and action recommendations that accompany it – should be grounded in the realisation that the savings, investment and innovation that lead to development are undertaken largely by private individuals, corporations and communities. The private sector can alleviate poverty by contributing to economic growth, job creation and poor people's incomes. It can also empower poor people by providing a broad range of products and services at lower prices.*

*... We endorse the view that market-oriented business ecosystems comprise many forms of private enterprise coexisting in a symbiotic relationship. The ecosystem generally includes multinational corporations, large domestic companies, cooperatives, small and medium enterprises and microenterprises, with formal and informal players. It encompasses the farmer in the field as much as the multinational company.*

## **Categorising the private sector**

There is no one-size-fits-all approach to categorising micro, small, medium and large enterprises. Micro-enterprises are usually defined as firms with less than 10 employees and large companies as firms with more than 250-500 employees, depending on the country. Even within the small and medium enterprise sector that sits between these two groups, there is great variety in terms of the motivation, orientation, impact and needs of different enterprises.

Patricof and Sunderland differentiate between what they call ‘necessity entrepreneurs’ and ‘opportunity entrepreneurs’: “Most of the companies in the SME-size category in developing countries are similar to micro-enterprises in that they provide basic employment and income generation for a family or farming cooperative group. Because these types of ‘necessity entrepreneurs’ – traders, niche domestic service providers and agricultural producer groups – are oriented toward generating immediate income, they are unlikely to have or be able to re-invest capital in their businesses and take risks to grow significantly. ...A smaller segment of companies in the SME-size category, including high-potential start-ups, have the potential to grow and become modern, globally competitive enterprises. These types of companies are run by ‘opportunity entrepreneurs’ committed to innovating, adding value to exports, applying technology, achieving scale in production and reinvesting profit in their business.”<sup>51</sup>

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## **The importance of small enterprises**

Debate persists on the relative contribution of small, medium and micro-enterprises (which are all grouped as small enterprises in this report) to economic growth, productivity and employment compared to that of larger companies. Despite this ongoing debate their role cannot be ignored and most major development institutions are paying them greater attention.

The former director of UNIDO’s Small Enterprise branch, Wilfried Luetkenhorst, drawing on research by Harvard’s Institute for International Development summarises their role as follows: “...in economic and industrial development, a critically important role is played by micro, small and medium enterprises which, on average, make up over 90% of enterprises and account for 50-60% of employment – in particular in the developing world. While being important at all levels of development, empirical studies have clearly shown that at the lower

income levels typical for developing countries, the prevalence of small enterprises is particularly pronounced. Also, as average income increases, the size distribution of firms typically moves upwards, with the share of micro-enterprises going down and that of more sophisticated medium enterprises rising.<sup>52</sup>

Some of the contributions that small enterprises make to development are outlined in Box 3.

### BOX 3: THE DEVELOPMENT IMPACT OF SMALL ENTERPRISES

Research by UNIDO concludes that the development contributions of small enterprises, "...can be found at the intersection of economic and social dimensions: small enterprises foster *economic cohesion* by linking up with, and supporting, larger enterprises, by serving niche markets and in general by contributing to the build-up of systemic productive capacities. At the same time, small enterprises foster *social cohesion*, by reducing development gaps and disparities, thus spreading the gains of economic growth to broader population segments and backward regions."<sup>53</sup>

Commonly cited development impacts of small enterprises include the following:

#### ECONOMIC IMPACTS

**EMPLOYMENT:** Research by the World Bank, UNIDO and the UN's Commission on the Private Sector and Development, cite employment – either self-employment or access to jobs, wages and salaries – as being the key link between output growth and poverty reduction. Small enterprises – in part as a result of the industrial sub-sectors and product groups covered by them – tend to employ more labour-intensive production processes than large enterprises. Small enterprises are estimated to account for between 30% and 70% of employment in most economies.

**EQUALITY OF INCOME DISTRIBUTION:** There is some empirical evidence that countries with a high share of small industrial enterprises have succeeded in making income distribution (both regionally and functionally) more equitable. Small enterprises tend to promote more equitable distribution of income than large enterprises, as they are usually more labour-intensive, more broadly dispersed in both urban and rural communities, and provide employment and income for disadvantaged members of the workforce, such as the unskilled, women with household obligations and the elderly. On the flip side, however, research by the German Development Institute and others, emphasizes the point that jobs in small enterprises tend to be less well remunerated, with greater insecurity and worse working conditions.

**ECONOMIC GROWTH:** Research by Beck, Demirgüç-Kunt, and Levine exploring the relationship between the relative size of the SME sector, economic growth and poverty alleviation, using a sample of 45 countries, finds a strong, positive association between the importance of SMEs and GDP per capita growth. The data do not, however, confidently support the conclusions that SMEs exert a causal impact on growth and find no evidence that SMEs decrease income inequality.<sup>54</sup>

**ECONOMIC RESILIENCE:** Small enterprises often serve as an employment buffer and provide wage flexibility in times of economic crisis, which is especially important in post-conflict situations and periods of economic downturn. The creation of more resilient economic systems is especially likely when small and large firms are interlinked.

**ECONOMIC TRANSITION:** Small enterprises play a valuable role in the transition from agriculture-led to industrial economies, as they provide simple opportunities for value-adding processing activities that can generate sustainable livelihoods. This is of particular importance in sectors where women play a predominant productive role.

**PRODUCTIVITY GROWTH:** The findings on small enterprise contributions to productivity are mixed. Research by the German Development Institute concludes that small firms on average are less productive and use their resources less efficiently than large firms. This is especially the case in developing countries where they tend to fall far behind in productivity growth, especially relevant to their industrialised economy counterparts. The research emphasizes, however, the important contribution to competitiveness resulting from an adequate mix of large and small firms, and

complementary specialisation and division of labour between these firms. In short, *large firm-small firm linkages* are an important factor in productivity, competitiveness and economic growth.<sup>55</sup> Some of the reasons for this are outlined in Section III. Support for improving management and organizational skills can be especially valuable in raising the productivity of small enterprises.

**INNOVATION:** Under the right conditions, small enterprises can serve as a seedbed for entrepreneurship, innovation and risk-taking behaviour and provide the foundation for long-term growth dynamics and the transition towards larger enterprises. This is especially the case for what Patricof and Sunderland have termed ‘opportunity entrepreneurs.’<sup>56</sup> It is also more relevant in certain industries, such as information and communication technologies and value-adding manufacturing processes.

## **SOCIAL IMPACTS**

**HOUSEHOLD INCOME/ WOMEN:** As outlined above, small enterprises tend to employ more of the disadvantaged economic groups, including women. As such, they can have an important impact on the allocation of household income to meet family education and health needs. The UN estimates that in Latin America and the Caribbean, between 25% and 35% of formal sector micro-enterprises and small and medium enterprises are owned and operated by women, and numbers are estimated to be even higher in parts of Africa.<sup>57</sup>

**PROVISION OF BASIC GOODS AND SERVICES:** Many small enterprises are focused on providing basic goods and services to low-income communities ranging from health and education services, to food, housing, transport, water, energy, clothing, and basic manufactured products. Given the crucial importance of agricultural productivity and food security to poverty reduction, efforts to improve efficiency and an increase in the scale of output in areas such as small enterprise food production and service delivery could provide an important foundation for poverty reduction.

**HUMAN CAPITAL DEVELOPMENT:** Small enterprises provide apprenticeships and on-the-job training for poor people without access to formal education and vocational training. The German Development Institute estimates that 70% of all African workers in the urban informal sector have been trained through informal apprenticeships. However, as with quality of employment, the level of investment in training and quality of skills developed is usually less than in larger firms.<sup>58</sup>

**YOUTH ENTERPRISE:** One of the most urgent development challenges is to create jobs and livelihood opportunities for the estimated 1.2 billion young people who will be entering the global labour market over the next decade. Relatively few of these jobs are likely to come from the formal larger-scale business sector, and many will need to result from self-employment opportunities and employment in small, medium and micro-enterprises.

## **ENVIRONMENTAL IMPACTS**

**RESOURCE USE AND WASTE GENERATION:** Research by UNEP shows that small enterprises are particularly strong in sectors characterised by high intensity of resource use and by polluting emissions – for example, metal finishing, leather tanning, dry cleaning, printing, dyeing, brewing, food processing, fish farming, textile making, and chemicals. According to UNEP, while most small enterprises are in the service sector, the 25-33% or so engaged in manufacturing produce an important share of industrial waste. UNEP also argues that far too often, small enterprises do much less than larger companies to address their negative environmental impacts – for a variety of reasons ranging from relative lack of training, know-how, technology, and money, to poor implementation of occupational health, safety and environmental laws in this sector, and less consumer or NGO pressure.<sup>59</sup>

**ECO-FRIENDLY ENTERPRISES:** The converse of the above is the fact that many of the emerging firms in what UNEP refers to as the ‘sustainability sector’ – such as eco-tourism, sustainable agriculture practices, and eco-services are either small enterprises or value chains that include a large number of small enterprises.

Sources: UNIDO, German Development Institute, UNEP, UNDP, International Business Leaders Forum, and National Bureau of Economic Research.

## Supporting private sector development, especially small enterprises

Despite growing recognition of the importance of the private sector in driving economic growth and supporting the achievement of the Millennium Development Goals, most countries still lack a suitable enabling environment for effective private sector development.

Carl Schramm, President and CEO of the Ewing Marion Kauffman Foundation, argues that support for entrepreneurship and start-up firms is especially lacking, “The Washington Consensus focuses on macroeconomic issues such as finance and trade, along with general institution building. Nations are urged to create good banking systems, reasonable interest and exchange rates, and stable tax structures. They are expected to privatise, deregulate, and invest in infrastructure and basic education. Entrepreneurship, meanwhile, is considered only as an afterthought and in piecemeal fashion.”<sup>60</sup> He argues that even in developed economies, “The system that generates and supports entrepreneurship in the United States is surprisingly unappreciated.”<sup>61</sup> Yet, he and others believe that with the right development policies it is a system that could be cultivated in other countries.

The lack of a more dedicated and systematic focus on private sector development in many developing countries is due to a variety of reasons. Not least a legacy of public ownership and mistrust or mutual ignorance between public sector officials and development practitioners on the one hand and business leaders and entrepreneurs on the other. In a number of developing countries there is no longstanding tradition of private sector development, especially beyond the informal, subsistence economy at one end of the spectrum and large state-owned enterprises at the other end. There is also limited experience in building the necessary financial institutions, business support systems and research organisations that are essential for nurturing what Schramm describes as, “high-impact firms – the kind that create value and stimulate growth by bringing new ideas to market, be they new technologies, new business methods, or simply new and better ways of performing routine tasks.”<sup>62</sup>

There is much work to be done by public policymakers, donors and business leaders to address this shortfall and to work together to create the appropriate enabling environment not only for improved access by entrepreneurs to essential resources such as capital, technology, and skills, but also to increase the linkages between large and small companies, urban and rural economies, formal and informal sectors, foreign and domestic markets, and developed and developing countries. As explored in more detail in Section III, building such linkages is an essential component of ensuring more productive, profitable, sustained and equitable patterns of economic growth.

The differences in motivation, orientation, impact and need between micro, small, medium, and large enterprises, and within each of these categories, have important implications for the type of public policy interventions, market mechanisms and

intermediaries or partnership models that are required to support private sector development and the implementation of competitive and responsible business practices.

Systemic and integrated approaches are essential, even if the focus will vary for different stages and types of private sector development. As explored in more detail in Part III of this report, key areas of intervention to support small enterprise development include the following:

- Improving access to finance, business services and legal rights
- Upgrading and integrating small enterprises into value chains
- Implementing responsible business practices in small enterprises

A critical leadership challenge in each of the above areas is ensuring the most appropriate and effective combination of market-driven approaches and public sector, NGO and donor support. On the one hand, there is the need to minimise public interventions where they are likely to create unhelpful market distortions and subsidies. On the other, there is the need to recognise that under current circumstances and constraints in many developing countries – ranging from market failures to governance gaps and lack of institutional capacity – approaches that are purely market-driven may create undesirable externalities and may exclude not only vulnerable groups from income-generating opportunities, but also high-potential ‘opportunity entrepreneurs’. In many cases new types of ‘hybrid’ approaches, combining both market-driven and public sector elements, and public-private or private-NGO alliances are going to be essential.

## SUMMARY OF PART I:

### TOWARDS A GROWING CONSENSUS ON DEVELOPMENT AND POVERTY REDUCTION

The following five components of development thinking and practice are serving to reframe approaches to international development:

#### 1. The centrality of economic growth

There is growing recognition that *economic growth, which ensures participation of the poor and takes measures to protect environmental sustainability*, is an essential and powerful force in the fight against global poverty – both in terms of its potential to generate direct improvements in standards of living and to support broader social progress.

#### 2. The foundation of good governance

There is appreciation that *good governance, supported by effective institutions* forms another fundamental pillar for sustained development and poverty reduction.

#### 3. The shared responsibility of governments as development partners

There is greater acceptance that *both developing country governments and donor governments must share responsibility and take mutual leadership* for creating the necessary enabling environment – at both national and global levels – for achieving development goals.

#### 4. The active participation of the poor

There is increased understanding of the need and the great potential to harness the *assets, capabilities and voices of the poor* themselves in creating effective approaches to poverty reduction, with civil society organisations often playing a key role as interlocutors and advocates.

#### 5. The importance of private sector development

There is a strong emerging evidence of the crucial importance of a *diversified, productive, profitable and responsible private sector* – ranging from large multinationals and domestic corporations, to small, medium and micro-enterprises in both rural and urban communities. The vital role of small enterprises as key producers, employers, distributors, innovators and wealth creators is increasingly recognised.



# II THE EMERGENCE OF CORPORATE SOCIAL RESPONSIBILITY (CSR) AND MULTI-SECTOR PARTNERSHIPS

The concepts of corporate social responsibility (CSR) and corporate citizenship have been part of the business lexicon and the focus of academic study for many years. Over the past decade, however, they have grown to encompass a more complex, multi-dimensional and global set of issues, with strategic implications for both business leaders and policy makers, and with relevance to both industrialised and developing economies.<sup>1</sup>

This process has been driven by a combination of factors. They include:

- Political transformation, market liberalisation, privatisation and technical innovation, which have increased the global reach and influence of the private sector, at the same time that they have challenged the ability of nation states to govern the global public domain. The United Nations estimates, for example, that the number of transnational corporations almost doubled from 37,000 in 1990 to over 60,000 in 2001, with their foreign affiliates growing over four-fold from 170,000 to 800,000. Growth in the size, reach and influence of private enterprises has conferred global companies with new rights and opportunities, but also created new competitive pressures and raised societal expectations for new levels and types of corporate responsibility.
- Growth in the sophistication, number and influence of well-informed civil society organisations and activists, who are calling for increased corporate responsibility and who have unprecedented communications capacity and connectivity via the global media and Internet.
- The increased financial muscle and activism of institutional investors, who together with regulators have responded to the spate of corporate scandals and governance crises with calls for better corporate governance and greater corporate accountability, transparency and integrity.
- The growing importance of intangible assets as a key driver of corporate value and reputation. In a knowledge-driven economic environment, assets such as brand equity, alliances, leadership capacity, management depth, innovation, quality, and stakeholder relationships have become more important in determining the way that companies are valued by both their investors and other stakeholders.
- Greater awareness by governments of the downsides of globalisation, and in particular, the risks and costs of high levels of income inequality and

environmental degradation – and at the same time, limited public resources and in some countries limited political will and/or public capacity and institutions for addressing these challenges.

- Demographic trends (increased diversity, aging populations in some countries and a youth bulge in others), technological advances (from information technology to biotechnology and nanotechnology), and increased private investment in politically fragile and conflict-prone emerging markets, all of which, in different ways, are creating new social, environmental and reputation risks for business, as well as new market opportunities.

As a result of these drivers, wider societal issues are emerging as an unavoidable item on the corporate agenda; at least for many of the world's leading companies, with brands and reputations to protect and new markets to invest in. The issues are varied, complex and constantly evolving.

They range from:

- Human rights and conflict prevention ...to ethics and anti-corruption measures;
- Managing the social impacts of mergers and acquisitions ...to addressing the environmental impacts of new investments and projects;
- Downsizing and closing factories in Europe and the United States ...to outsourcing, market entry and new business development in developing countries;
- The implementation of global labour standards ...to the responsible management of supplier relations and product environmental life-cycles
- Supporting employee share ownership schemes ...to community investment and venture philanthropy;
- Sharing the benefits of new technologies, such as information and communications technology, biotechnology and nanotechnology ...to anticipating and managing the unintended consequences of and/or unequal access to these technologies;
- Limiting negative impacts of corporate activities ...to increasing access to basic products and services for people who are currently excluded due to poverty, ethnicity, gender or disability;
- Efforts by individual companies to establish local, community-level initiatives ... to the creation of multi-stakeholder global policy alliances; and
- Establishment of new corporate governance systems at the firm level ...to engagement in initiatives aimed at improving public governance frameworks at the national and even global level.

The specific CSR-related issues of greatest relevance to a particular company will vary markedly from one industry to the other and between countries. They involve different interest groups and stakeholders, and influence different aspects of a company's operations. There seems to be only one certainty. These issues are not likely to disappear and they are creating fundamentally new leadership challenges for business. In particular, business leaders face the need to:

- Restore trust and credibility – calling for greater transparency and accountability to more stakeholders in more places than ever before;
- Manage new, and often unfamiliar, risks;
- Respond to rising stakeholder expectations;
- Remain profitable, productive and competitive.

In short, business leaders of large high-profile companies are under unprecedented pressure to demonstrate good performance not only in terms of their competitiveness, market growth and financial results, but also in their corporate governance and their ethical, social and environmental performance. They are being called on to engage with activists as well as analysts, to manage new types of social and environmental risk in addition to market and financial risk, and to cooperate as well as to compete – often with non-traditional partners focused on unfamiliar issues, ranging from HIV/AIDS and poverty reduction to climate change and conflict prevention.

In response to these challenges, the concept of corporate social responsibility is moving beyond the boundaries of legal compliance, public relations and 'nice-to-do' philanthropy, and becoming a central factor in determining corporate success and legitimacy. It has gained traction in many major companies as a new approach to: managing emergent business risks, impacts and opportunities; improving corporate engagement with key stakeholders; and ensuring greater public accountability of the private sector.

The concept of CSR is also becoming more relevant to public policy makers, the media, investors, consumers, employees, trade unions and other actors who regulate, monitor or otherwise influence business behaviour and performance. As outlined in the following pages, this has implications not only for corporate governance, corporate strategy and enterprise risk management at the level of the individual firm, but also for national and global governance.

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## 1 CSR strategies at the enterprise level

From the corporate perspective, over the past decade CSR has come to encompass not only what companies do with their profits, but also how they make them. Despite a wide variation in definitions, there is increasingly broad agreement that **CSR addresses the manner in which companies manage their economic, social and environmental impacts and their stakeholder relationships, in all their spheres of influence: in the boardroom; in the workplace; in the marketplace; along the value chain; in the community; and in the public policy realm.**<sup>2</sup>

Similar to the above definition, research by UNIDO and AccountAbility describes CSR as having two key dimensions:<sup>3</sup>

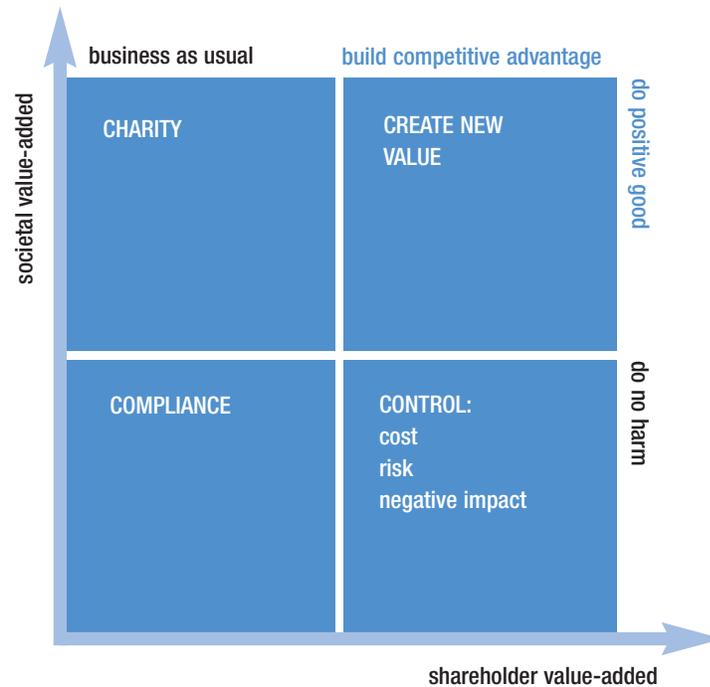
- *Substantive* – how issues such as labour standards, human rights, environmental sustainability and transparency are addressed;
- *Process* – the ways in which business engages with other actors in achieving these objectives and in identifying its boundaries of accountability.

At a minimum, effective CSR calls for a defensive ‘do no harm’ approach in all these spheres of influence – calling for compliance with regulations and voluntary norms, principles and codes, as well as a risk management mindset focused on controlling risks, negative impacts, liabilities and costs that may arise from the company’s economic, social and environmental impacts. In short, protecting existing market and social value.

More ambitiously, and where leading companies are increasingly focusing attention, CSR calls not only for a defensive approach, but also aims to ‘do positive good’ through creating new value for the company and society. This can be achieved either through harnessing the resources, competencies and networks of the company’s core business operations or through strategic social investments, that aim to create direct or indirect value for the business, while also directly addressing a specific economic, social or environmental challenge, or set of challenges.

In aiming to ensure that their business activities ‘do no harm’ and in undertaking efforts to do ‘positive good’ companies can employ a number of different strategies at the level of the individual firm. Four of these are outlined in Figure 5:

**FIGURE 5: CSR STRATEGIES AT THE LEVEL OF THE INDIVIDUAL FIRM**



Source: Adapted from Nelson, J. *The Business of Peace*. IBLF, Council on Economic Priorities and International Alert, 2001.

- i) **Compliance** – In addition to ensuring compliance with national laws, a growing number of companies are signing up to voluntary international or sector-specific principles, norms, and standards. These range from unmonitored frameworks to more rigorous systems, which call for peer reviews, independent audits, external certification, and/or public reporting. While legal compliance should be seen as a minimum requirement for strengthening the business contribution to development, even this basic strategy is beset by operational and governance challenges for companies with hundreds of operating units and business partners in numerous different countries and legal jurisdictions. Ensuring that the company has policies and systems in place to address this challenge – including board level oversight – is an important demonstration of good intent.
- ii) **Control of risks, liabilities and negative impacts** – Going beyond compliance, companies can also implement systems to ensure that they identify, manage, and where necessary ameliorate social and environmental risks, in addition to more familiar market, financial, operational and political risks. Research by Booz Allen Hamilton and the Kennedy School of Government’s CSR Initiative illustrates the growing value of stakeholder engagement as an effective strategy for this broader risk management.<sup>4</sup>

- iii) **Charity and community investment** – Moving from value protection to value creation, companies can create social value, while either protecting or enhancing their market value, through effective philanthropy. This is more likely to have a positive impact on both social and market value when it is aligned not only to community needs, but also to corporate competencies and interests. Energy companies, for example supporting community investment projects to improve access to energy, logistics companies providing distribution support for humanitarian crises, ICT companies helping to improve access to technology, healthcare companies providing medical donations etc.
- iv) **Creating new market and social value** – The most strategic approach for strengthening the company’s contribution to development comes through its core business activities. Through innovation, for example, in new products, services, processes, and even business models that directly align development needs with profit-making business opportunities. Examples include market-driven approaches to deliver basic products and services such as water, energy, credit, and consumer goods to low-income consumers, investments in new environmental technologies, and forward and backward business linkage initiatives with small, medium and micro-enterprises. Some of these opportunities may offer the company a full market-driven financial return, while others may require a combination of commercial and social or public financing in order to make them a viable proposition.

“CSR has become a major social enterprise in the first place largely because of the growing gap between the scope, inventiveness and power of private sector institutions, on the one hand, and public institutions on the other. For a generation now, the role of markets has expanded steadily, at home and abroad. CSR may be seen as a voluntary effort to realign the efficiency of markets with the shared values and purposes that societies demand, and that markets themselves require to survive and thrive. How much of the burden CSR can and should carry is the key governance question before us.”

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## 2 The link between CSR and governance

The emerging CSR agenda has implications not only for corporate strategy and risk management at the firm level, but also for governance more broadly at the global and national levels. In fact, it is important to view CSR within a broader context of the governance systems in which companies are operating. Often corporate responsibility strategies undertaken by individual companies or industry-wide initiatives are a response to governance gaps or failures.

Professor John Ruggie has argued that, “CSR has become a major social enterprise in the first place largely because of the growing gap between the scope, inventiveness and power of private sector institutions, on the one hand, and public institutions on the other. For a generation now, the role of markets has expanded steadily, at home and abroad. CSR may be seen as a voluntary effort to realign the efficiency of markets with the shared values and purposes that societies demand, and that markets themselves require to survive and thrive. How much of the burden CSR can and should carry is the key governance question before us.”<sup>25</sup>

## CSR and global governance

Ruggie identifies two forms of global imbalances that have implications for CSR and for the sustainability of globalisation itself. “One is the imbalanced system of global rule making. Rules that favour global market expansion have become more robust and enforceable – intellectual property rights, for example, or trade dispute resolution through the WTO. But rules intended to promote equally valid social concerns, be they labour standards, human rights, environmental quality or poverty reduction, have not kept pace. ...The other imbalance is in outcomes on the ground: half the world’s population having to make do on \$2 a day. The social legitimacy of sustainable markets – not to mention capturing new market opportunities – depends on doing a lot better. Let’s remember this. The collapse of the Victorian era of globalisation, and the collapse of the world economy again in the 1930s, demonstrated the limits to social tolerance for rules and outcomes that privilege one segment of society over others. Once these limits are crossed, the demand for social protection becomes politically irresistible. And it easily translates into economic protectionism – or into even worse ‘isms’, as it did in the 1930s.”<sup>6</sup>

Although individual firms can, and do respond to these global governance challenges directly, their solution often calls for collective efforts – either on an industry-wide basis or through more complex multi-stakeholder alliances and global public policy networks.

## CSR and national governance

In many cases, CSR-related activities are a firm-level response to the four types of governance failures outlined in Section I.

In situations of bad governance, for example, large companies, especially those that generate high levels of public revenues such as those in the extractive and infrastructure industries, have faced increased offshore stakeholder demands to demonstrate that they are not responsible or complicit in the corrupt, repressive or misdirected use of these revenues by recipient governments. In extreme cases of bad governance, for example in zones of conflict, companies are increasingly in the spotlight to demonstrate they are not causing or exacerbating the conflict or complicit in human rights abuses.

A growing challenge in this area is the impact of increased investment by emerging market companies in countries that experience bad governance. There has been a major increase of Chinese investment in the natural resource sector in Africa, for example. While south-south investments and economic relationships have many benefits, there is a potential challenge related to how established multinationals compete against emerging market counterparts that are willing and able to adhere to lower standards in the areas of human rights, labour rights and the environment.

In situations of weak governance, due to lack of public resources or inadequate institutional capacity, companies are increasingly supporting efforts to build public capacity, in order to protect their investments and improve their operating environment. These can range from support for public health initiatives, to efforts to improve the quality of local government, to efforts to support small and medium enterprise development and education reform.

In situations where governments lack political will to address key development issues or are implementing macroeconomic policies that are clearly at odds to economic growth and poverty reduction, companies may undertake advocacy or lobbying activities to influence government behaviour, usually through representative business bodies, such as chambers of commerce and industry, or business leadership coalitions rather than individually. As with global governance challenges, these national-level governance gaps often call for more than an individual firm-level response; few can be adequately addressed in the absence of collective or partnership-based solutions, which are reviewed in the next section.

Whether or not the emerging CSR agenda will result in fundamental and long-term shifts in the way businesses operate and in the relationship between business and government, and whether it will spread to more companies in the absence of regulation, remains open to question and the subject of intense debate. The answer will depend largely on how companies and their stakeholders address the following critiques of the current CSR agenda.

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### 3 Critiques of CSR

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#### **CRITIQUE # 1: THE BUSINESS OF BUSINESS IS BUSINESS – TOO MUCH IS BEING EXPECTED OF COMPANIES AND/OR THE ‘BUSINESS CASE’ FOR CSR IS TOO WEAK**

Some sceptics of CSR argue that the emerging CSR agenda is in fact irresponsible, distracting companies from their core purpose of profit maximisation and creating value for shareholders, and making unrealistic and unreasonable demands on corporate management. They argue that the sole social responsibility of business is to make profits while obeying the law – and that governments, not companies, should assess societal expectations and then regulate and tax companies accordingly. Equally, they argue that employees, shareholders, governments and other beneficiaries of corporate profits, not company executives, should be left to decide how, and if, they will allocate these profits to address broader social issues. And they argue that a more integrated and comprehensive approach to CSR will raise costs and prices, lead to unnecessary and onerous regulations, let ‘governments ‘off-the-hook’, and far from creating public value, may actually reduce society’s welfare.<sup>7</sup> These are substantial and important concerns.

A 2005 survey of CSR by the Economist magazine concluded, “The business of business is business – no apology needed.”<sup>8</sup> This view harks back to the oft-quoted Milton Friedman statement, “...there is one and only one social responsibility of business – to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game.”<sup>9</sup>

The counter-argument to these views is that the so-called ‘rules of the game’ have fundamentally changed over the past two decades, as a result of trends such as globalisation, technological innovation, political emancipation, new governance gaps and failures, the emergence of new social and environmental risks for business (for example HIV/AIDS, obesity, global supply chain issues, climate change) and changing societal expectations of the role of business. This shift should not be over-emphasized, however. There are many examples in both developed and developing economies where entrenched special interests and lobbying power prevent the ‘rules of the game’ from evolving in a progressive manner.

There is also no doubt that the delivery of goods and services in a profitable and legal manner remains the core driving force of most companies. In order to achieve this goal on a long-term, sustainable basis, however, large companies and a growing number of smaller enterprises are recognising the benefits of responsible business practices. In particular, they are recognising the need to better manage emerging social and environmental risks, harness new social and environmental opportunities for innovation and increased competitiveness, and engage more proactively with a wider range of stakeholders than previously.

One of the central challenges in this debate is the lack of a clear and commonly agreed definition on what exactly constitutes CSR. When is the systematic management of a company’s broader economic, social and environmental performance and stakeholder relationships no longer a separate business concept or activity called CSR (or corporate responsibility, corporate citizenship, or sustainable development) but simply integral to good business? Some of the critics who point to the lack of a substantial business case for CSR argue that if such a business case existed then companies would seize it and adopt the appropriate strategies. This would then, by their definition become part of doing business, rather than qualifying as CSR.

Notwithstanding this lack of clarity on definition and business case, some of the world’s leading companies are increasingly adopting a more integrated or embedded approach to managing their broader economic, social and environmental impacts and stakeholder relations. Regardless of what they label it, such companies are viewing good performance in these areas not as a ‘nice-to-do’ philanthropic add-on or an activity limited by compliance requirements, but as a more strategic business issue important to long-term value protection and creation. In some cases this is a response to governance gaps and failures and to the need to manage risks and regain some control or predictability over key external drivers of

Leading companies are increasingly adopting a more integrated or embedded approach to managing their broader economic, social and environmental impacts and stakeholder relations. Regardless of what they label it, such companies are viewing good performance in these areas not as a ‘nice-to-do’ philanthropic add-on or an activity limited by compliance requirements, but as a more strategic business issue important to long-term value protection and creation.

business success. In others it is a proactive effort to shape new markets and gain competitive advantage.

Despite the anecdotal evidence, however, making a sound business case for CSR backed by rigorous statistics and empirical evidence remains a challenge for many companies. Some of the arguments underpinning the general business case at both the micro- or firm level and at the macro- or national level are outlined in the next section. Making a business case for CSR is particularly challenging for small enterprises, as will be explored in more detail in Part III of the report.

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## **CRITIQUE # 2: VOLUNTARY CORPORATE ACTION IS NOT ENOUGH**

The second major critique of the emerging CSR agenda argues that voluntary action by companies on ethical, social and environmental issues is necessary, but not sufficient to minimise the collective negative impacts of private sector operations and mobilise the necessary resources to address major public problems. There are those who argue that in many cases CSR remains little more than a public relations exercise, or an effort to avoid regulation at best, and cynical manipulation by companies to undermine genuine corporate accountability and responsibility at worst.

Critics point to the fact that of the UN's estimated 60,000 multinational companies, probably fewer than 3,000 are embracing a more comprehensive and integrated approach to CSR, accompanied by measurement and public disclosure. They argue that in the absence of major investor and consumer interest, market forces and voluntary actions are vastly inadequate for delivering more desirable social and environmental outcomes. They argue that more comprehensive national and global regulation of business behaviour is required to 'move beyond the usual suspects', 'engage the laggards', 'avoid free-rider' problems, and 'level the playing field' for all companies.

A growing number of the corporate pioneers in CSR would accept at least part of this argument. They recognise the need for more effective government implementation of existing social and environmental regulations, and in some cases the need for new regulation. At the same time, they express concerns about the unintended consequences and extra red tape and bureaucracy that are all too often an outcome of hastily imposed and highly prescriptive regulation. One regulatory development appears to be increasingly likely – and is already underway in some countries – an increase in disclosure requirements on ethical, social and environmental risks and performance. In some European countries, and in South Africa and Australia, increased demands for more public and comprehensive disclosure on corporate risks and performance are being driven not only by regulatory authorities, but also by stock exchanges, rating agencies, insurers, investors, and banks.

The voluntary versus regulatory debate is unlikely to go away. What is needed is an ongoing dialogue to ensure the most effective balance between market mechanisms, voluntary initiatives and regulatory approaches, and between different types of regulation, from prescriptive requirements to performance-based regulatory regimes.

The voluntary versus regulatory debate is unlikely to go away. What is needed is an ongoing dialogue to ensure the most effective balance between market mechanisms, voluntary initiatives and regulatory approaches, and between different types of regulation, from prescriptive requirements to performance-based regulatory regimes. As Fox has argued, “Voluntary and regulatory approaches have too often been treated as exclusive to each other, rather than options within a balanced approach to eradicating bad (socially irresponsible) behaviour while encouraging responsible activities.”<sup>10</sup>

Understanding and managing changing stakeholder expectations and negotiating the most appropriate, effective and fair boundaries of responsibility between business and government are two of the core leadership challenges facing business today. Throughout the history of the corporation there has obviously been the need to negotiate boundaries of responsibility with government, but the complexities of these boundaries and the stakes involved have grown over the past decade.

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### CRITIQUE # 3: CSR EXCLUDES 90% OF ENTERPRISES

Another highly valid critique of the emerging CSR agenda is the fact that it focuses almost exclusively on, and is driven by large companies, especially multinational corporations. Until recently the implementation of CSR practices by small and medium sized companies has received minimal attention – even in industrialised countries, let alone developing economies.

Fox has argued, “Where the debate does touch on small- and medium-sized enterprises (small enterprises), this is usually in a reactive sense, either as suppliers to larger companies, or as beneficiaries of CSR initiatives. This is short-sighted – not only are small enterprises the mainstay of most economies in terms of employment creation, but their cumulative social and environmental impacts are highly significant. This offers the potential for significant progress towards sustainable development if CSR can be made relevant and applicable to SMEs.”<sup>11</sup>

As outlined in Part III, some progress has been made in this area – both in terms of defining the business case and developing the appropriate tools and other enabling factors for small enterprises to implement ethical, social and environmental practices. The European Union, in particular, has played a leadership role in promoting this agenda with its initiative on *Responsible Entrepreneurship*. The major challenge is to share these lessons and approaches with small enterprises in developing countries, and do so in a manner that helps to enhance productivity and competitiveness rather than impose undue burdens and costs. This point leads to the next critique of the CSR agenda.

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#### CRITIQUE # 4: CSR PROMOTES AN EXCLUSIONARY 'NORTHERN' AGENDA

A fourth rapidly emerging criticism of the CSR agenda is aimed at its bias towards northern corporate, NGO, media and government agendas and its failure to address priorities and constraints in developing countries.

Fox has argued, "...the current CSR agenda is overwhelmingly shaped by actors in the North. It emerged from the globalisation debates of the 1990s, fuelled by revelations of environmental, labour and human rights abuses within the operations and supply chains of large, high-profile companies based in the North, but often operating in or sourcing from the South. There are of course exceptions, and distinctive local agendas are emerging, for example in Brazil, South Africa and the Philippines. But the international debate is yet to fully embrace and allow room for these 'indigenous' agendas, and it remains dominated by OECD-based NGOs, investors, consumers, businesses and business associations."<sup>12</sup>

From the perspective of promoting economic growth, small enterprise development and poverty reduction in developing countries, this northern bias has four important implications:

##### The threat of non-tariff protectionism

"The key concern most often voiced by both developing country governments and industrialists is that CSR standards are a mechanism for retaining jobs, trade and investment in developed countries at the expense of developing economies, which tend to compete through lower labour costs and less stringent environmental regulations."

Rigorous codes of conduct and standards in ethics, human rights, labour and the environment developed by northern organisations with minimal or inadequate consultation with their developing country counterparts, and which go beyond the requirements in existing international treaties, run the risk of raising protectionist barriers to OECD market entry. UNIDO has pointed out, "The key concern most often voiced by both developing country governments and industrialists is that CSR standards are a mechanism for retaining jobs, trade and investment in developed countries at the expense of developing economies, which tend to compete through lower labour costs and less stringent environmental regulations. ...While voluntary eco-labels and other CSR initiatives have not been formally found to be 'Non-Tariff Technical Barriers to Trade' under WTO rules, concerns remain that these standards are effectively protectionist in their impact, if not their intention."<sup>13</sup>

##### The high costs of implementation

Even when standards adhere to internationally agreed treaties and conventions, critics argue that their implementation places an unfair cost and burden on many enterprises in developing countries, most notably small enterprises that lack the technology, the information and the skills to implement these standards in a manner that is comparable and competitive with their northern counterparts – be these clients or competitors. There is a need to build local CSR capacity in developing countries to overcome this challenge – as will be addressed in more detail in Part III.

### The lack of harmonisation and burden of monitoring standards

Another challenge linked to both the northern bias and the voluntary nature of most CSR codes of conduct and standards is the fact that there has been a proliferation of such mechanisms, even in the same industry sectors and/or addressing the same issues. This has resulted in a complex and uncoordinated array of standards, requirements and metrics, which not only make it difficult to benchmark and evaluate the companies that are already active in the field of CSR, but also create high barriers of entry and additional costs for many medium and small-sized firms, especially in developing countries. Along global supply chains, for example, contractors and suppliers often have to deal with numerous different buyers' codes, making it a costly, time-consuming, and sometimes prohibitive process. One firm in China, for example, reported being audited by teams from 40 customers in a single month.<sup>14</sup>

Another challenge associated with the proliferation and lack of harmonisation between such a complex array of standards and monitoring procedures is the opportunity this provides for some companies to 'free-ride' in the sense that they can sign up to various initiatives relatively comfortably in the knowledge that these are difficult to effectively monitor and compare.

### A defensive versus value-creating, pro-poor approach

A fourth criticism linked to the northern genesis of much of the CSR debate is the fact that it has been driven mainly by a defensive 'do no harm' mindset, often responding to offshore NGO and media concerns about the negative impacts of private sector activities in developing countries, and thereby failing to fully promote and harness the positive contributions that business can make. Indeed in some cases, well-intentioned efforts by companies to respond to northern NGO and media concerns back in their own country have resulted in local stakeholders becoming more disadvantaged rather than less so, especially if progressive companies disinvest and are replaced by less progressive and less accountable enterprises.

Having said this, there is no doubt that the operations of both foreign and domestic companies – of all sizes – can have detrimental impacts on social and environmental indicators that are essential to promoting more equitable and sustainable patterns of development. Yet, there is also enormous potential to harness the core competencies, resources, networks and value-creating assets of the private sector – both foreign and domestic companies, and large-scale and small-scale enterprises – to positively impact development.

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## 4 The case for CSR and responsible competitiveness

### Making the micro-level 'business case' for CSR

It is useful to think of the 'business case' for CSR in terms of risks and costs or opportunities and benefits:

#### The benefits of 'getting it right'

There are obviously cases where responsible companies will incur greater costs on a certain project, miss an opportunity, or be under-priced by a company working with corrupt officials, paying below minimum wages, or using cheaper but environmentally damaging technologies. Equally, there are cases where a company using unethical or irresponsible practices will do better than companies that do not – at least in the short-term and especially in the case of companies that are producing products or services that are in high demand either by consumers or governments. Given the growing emphasis on transparency and accountability, however, it is likely to become increasingly difficult for companies to sustain unethical or socially and environmentally irresponsible business practices over the longer term, especially in the case of publicly quoted companies. As the *Financial Times* has observed, “Managing big companies unethically can produce gain but usually it is short-lived. Long-term success demands ethical behaviour that encourages the trust on which all social endeavours ultimately depend.”<sup>15</sup>

Over the longer-term, the benefits of 'getting it right' on ethical, social and environmental performance are likely to translate directly or indirectly into better overall operational performance and profitability. These benefits include:

- Better risk management;
- Better relationship management in terms of employee, customer, community and government relations and increasingly shareholder relations;
- Better responsiveness in anticipating and meeting changing consumer needs, emerging societal expectations and new regulations;
- Better resource and cost management;
- Better reputation management; and
- Greater readiness to innovate and experiment with new products, services, processes, markets, alliances and business models.

#### BOX 4: CSR-RELATED COSTS, RISKS, BENEFITS AND OPPORTUNITIES

**Potential costs and risks of ‘getting it wrong’** – unacceptable ethical, social and/or environmental performance may *destroy or undermine* a company’s financial value.

**Potential benefits and opportunities of ‘getting it right’** – good ethical, social and environmental performance and/or leadership on a specific issue can *protect or enhance* a company’s financial value.

- |   |   |
|---|---|
| <ul style="list-style-type: none"><li>• Corporate failure and liquidation</li><li>• Criminal charges and imprisonment of corporate officers</li><li>• Litigation costs</li><li>• Government fines, increased regulatory supervision and greater compliance burdens</li><li>• Higher costs of capital and insurance premiums</li><li>• Problems with stock exchange listings, unsuccessful public offers and inability to attract investment capital</li><li>• Lost customers</li><li>• Higher operating costs and/or inefficiencies</li><li>• Reputation damage through media exposés, consumer boycotts, lawsuits, activist campaigns</li><li>• High employee turnover and low employee morale and engagement</li><li>• Poor quality control</li><li>• Opportunity costs due to distraction, time spent on litigation, crisis management and compliance burdens</li><li>• Inward, compliance-oriented focus, poor executive-board relations, and risk-averse, hostile and suspicious corporate culture</li><li>• Accelerated depletion of intangible assets such as innovation and good relationships and lost competitive-edge.</li></ul> | <ul style="list-style-type: none"><li>• Improved risk management, better risk profile and credit ratings</li><li>• Avoidance of costly regulation</li><li>• Better access to capital through greater investor confidence, access to socially responsible investment funds, lower insurance premiums and more favourable credit terms</li><li>• Reduced operating and resource costs</li><li>• Improved process efficiency and effectiveness</li><li>• Enhanced intangible assets, such as good reputation, brand equity, product and service quality, successful innovation, increased employee motivation and productivity, positive stakeholder relationships</li><li>• Better organisational functioning, through creation of a more integrated performance-driven culture, greater cross-boundary linkages and employee learning and motivation</li><li>• Easier to attract and retain talented employees and loyal customers</li><li>• More attractive as a reliable strategic partner</li><li>• Recognition as a neighbour of choice by local community leaders and public authorities</li><li>• Increased differentiation of existing product and service offering</li><li>• Greater opportunities for innovation and for new product, service and market development</li><li>• Competitive advantage, through lower costs, differentiated products, or new products, services and customer solutions.</li></ul> |
|---|---|

Sources: Jackson, Ira and Nelson, Jane. *Profits with Principles: Seven strategies for delivering value with values*. Currency/Doubleday, 2004, page 46. Adapted from Nelson, J. *Business as Partners in Development*. International Business Leaders Forum, UNDP and the World Bank 1996; Nelson, J. *Building Competitiveness and Communities*. International Business Leaders Forum, UNDP and the World Bank, 1998; and Nelson, J. and Zadek, S. *Partnership Alchemy*. Copenhagen Centre, 2000.

#### The costs of ‘getting it wrong’

Delivering or being perceived to deliver bad ethical, social or environmental performance is increasingly likely to have a negative impact on reputation and financial results. This is especially the case when well-known companies are deemed to be responsible for a major fraud, or for a health, environmental,

corruption or human rights crisis. Costs of ‘getting it wrong’ may include the following:

- Reputation damage resulting from consumer boycotts, shareholder activism, negative media coverage or Internet campaigns against a company;
- Costly and high profile litigation, sometimes resulting in expensive compensation or remediation;
- Increased regulation, fines and regulatory oversight; and
- In severe cases, jail sentences for company executives and the demise or liquidation of the company.

Despite the value of being able to describe these costs and benefits, enormous challenges persist in developing empirically rigorous and comparable firm-level data to quantify and substantiate them. AccountAbility argues, “Despite a growing volume of data, most variables are poorly specified and therefore non-comparable (‘apples and pears’), the analysis ignores contextual factors in particular competitive dynamics, and it is unclear what is the relevant timeframe being explored. Most of all, causality is questionable where there are observed correlations between responsible business practices and business success.”<sup>16</sup> These challenges of measurement and evaluation, however, should not detract from the evidence that a growing number of companies are starting to address corporate responsibility issues on a more systematic and strategic basis.

A major challenge for any company is determining what to prioritize among the many ethical, economic, social and environmental risks and opportunities the company faces. What issues have the most material consequences and costs to the company if it fails to address them? What issues offer the greatest potential for gaining competitive edge or reputation benefits? There are no clear answers to these key questions, as the materiality of CSR-related risks and opportunities will vary not only between different industry sectors, firm size and types of ownership, but also between different geographies and governance systems. The way forward for any company is to undertake a rigorous risk-opportunity analysis and stakeholder analysis for CSR issues most likely to be relevant to the company and its industry peers and competitors.

### **Making the macro-level ‘national competitiveness case’ for CSR**

In addition to ongoing efforts to bring greater empirical rigour to the micro-level business case for CSR at the level of the individual firm, there is also an emerging field of research that sets out to address the question:

*Assuming that a critical mass of companies acts in a socially and environmentally responsible manner and that economic governance structures and policy incentives are designed to encourage such a strategy, would this result in enhanced overall national or regional competitiveness?<sup>17</sup>*

Led by UK-based AccountAbility, a consortium of think tanks, business networks and research institutions from Europe, Asia, Africa and Latin America, with support from institutions such as the World Bank, the European Commission, the Danish and UK governments and the United Nations Global Compact, have been researching this question since 2002.

Simon Zadek, CEO of AccountAbility, argues for a broader, more macro-level context for understanding the evolution of corporate responsibility: “Corporate responsibility can be understood as being about the process by which businesses’ roles in societies are renegotiated and realigned. In this sense, it is more usefully seen as an on-going macro or societal process with micro-level, organisational implications, rather than a micro-level experience that requires generalisation.”<sup>18</sup>

“The societal benefits of corporate responsibility practices will remain limited unless they can be incorporated into broader strategies, and public policies certainly have a role to play in this respect. Until now the debate has largely focused on what individual companies can do to enhance sustainable development goals.”

Likewise, Pascal Lamy, Director General of the World Trade Organisation and former European Commissioner for Trade, has observed, “The societal benefits of corporate responsibility practices will remain limited unless they can be incorporated into broader strategies, and public policies certainly have a role to play in this respect. Until now the debate has largely focused on what individual companies can do to enhance sustainable development goals. [We need to explore]... the challenges, dilemmas, and tensions surrounding the corporate responsibility debate and notably the link between it and the competitive advantage of nations.”<sup>19</sup>

AccountAbility and its research partners define responsible competitiveness as, “markets where businesses are systematically and comprehensively rewarded from more responsible practices, and penalised for the converse.”<sup>20</sup> In 2003, they launched a pilot *Responsible Competitiveness Index* (RCI), which considered corporate responsibility indicators alongside more traditionally accepted factors that affect a country’s economic competitiveness. In 2005, a second more robust index was launched with Brazilian-based Fundação Dom Cabral, covering over 80 countries and providing two unique frameworks:<sup>21</sup>

- *A National Corporate Responsibility Index* (NCRI) – looking at the state of corporate responsibility on a country-by-country basis, allowing comparison between countries and regions, across different variables and over time;
- *A Responsible Competitiveness Index* – which links the NCRI with the competitiveness of nations, drawing on the World Economic Forum’s *Growth Competitiveness Index*.

The variables used to construct the 2003 and 2005 NCRI’s are listed in Box 5. In the 2005 index, Nordic countries score well, along with Canada, Austria and Belgium, with South Africa being ranked as the highest emerging economy (excluding Eastern Europe) followed by Korea, Chile, Malaysia, Costa Rica and Thailand. Despite some questions on the robustness of the findings, there is a significant correlation between the competitiveness of a country and its corporate

responsibility level. The authors of the indices emphasize, however, the fragility of the data and associated statistical and theoretical problems in constructing these new approaches to assessing national and regional competitiveness and they caution that, “such measures therefore need to be treated as indicative, rather than proof of possible causal relationships.”<sup>22</sup>

Having said this, the data offer some support for the proposition that corporate responsibility can fuel country competitiveness. These indices, together with supporting case study material and other research represent an important contribution to understanding the role that responsible business can play in enhancing a country’s competitiveness.

#### BOX 5: NATIONAL CORPORATE RESPONSIBILITY INDEX VARIABLES: 2003 AND 2005

NCRI 2003	NCRI 2005
<p><b>1. Corporate governance</b></p> <ul style="list-style-type: none"> <li>• Transparency and disclosure rating</li> <li>• Strength of auditing and accounting standards</li> <li>• Are boards independent?</li> </ul> <p><b>2. Ethical business practices</b></p> <ul style="list-style-type: none"> <li>• Bribe payers’ Index</li> <li>• Anti dumping measures against country/bn US\$ exports</li> <li>• Business costs of corruption</li> <li>• Strength of corporate ethics</li> </ul> <p><b>3. Progressive policy formulation</b></p> <ul style="list-style-type: none"> <li>• Are environmental gains adversarial?</li> <li>• Are regulatory standards demanding?</li> <li>• Ratification of Kyoto Protocol</li> <li>• Sign up to UN Global Compact</li> </ul>	<p><b>1. Internal dimension: Corporate governance-ethical practices and Human Capital Development</b></p> <ul style="list-style-type: none"> <li>• Strength of auditing and accounting standards</li> <li>• Efficacy of corporate boards</li> <li>• Corruption Perception Index</li> <li>• Gap in the implementation of the basic worker rights</li> <li>• Quality of human resources approach: training and employee development</li> <li>• Gender equality: private sector employment of women</li> </ul>
<p><b>4. Building human capital</b></p> <ul style="list-style-type: none"> <li>• Fatal accidents/100,000 workers</li> <li>• Extent of staff training</li> <li>• Employee protection legislation</li> <li>• Employment Laws Index</li> </ul>	<p><b>2. External dimension: Civil society context</b></p> <ul style="list-style-type: none"> <li>• Customer orientation</li> <li>• Civic freedom</li> <li>• NGOs/1,000,000 people (NGO density per 1,000,000 people group)</li> </ul>
<p><b>5. Engagement with civil society</b></p> <ul style="list-style-type: none"> <li>• Degree of civic freedom</li> <li>• Total of consumer groups per 10m people</li> <li>• Public trust in business</li> <li>• Sophistication of consumers</li> <li>• Customer orientation of companies</li> </ul> <p><b>6. Contributions to public finance</b></p> <ul style="list-style-type: none"> <li>• Corporate tax levels</li> <li>• Prevalence of irregular payments in tax collection</li> <li>• Public spending on education as % of total public spending and GNP</li> </ul> <p><b>7. Environmental management</b></p> <ul style="list-style-type: none"> <li>• Compliance with environmental regulations</li> <li>• Prevalence of environmental management systems</li> <li>• Emissions of carbon dioxide per unit of GDP</li> <li>• Total of Dow Jones Sustainability Index rated companies as % of total listed companies</li> </ul>	<p><b>3. Environmental management</b></p> <ul style="list-style-type: none"> <li>• Stringency of environmental regulations</li> <li>• Signing and Ratification of environmental treaties – Cartagena Protocol on Biosafety/ Framework Convention on Climate Change/ Convention on Biological Diversity/ Kyoto Protocol to the Framework Convention on Climate Change (US)</li> <li>• Fossil fuels footprint (WWF) – Total energy footprint (global ha/person)</li> <li>• Number of certified ISO 14001 – companies per US\$ billion</li> </ul>

Source: *Responsible Competitiveness: Reshaping Global Markets Through Responsible Business Practices*. London: AccountAbility in association with Fundação Dom Cabral, 2005.

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## 5 CSR and the development agenda

“...the private sector can, and in numerous cases already is, playing a leadership role in moves towards sustainable development. It is doing so, first and foremost, by focusing increased attention on the economic, social and environmental spin-offs of core business activities. Some companies are also adopting a more strategic approach to their social investments and traditional philanthropic activities. Many are contributing to the policy dialogue at both national and international levels.”

*Business as Partners in Development*, a 1996 report by the International Business Leaders Forum, in cooperation with the World Bank and UNDP, made a strong case for the role that the private sector and CSR can play in directly supporting international development objectives. The report concluded that, “...the private sector can, and in numerous cases already is, playing a leadership role in moves towards sustainable development. It is doing so, first and foremost, by focusing increased attention on the economic, social and environmental spin-offs of core business activities. Some companies are also adopting a more strategic approach to their social investments and traditional philanthropic activities. Many are contributing to the policy dialogue at both national and international levels. ...Companies are forging new types of partnership with each other, and with governments and non-governmental organisations in each of these areas.”<sup>23</sup>

As outlined in Section I, the contribution of the private sector to development has received growing prominence since 2000, through a series of expert-led commissions and reports. All too often, however, this development contribution has not been effectively aligned to the CSR agenda. The situation is now changing, and there is a growing focus within the CSR community on the impact that business has on economic development, in addition to social and environmental issues.

There is clearly wide variation in the specific contributions that different companies can make to supporting key development goals such as poverty reduction. Their contribution depends not only on the type of development intervention needed – such as mobilising resources, improving governance and public capacity, or building new markets – but also on factors such as the industry sector and the company’s own business model, ownership structure, and size.

Despite these differences, almost all companies have the potential to make a contribution to development and poverty reduction through the following three spheres of business impact and influence outlined in *Business as Partners in Development*:<sup>24</sup>

- i) **Core business activities** – The company’s operations, investments and relationships in the boardroom, the workplace, the marketplace, and along the value chain. The greatest and most sustainable contribution that any company can make to development is through carrying out its core business activities in a productive, profitable, and responsible manner, building business linkages and creating other ‘economic multipliers’ in host countries and communities. The key goals should be to minimise any negative impacts that may arise from the company’s activities, and to increase and leverage positive impacts.

The diagram in Figure 6 outlines the areas where companies can create positive value for host countries and communities through their core business activities.<sup>25</sup>

These can be summarised as follows:

- Producing safe and affordable products and services
- Generating income and investment
- Creating jobs
- Developing human resources
- Building local business linkages
- Spreading responsible business standards
- Supporting technology development and transfer
- Establishing physical and institutional infrastructure.

ii) **Social investment and philanthropic activities** – aimed at mobilising not only money, but also the company’s people, products and premises to help support and strengthen local communities and non-profit partners, and to co-invest in the type of ‘hybrid’ and ‘blended value’ approaches outlined below.

iii) **Policy dialogue and advocacy activities** – efforts by companies, either individually or collectively, to support more systemic change and to participate in relevant public policy dialogues and advocacy platforms with both developing country governments and donor governments.

These three spheres of business impact and influence are illustrated in Figure 6. They can also be envisaged as a company’s ‘development footprint’ – the extent of which will vary depending on the company, industry sector, and situation in question.

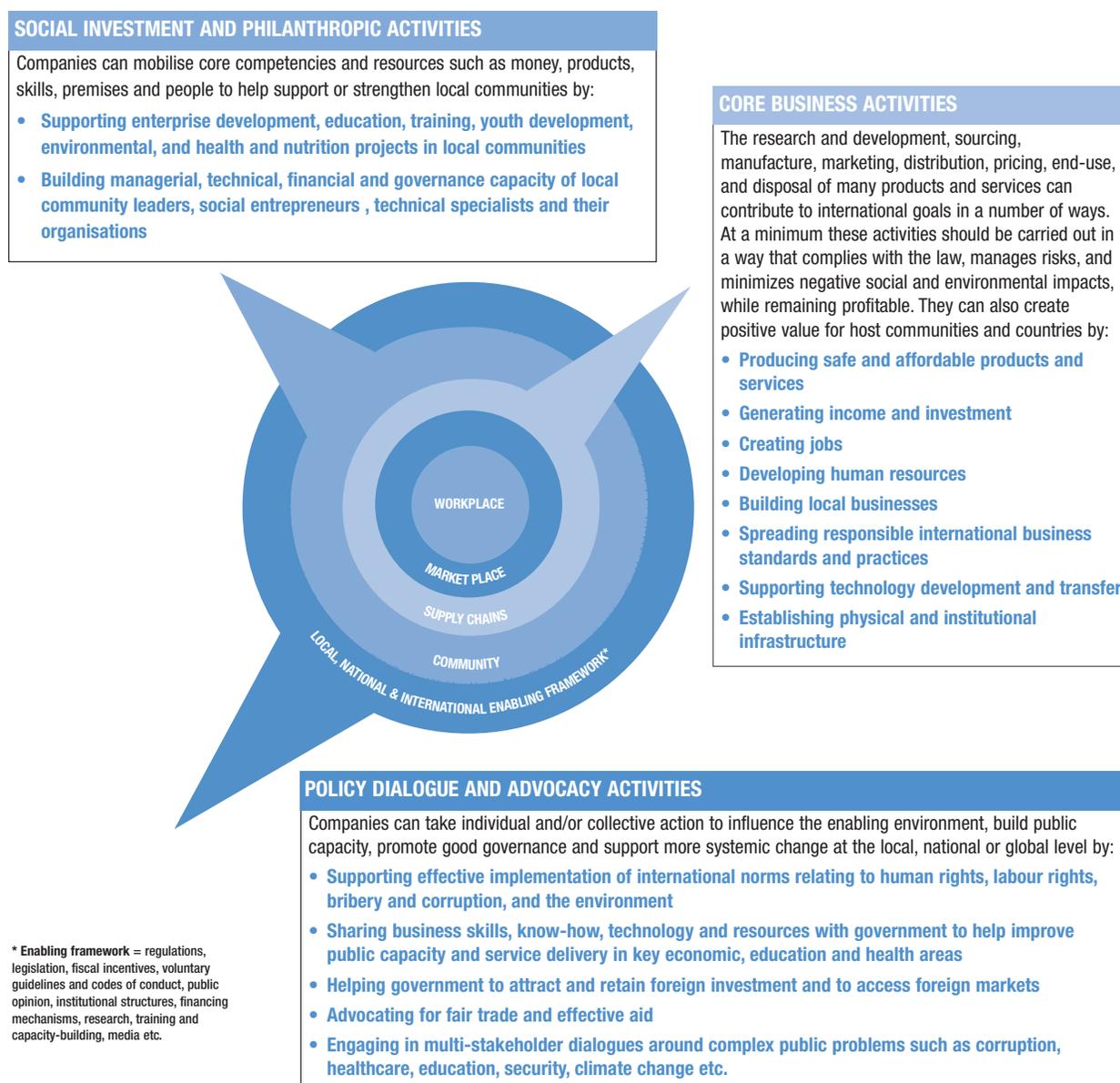
“In order to serve low-income markets profitably and with social impact, a new generation of partnerships that commercially link businesses and leading citizen sector organisations is necessary. Each partner creates economic and social value by leveraging each others’ core competencies.”

One of the most interesting developments in recent years has been the emergence of what Ashoka, the World Economic Forum and others are describing as ‘hybrid approaches’. These are essentially business models, practices or partnerships that combine the company’s core competencies and commercial acumen, with social investment, philanthropy and/or public finance.<sup>26</sup> In developing its concept of the Hybrid Value Chain™, Ashoka comments that, “In order to serve low-income markets profitably and with social impact, a new generation of partnerships that commercially link businesses and leading citizen sector organisations is necessary. Each partner creates economic and social value by leveraging each others’ core competencies. Differing from traditional ‘corporate social responsibility’ relationships, Hybrid Value Chains™ are commercial in nature with each partner receiving economic benefit according to their role and transaction in the partnership.”<sup>27</sup>

Such approaches are being used to support projects that may not currently meet commercial hurdle rates, but have the potential of becoming commercially viable over the longer term, while explicitly addressing a development or social need. They are often carried out in partnership with other actors, such as other companies, NGOs and/or donors – and are one of the innovative partnership models for supporting business linkages that are profiled in Section V.

Linked to these ‘hybrid approaches’, the term ‘blended value investing’ has been coined by Jed Emerson and his colleagues to describe private investment strategies and instruments that explicitly include social and/or environmental factors into investment decisions.<sup>28</sup> In their 2005 report, *Private Investment for Social Goals: Building the blended value capital market*, the World Economic Forum, International Finance Corporation and Rockefeller Foundation comment, “Financial returns in blended value investments may be at risk-adjusted market rates or below market rates. These types of investments inhabit a space between philanthropy, where no financial return is expected and pure financial investments, where social considerations are not a factor and financial profit is maximised.”<sup>29</sup> Such ‘blended value’ financing mechanisms are another of the innovative new partnership models detailed in Section V.

**FIGURE 6: SPHERES OF BUSINESS IMPACT AND INFLUENCE**



Sources: Nelson, J. *Building Partnerships*. United Nations and International Business Leaders Forum, 2002 and Nelson, J. *Business as Partners in Development*. International Business Leaders Forum, UNDP and the World Bank, 1996.

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## 6 CSR and linkages between large and small enterprises

One of the most obvious, and surprisingly untapped ways that large companies can support development objectives in the countries and communities in which they operate is through spreading economic opportunity through a variety of small enterprise development, training and business linkage initiatives.<sup>30</sup> Depending on the industry sector and the company's business model, such initiatives can be supported through all three spheres of company influence: core business activities; social investment and philanthropy; and engagement in the public policy agenda. Some examples are outlined in Box 6. Many of these lend themselves to collective business initiatives and other innovative types of cross-sector partnership – such as those that are explored in more detail in Part V of this report.

### BOX 6: LINKAGES BETWEEN LARGE AND SMALL ENTERPRISES

#### CORE BUSINESS ACTIVITY

Procurement

Agricultural outgrowers schemes

Manufacturing subcontracting

Outsourcing non-core functions and services

Distribution and retail

Franchising and leasing

Financial services provision

Utilities services provision – energy, water, technology

#### SOCIAL INVESTMENT AND PHILANTHROPY

Offering basic business training

Technical and vocational training

Volunteering management time

Donating premises, equipment, discards, cut-offs

Innovative community financing

Funding research and development

Enterprise education in schools

#### POLICY AGENDA and ADVOCACY FOR small enterprises

Business associations directly advocating for SME-related policies

Business engagement in national Poverty Reduction Strategy processes

Source: Adapted from Nelson, J. *Business as Partners in Development*. International Business Leaders Forum, UNDP and the World Bank, 1996.

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## 7 The case for partnership and collective action

The growth in the corporate responsibility agenda over the past decade has been matched by a marked increase in new types of non-traditional alliances aimed at addressing public problems and development challenges. These are either between companies themselves – what we refer to here as collective corporate action – or between organisations in the public, private and civil society sectors – commonly referred to as public-private, cross-sector, multi-sector or multi-stakeholder partnerships. Some are global in scope, others national or local. Many are focused on addressing a particular development challenge, although some aim to tackle a range of inter-related issues.

As is the case with CSR strategies at the level of the individual firm, many of these new forms of collaboration are a response to governance gaps and failures. It is important that they are not viewed as a substitute for government leadership. Having said this, they do have value both as interim approaches to responding to governance gaps and delivering public goods, and potentially as longer-term institutional structures.

“...public-private partnerships come in many forms, driven by different motivations and serving different purposes. Some are business ventures, centering on private gain. Some are social ventures, pursuing primarily public interests. And some have a double bottom line, trying to meet social goals while enhancing private welfare. Most operate at the leading edge, fostering institutional innovation.”

Inge Kaul, Director of UNDP’s Office of Development Studies comments, “...public-private partnerships come in many forms, driven by different motivations and serving different purposes. Some are business ventures, centering on private gain. Some are social ventures, pursuing primarily public interests. And some have a double bottom line, trying to meet social goals while enhancing private welfare. Most operate at the leading edge, fostering institutional innovation.”<sup>31</sup>

Professors John Donahue and Richard Zeckhauser use the term collaborative governance to describe a particular form of public-private collaboration, which they define as: “The pursuit of authoritatively chosen public goals by means that include engaging the efforts of, and sharing discretion with, producers outside of government.”<sup>32</sup>

They emphasise that, “Collaborative governance is distinguished from simple contracting and from philanthropy in the allocation of operational discretion. A pure service contract vests all discretion with the government. Pure voluntary provision vests all discretion with the donor. Strategic interaction, at both extremes, is relatively sparse. In what we term collaborative governance, by contrast, each party has a hand in defining not only the means by which a goal is achieved but the details of the goal itself. This yields relationships that promise to augment the capacity (whether financial, productive, or both) available for public missions and to increase the flexibility with which such missions are pursued, but at the price of more ambiguous lines of authority and far greater strategic complexity.”<sup>33</sup>

These new types of strategic alliance between governments and non-government actors, including business, are being experimented with by individual government entities as well as inter-governmental agencies such as the World Bank and United Nations. The authors of a 2005 UN report, *Business UNusual: Facilitating UN reform through partnerships* comment, “Partnering with business and civil society has turned into a necessity for the United Nations in order to “get the job done. ...Partnerships have become a catalyst for reform and institutional innovation across the entire United Nations system.”<sup>34</sup>

## Making the case for partnership

In a world beset by market failures, governance gaps and institutional constraints, the case for such alliances can be made at both the national and global level, and from the perspective of both public and private actors, in terms of:

- Improved Effectiveness – greater leverage, scale and systemic impact
- Greater Efficiency – minimising duplication and optimising resource use
- Increased Legitimacy – greater participation, consultation and accountability.

The general case for cross-sector partnerships and collective corporate action is outlined in Box 7:

### BOX 7: PROCESS BENEFITS OF PARTNERSHIPS

#### IMPROVED EFFECTIVENESS

- Leveraging greater amounts and a wider variety of skills and resources than can be achieved by different groups or sectors acting alone
- Accommodating broader perspectives and more creative approaches to problem-solving
- Addressing complex and interdependent problems in a more integrated and comprehensive manner
- Shifting away from coercive ‘command and control’ delivery of public goods to more informed joint goal-setting and allocation
- Achieving greater scale and more systemic solutions

#### GREATER EFFICIENCY

- Pooling scarce and/or dispersed financial, managerial and technical resources
- Avoiding duplication of cost and effort
- Optimising ‘division of labour’ and burden sharing
- Creating economics of scale
- Facilitating the sharing of information
- Promoting technology cooperation
- Overcoming institutional rigidities and bottlenecks
- Potentially decreasing costs associated with conflict resolution and societal disagreement on policies and priorities

#### INCREASED LEGITIMACY

- Improving the level and quality of consultation with key stakeholders
- Facilitating broader participation in priority-setting and problem-solving
- Obtaining ‘buy-in’ of beneficiaries and broader ‘ownership’ of proposed solutions, and thereby greater potential sustainability of outcomes
- Building the mutual trust needed to work through diverse, often conflicting interests

Source: Nelson, J. *Business as Partners in Development*. International Business Leaders Forum, UNDP and the World Bank, 1996 and Nelson, J and Zadek, S. *Partnership Alchemy*. Copenhagen Centre, 2000.

From the perspective of governments, multi-sector partnerships can play a useful role in delivering ‘public goods’ that neither the markets nor the public sector are able to deliver on their own. This is important at both the national and global level. Former UNIDO Director-General, Carlos Magariños, argues, “Globalisation, and such of its manifestations as growing poverty, inequality and environmental degradation, increases, not reduces, the need for the provision of ‘global public goods’. By ‘global public goods’ I mean ‘global commons’ such as a sustainable environment; peace and safety; the basic infrastructure of international economic relations; the furtherance of human rights; democratisation; poverty reduction and humanitarian assistance; and the creation, adaptation, and diffusion of knowledge. Equally important, the provision of global public goods means meeting needs that markets, and often even governments, left to their own devices, cannot satisfy.”<sup>35</sup>

Inge Kaul of UNDP comments, “Global public-private partnerships seem to be here to stay. They occupy an increasingly open middle ground between markets and states, permitting more nuanced and potentially more effective policymaking. They demonstrate that when markets fail, the policy response does not have to be government intervention alone. It can also be partnering. And when governments fail, the response is not necessarily to turn to the market. Again, it could also be public-private partnering.”<sup>36</sup>

Donahue and Zechkauser argue that, “Non-governmental actors are appropriately enlisted into public undertakings to improve performance in the creation of public value. This core rationale applies whether the mode of engagement is collaborative governance or more familiar forms of contracting and voluntarism. Private entities may offer advantages over governmental organisations in several (partly overlapping) dimensions.”<sup>37</sup> They cite the following four motives for involving the private sector in public missions:<sup>38</sup>

- *Resources* – Perhaps the simplest rationale for collaboration with the private sector is invoked when government itself lacks the resources – or the ability to mobilise the resources – required to accomplish some mission.
- *Productivity* – A second generic rationale for indirect government production is that external agents command productive capacity that government lacks.
- *Information* – Even if government’s resources are no more constrained, and its productivity no lower, than the private sector’s, private involvement may be warranted when it is impossible, or prohibitively costly for government to acquire pertinent information.
- *Legitimacy* – Private involvement may enhance the perceived legitimacy of an undertaking if a particular task is seen as inappropriate for government to pursue on its own.

From the perspective of individual firms, there are some development challenges that directly affect a company's profitability or operating environment that it is unable to address either effectively, legitimately, or to a sufficient scale on its own through its own business operations or corporate social responsibility strategies. Examples include: tackling bribery and corruption beyond the company's own business operations; improving the enabling environment for private investment, including small enterprise development, beyond the company's immediate value chain; supporting education reform, which is important to generate future skilled workers; addressing HIV/AIDS, malaria, TB and other infectious diseases beyond the workplace; and ensuring industry-wide social or environmental standards to avoid 'free-rider' problems.

“Despite achieving impressive momentum, the corporate responsibility movement is bumping up against real limits. Most company initiatives are too peripheral from core businesses, too isolated from one another, and too disconnected from wider systems to make much of a collective impact.”

None of these problems lend themselves to purely market-based or private solutions. Corporate responsibility at the level of the firm gives some indication for how an individual company will respond to these 'public goods' challenges, but in most cases provides insufficient resources and momentum for an effective solution in the absence of the company engaging in partnership or collective action with others.

As the UN Global Compact and SustainAbility have observed, “Despite achieving impressive momentum, the corporate responsibility movement is bumping up against real limits. Most company initiatives are too peripheral from core businesses, too isolated from one another, and too disconnected from wider systems to make much of a collective impact.”<sup>39</sup>

Likewise, Simon Zadek makes the case that, “Emerging collaborative arrangements between public and private institutions provide the potential for novel ways for enhancing the provision of public goods. This potential is framed by organisations' willingness and ability to participate in such arrangements. Business engagement is a particular challenge, given its distinct societal mandate to create private economic gain. The basis of business accountability establishes the logic of its terms and interests, and so participation in such collaboration.”<sup>40</sup>

There are two key strategic options for companies aiming to strengthen their contribution to development and to achieve greater scale and systemic impact through engaging in alliances with others:

- i) **Collective corporate action** – companies can address certain development challenge by engaging in collective corporate action. This can often be achieved through representative business organisations, such as Chambers of Commerce, Organisations of Employers, or trade and industry groups. It can also be achieved through more targeted business leadership groups, with a specific development or social mandate, such as national business councils for sustainable development, national business coalitions to tackle HIV/AIDS, or collective business linkage initiatives to support small enterprise development.

ii) **Multi-sector partnerships** – another strategy, with relevance at the global, national or local level, is for companies to participate in formal alliances with key development actors in other sectors – government bodies, donor agencies, NGOs etc. Such alliances vary widely in the formality and rigour of their governance and operational structures, as well as in their focus and purpose. Some are structured as consultation mechanisms, others as operational and delivery mechanisms. They can help to *protect* social and market value – as is the case in alliances to set standards and improve public and private governance systems – and to *create* new social and market value – as is the case in alliances to mobilise financial and other resources from different sectors. As with collective business action, such multi-sector partnerships can also play a crucial role in supporting competitive and responsible small enterprise development as outlined in Part V.

The development contribution of collective corporate action and multi-sector partnerships, whether in the area of business linkages or more broadly, comes from their ability to confer greater legitimacy and/or enable greater effectiveness and efficiency than any one of the participants could achieve on its own. But they are not a panacea. These alliances can have high transaction, operational and reputation costs. They may also face substantial governance and accountability challenges. Despite these challenges, they can be a valuable addition to a portfolio of strategies used by companies, governments and NGOs to strengthen the development impact of business.

In conclusion, in today's world resources and influence are too dispersed among the different actors for any one group – be it government, business, civil society or the poor themselves – to have all the necessary answers, the necessary capabilities, or the necessary legitimacy to find solutions on their own. Governments must continue to play a central role. But profitable and responsible business leadership, in partnership with policymakers and civic leaders, can make a vital contribution in developing innovative new solutions to international development challenges.

One of the areas of greatest potential and the focus of the remainder of this report is in establishing new models of partnership to support competitive and responsible small enterprise development. The next section reviews three of the major sets of obstacles to achieving such enterprise development and suggests ways forward for overcoming these, through new types of business linkages supported by multi-sector partnerships and collective business action.

## SUMMARY OF PART II:

## THE EMERGENCE OF CORPORATE SOCIAL RESPONSIBILITY (CSR) AND MULTI-SECTOR PARTNERSHIPS

Corporate social responsibility (CSR) is defined in this report as the manner in which companies manage their economic, social and environmental impacts and their stakeholder relationships, in all their spheres of influence: in the boardroom; in the workplace; in the marketplace; along the corporate value chain; in the community; and in the public policy realm.

## 1. CSR strategies at the enterprise level

Four CSR strategies that companies can employ at the level of the individual firm are: compliance with regulations and voluntary norms, principles and codes; control of risks, negative impacts, costs and liabilities; community investment and philanthropy; and creation of new market and social value through the development of new products, services, processes, markets and alliances.

## 2. The link between CSR and governance

The emerging CSR agenda has implications not only for corporate governance, strategy, and risk management at the firm level, but also for governance more broadly at the global and national levels. In many cases CSR is a corporate response to dealing with governance gaps and failures on the part of government – for example, bad governance, weak governance or indifferent governance.

## 3. Critiques of CSR

There are a number of well-argued critiques of CSR that need to be addressed if responsible business practices are to become the norm rather than the exception. These include arguments that CSR is in fact irresponsible in the face of legal requirements for companies to maximize shareholder value; that the ‘business case’ and drivers for CSR are too weak to ensure wide adoption in the absence of regulations; that CSR as currently promoted excludes small enterprises and supports an exclusionary ‘northern’ agenda that excludes or penalises developing economies.

## 4. The case for CSR and responsible competitiveness

Research is being undertaken by a number of scholars and practitioners to test both the micro-level ‘business case’ for CSR at the level of individual firms and the macro-level ‘national competitiveness case’ for CSR at the level of national economies. Although still at an early stage, this research offers some support for the proposition that CSR can fuel both corporate and country competitiveness.

## 5. CSR and the development agenda

There is growing interest in the link between CSR and the achievement of the Millennium Development Goals. Research by the International Business Leaders Forum, World Bank and UNDP has identified three key spheres of influence through which responsible business practices can contribute to development and poverty reduction: through core business activities; through social investment and strategic philanthropy; and through engagement in public policy dialogue, advocacy and institution building.

## 6. CSR and linkages between large and small enterprises

One of the most obvious and surprisingly untapped ways that large companies can support development objectives in the countries and communities in which they operate is through spreading economic opportunity through a variety of small enterprise development, training and business linkage initiatives.

## 7. The case for partnership and collective action

Over the past decade there has been a marked increase in new types of alliances – both between companies and between business, government and civil society organisations – aimed at addressing public problems and development challenges. Although such alliances are not a panacea, they can help both governments and companies to improve the effectiveness, efficiency and legitimacy of their activities beyond what could be achieved by acting alone.

# III OVERCOMING CHALLENGES TO COMPETITIVE AND RESPONSIBLE ENTREPRENEURSHIP

Few people who have visited the informal markets in urban and rural communities throughout Africa, Asia and Latin America can fail to be humbled and impressed. In the midst of enormous deprivation, despair, heavy-handed bureaucracy, crime, corruption, and often violence, there are millions of men, women, youth and even children somehow surviving as self-employed entrepreneurs.

These people don't lack ideas, courage or persistence. In a surprising number of cases, they don't even lack financial and physical assets such as savings and property. What they do lack is access to legal documentation and property rights to serve as collateral for capital. They lack access to technology and to reliable and affordable energy and water. They have limited access to markets, to reliable business partners, to information, to business skills and to legal advice. And they lack access to education, training, health care, and insurance. In short, they lack access to opportunity in order to create economic value and they lack access to effective risk management products and services in order to protect this value.

Improving the enabling environment and providing such services creates a crucial opportunity to unleash and increase the untapped human capital and financial assets that already exist in millions of low-income households and communities around the world.

Yet, these are just the basics. Supporting small and micro-enterprises operating in the informal economy to enter and survive in the formal economy is necessary, but not sufficient to enable developing economies to make the gains in productivity, profitability and competitiveness that are needed to achieve more sustained economic growth.

Efforts are also needed to support more mature small and medium-sized enterprises to upgrade their products, processes and functions, and to improve their levels of quality, productivity and innovation to enable them to integrate into national, regional and global value chains. A major breakthrough in many countries would be achievement of food self-sufficiency and the creation of a dynamic ecosystem of market-driven rural and urban enterprises to facilitate this. There are also opportunities to support the emergence of small firms that are adding value to agricultural commodities and fishery products, producing textiles, toys and footwear, supplying manufacturing components, servicing back-office,

printing and information technology contracts, providing eco-tourism services, and acting as local distributors, franchisees and retailers for large company consumer products and services. These firms need access to increasingly sophisticated and diversified forms of capital, business advisory services, and business linkage initiatives.

As these firms start to enter more sophisticated production networks and value chains, they face new challenges to implement responsible business practices – in areas such as occupational health, safety and the environment. These challenges are driven by the need to meet standards required by their business partners, or by the need to better manage risks and costs, further improve quality, productivity and innovation, and harness new business opportunities and relationships. Again, these call for improved access to different types of credit, information, skills and technology.

These are the types of small and medium enterprises that offer great potential for sustained economic growth and poverty reduction in many developing and transition economies: *Profitable, productive and performance-driven enterprises that are capable of upgrading and ready to implement social and environmental practices into their operations. What we've termed as 'competitive and responsible entrepreneurship' for the purpose of this report.*

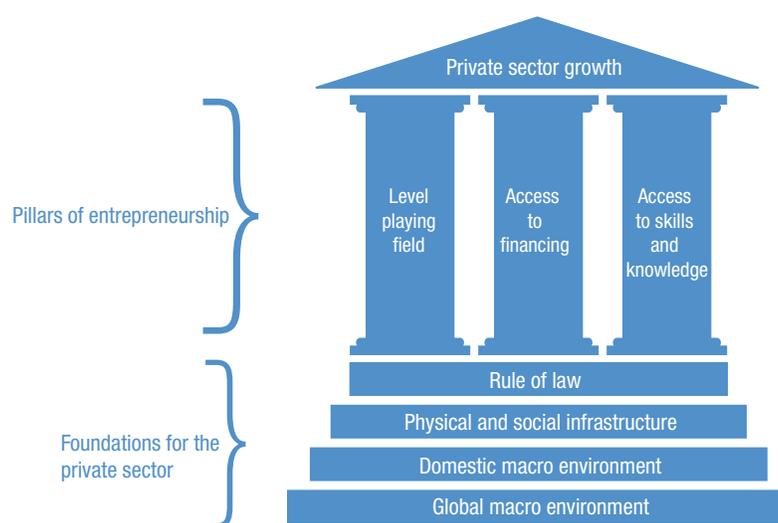
What are the key challenges to be overcome to develop more of these competitive and responsible entrepreneurs in developing countries? As outlined above, three stages of support are essential:

- *Improving access to finance, business services and legal rights* – Initiatives to improve the access of small enterprises to appropriate products, services and legal and institutional support – with the goals of developing high-potential 'opportunity entrepreneurs', who have the prospect of becoming major job creators and wealth generators, and also supporting informal sector entrepreneurs to move into the formal sector in rural and urban communities.
- *Upgrading and integrating small enterprises into value chains* – Initiatives that support small enterprises to upgrade their products, processes and functions and to improve their levels of quality, productivity and innovation – with the aim of enabling them to build successful linkages with large domestic companies and foreign investors and to integrate into broader production networks and value chains;
- *Implementing responsible business practices in small enterprises* – Initiatives that support small enterprises to implement ethical, social and environmental practices. To be sustainable over time, these need to be both supply-driven, for example by support services and government interventions, and demand driven, for example by customer requirements and by smaller companies themselves recognizing that they can increase the net value added to the products and services they produce if they adopt some of these responsible business practices and standards.

## 1 Improving access to finance, business services and legal rights

There is broad agreement emerging on the basic building blocks for supporting private sector development and entrepreneurship. This is well summarised by the findings of UN Commission on the Private Sector and Development, which identifies the following foundations for private sector development and entrepreneurship. The full set of the Commission’s recommendations to governments and private institutions is outlined in Appendix II.

**FIGURE 7: FOUNDATIONS FOR THE PRIVATE SECTOR AND PILLARS OF ENTREPRENEURSHIP**



Source: *Unleashing Entrepreneurship: Making business work for the poor*. Report by the Commission of the Private Sector and Development, to the Secretary-General of the United Nations. March 2004.

“Even with strong macroeconomic and institutional foundations, three additional factors are indispensable for entrepreneurship and the private sector to flourish in an economy: a level playing field, access to finance, and knowledge and skills.”

Creating the foundations or enabling environment for private sector development is largely the role of government, which is explored in more detail in Part IV.

The UN’s Commission on Private Sector and Development argues, however, “Even with strong macroeconomic and institutional foundations, three additional factors are indispensable for entrepreneurship and the private sector to flourish in an economy: a level playing field, access to finance, and knowledge and skills.”<sup>1</sup>

These three fundamental pillars are important at all levels and stages of enterprise development, and are summarised briefly below, drawing on the conclusions of the UN Commission’s report *Unleashing Entrepreneurship*.

## A level playing field – with fair rules, fairly enforced

The UN Commission calls for, “a system of rules and enforcement mechanisms that is fair, trustworthy, effective and predictable.”<sup>2</sup> The report highlights the importance of such rules for business entry, operation, and exit, as well as rules for credit, tax and market competition and pricing. It emphasises in particular, the need for legislation and policies aimed at: simplifying regulations; improving market competitiveness, and simplifying, clarifying and stabilising taxes. Addressing these challenges is primarily the role of government, although large domestic companies, foreign investors and business associations can play an important role in advocating for such changes, and professional service firms and private financial institutions can offer valuable technical assistance and advice.

## Access to finance

There is increasingly strong evidence on the importance of access to market-driven finance for small enterprises. The eminent Advisors Group to the UN International Year of Microcredit in 2005 cites, “recent empirical evidence by the World Bank, which for the first time shows that increased access to finance helps to reduce poverty (rather than, as is sometimes argued, that greater financial access is merely a consequence of reductions in poverty). The results support the view that building an inclusive financial sector should be considered a driving force of economic development and poverty reduction. ...The World Bank analysis is noteworthy in two other respects. First, it confirms that access to financial services remains extremely limited in most poor countries. ...Second, the World Bank analysis also finds that government ownership of the financial sector is inversely correlated with access. This underlines a crucial lesson for policymakers as they consider how to ‘scale up’ microfinance: the private sector will play a critical role in enabling poor people to receive financial services.”<sup>3</sup>

In common with many studies, the UN Commission on the Private Sector and Development highlights the particular challenges faced by small enterprises that operate between large companies, that are usually well served by existing banking systems, and the micro-enterprise sector, that has benefited from good, although still not sufficient progress in microfinance over the past decade.

In terms of microfinance, for example, the UN estimates, that over 40 million poor people are now being served by microfinance institutions in more than 65 countries. Although the total market for this sector is estimated at some 500 million people, so a large percentage of the potential customer base is still not being served or is being underserved. Despite the operational challenges there is now increased political and empirical support for the viability and impact of market-driven microfinance services.

Even more slow and problematic, however, has been progress on small and medium enterprise financing, especially for the type of high-potential ‘opportunity entrepreneurs’ that offer the greatest hope of raising productivity and employment levels.

Patricof and Sunderland argue, “Donors need to face the reality that the young companies that can really move the needle on innovation, inspiration, and employment need high-risk, reasonably-sized equity investments to grow, not the limited doles of short term, high interest debt currently provided.”<sup>4</sup> They observe that the type of long-term, permanent equity capital provided to young growth companies in developed countries by Angel investors and venture capitalists is almost impossible for similar companies to access in developing countries.

Citing challenges such as weak managerial capacity, business environment risks, limited exit opportunities, high transaction costs, limited deal flow, and currency risk, they argue that, “The combination of these factors makes SME investing in growth-oriented companies in developing countries difficult, if not impossible, to justify in commercial terms.”<sup>5</sup> They are among a growing number of investment practitioners calling on donors, governments and private sector financial institutions to explore new financing models that, “take into account the high risks, high transaction costs, low volume, and below market rates of return endemic to the sector.”<sup>6</sup>

The UN Commission concurs with this challenge, and like Patricof and Sunderland it argues that a web of factors is at work, not just lack of capital. Related challenges cited by the Commission include: weak property rights; lack of enforcement of contracts; lack of bankruptcy laws, further increasing the risk to investors; poor financial institutions with limited interest and lending skills for entering this market; lack of reliable credit information agencies and disclosure requirements; illiquid capital markets and lack of exit opportunities; and lack of skill and will on the part of SME entrepreneurs themselves for receiving risk capital.

While these obstacles are not insurmountable, most of them require fundamentally new approaches and a fine balance between government-supported interventions, market-driven incentives, and ‘blended value’ – social/commercial investment approaches. Such approaches, which often rely on partnerships between different actors, are explored in more detail in Part V.

### **Access to skills and knowledge**

The third essential pillar of entrepreneurship identified by the UN Commission is human capital: “A firm’s competitive advantage comes from its entrepreneurial capabilities; its management and technical know-how, including labour-management relations, information technology skills, basic finance, economics and project management; as well as the skills, education and adaptability of its employees.”<sup>7</sup>

“A firm’s competitive advantage comes from its entrepreneurial capabilities; its management and technical know-how, including labour-management relations, information technology skills, basic finance, economics and project management; as well as the skills, education and adaptability of its employees.”

Important at all stages of enterprise development, such human capital is essential for small enterprises aiming to upgrade and integrate into regional and global value chains.

Some of the recommendations made by the UN Commission to tackle skills and knowledge gaps include: public-private partnerships that combine on-the-job apprenticeships with basic education; teach-the-teacher programmes to build local training capacity; entrepreneurial networks and associations for peer-to-peer learning; mentoring and coaching relationships between local entrepreneurs and expatriate managers or the country's own diaspora; investment in local research on entrepreneurship and management courses; and efforts to stem the brain drain of professionals that occurs in many developing countries and to encourage diaspora to return. Many of these recommendations lend themselves to the type of public-private partnerships profiled in Part V.

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## 2 Upgrading and integrating small enterprises into value chains

Even when the fundamental pillars for entrepreneurship are being addressed, major obstacles persist in increasing the productivity and growth of small enterprises.

Research by the German Development Institute on the role of small enterprises in productivity enhancement points to the fact that small enterprises in developing countries tend to contribute less to productivity growth and national competitiveness than their counterparts in industrialised countries.<sup>8</sup>

The research suggests five essential and inter-related gaps in small enterprise performance comparing stylised enterprises in developing and industrialised economies. All five of these 'gaps' need to be addressed in order to improve prospects for high-impact small enterprise development in developing economies:

- *Role of entrepreneurship* – In many developing countries 'necessity entrepreneurship' prevails, versus greater levels of 'opportunity entrepreneurship' in industrialised countries, which tend to be led by higher skilled and better-capitalised entrepreneurs.
- *Firm growth and upgrading* – In many developing countries only a small proportion of micro and small firms grow beyond a certain threshold, due mainly to lack of specific management and/or marketing skills. The lack of trust in society is another impediment, limiting many small firms to what their families and immediate communities can control or supervise. The result is a lack of more specialist and sophisticated medium sized companies, often called the 'missing middle'.

“...integration into global value chains represents one of the most effective ways of promoting the upgrading of developing country small enterprises since such integration can provide them with access to markets, upgraded technology, improved management practices, and other benefits.”

- *Technological capabilities* – Small enterprises in developing countries mostly focus on low-tech routine operations and use mature technologies as blueprints. On average, compared to their industrialised economy counterparts they are less capable of creating knowledge, applying new technologies and rarely perform R&D, often due to the lack of human capital, business competencies and skills.
- *Export competitiveness* – In developing countries the export share of small enterprises tends to be much lower than in industrialised countries, with a few remarkable exceptions in Asia such as China, Taiwan and increasingly, Viet Nam. This situation reflects the technology gap, and in turn results in small enterprises being excluded from international best practices and sources of knowledge.
- *Large firm-small firm interactions* – Many developing countries fail to exploit the advantages of large firm- small firm integration and the opportunities this presents for complementary specialisation, multiple interactions and the transfer of a wide range of resources, skills and technologies.

Other research by UNIDO on integrating small enterprises into global value chains concludes, “The lessons from international experience suggest that the path to sustainable income growth lies in the capacity to upgrade. The lessons from value chain analysis suggest that upgrading must be seen in a systemic context, involving process, product, functional, and chain upgrading. ...Yet upgrading, in itself, may not be adequate to provide for sustainable income growth. Efficient producers need to be connected to appropriate final markets, and here too value chain analysis has a key role to play in assisting producers in general, and small enterprises in particular to participate effectively in the global economy.”<sup>9</sup>

### The importance of linkages between large and small firms

Critical to the process of upgrading, innovating and remaining competitive are the number, type, intensity and ‘spillover effects’ of linkages between small enterprises and other firms – both firms of their own size for example through horizontal integration at the level of industry clusters, or vertical integration within value chains. UNIDO argues that integration into global value chains driven and governed by large national or global firms, which make up a significant part of world trade (currently estimated at some 75%), “represents one of the most effective ways of promoting the upgrading of developing country small enterprises since such integration can provide them with access to markets, upgraded technology, improved management practices, and other benefits.”<sup>10</sup>

Luetkenhorst notes, however, that, “...integration of small enterprises in global value chains generates both opportunities and risks. On the positive side, technology may be upgraded, technical and managerial skills enhanced, and market access strengthened. The extent to which such benefits are disseminated to

society-at-large can vary considerably. This depends on spillover effects, which are likely to be particularly strong when the SMEs participating in value chains are themselves linked in networks with other firms and institutions, or better still, form part of a local cluster of firms. At the same time, there is a danger that small enterprises may be relegated to the role of mere suppliers of parts and components, thus possibly stifling their own innovation dynamics and exposing them to a high degree of dependency on the prime manufacturers to whom they supply.”<sup>11</sup>

Notwithstanding this caution, the creation and deepening of business linkages between large and small firms offer great potential for building more competitive and responsible enterprises, and are worthy of much greater research and experimentation. The Japanese experience, where the largest firms took on many small firms as suppliers and distributors, offers one useful model where business and government worked together to create an institutional framework and set of incentives that both rewarded and nurtured innovation and productivity increases by small enterprises.

### Different types of business linkages

There is much variety in the possible types of linkage between large and small firms. UNCTAD’s 2001 *World Investment Report* and the UK’s Department for International Development (DFID) use the common categorization of forward linkages, backward linkages, and horizontal linkages outlined in Box 8.

#### BOX 8: DIFFERENT TYPES OF BUSINESS LINKAGE

**Vertical Backward Linkages:** These exist when foreign affiliates or domestic companies acquire goods and services *from* small enterprises, for example through procurement, sub-contracting or outsourcing arrangements.

**Vertical Forward Linkages:** These occur when foreign affiliates or domestic companies sell goods and services *to* small enterprises or distribute goods and services *through* small enterprises, for example under franchise or retailing arrangements.

**Horizontal Linkages:** These involve interactions or cooperation between small enterprises, often engaged in competing activities e.g. sharing production of large orders, bulk purchasing, or group leasing of equipment. Such linkages often provide the impetus for the development of industrial clusters.

Linkages broadly defined, can also involve non-business entities like universities, training centres, research and technology institutes, NGOs, export promotion agencies, quality organisations, trade and industry associations, and other official and private institutions.

Source: Adapted from *World Investment Report 2001*, UNCTAD and Stanton, D. and Polatajko, T. *Business Linkages: Their value and donor approaches towards them*. UK Department for International Development, 2001.

Another commonly used categorisation developed by Professor Gary Gereffi distinguishes between two main types of global value chains:<sup>12</sup>

- *Producer-driven chains* – which are mostly investment-based, vertically integrated and closely controlled by the lead firm seeking resources or markets in a developing country. The automotive, electronics, other consumer durables, and natural resource sectors such as agribusiness, oil and mining, are typical examples of industries characterised by such value chains.
- *Buyer-driven chains* – which are mostly trade-based, horizontally networked and decentralised. This type of chain is commonly found in labour-intensive, non-durable consumer goods industries such as apparel, footwear, leather, and toys.

The actual contractual arrangements and ownership structures of these different types of linkages can vary widely, and may be both formal and informal in nature, short-term or long-term, and arms-length or joint equity. Formal arrangements include supply contracts; marketing, franchising or technology licensing agreements; strategic partnerships or joint ventures. Informal arrangements can include collaboration in market information or technology transfer networks. (Stanton and Polatajko, 2001).<sup>13</sup>

Box 9 offers a framework for looking at some of these different types of business linkages and contractual arrangements.

<b>BOX 9: BACKWARD LINKAGES AND OTHER RELATIONSHIPS BETWEEN FOREIGN AFFILIATES AND LOCAL ENTERPRISES AND ORGANISATIONS</b>				
<b>FORM</b>	<b>BACKWARD LINKAGE (sourcing)</b>	<b>FORWARD LINKAGE (distribution)</b>	<b>HORIZONTAL LINKAGE (co-operation in production)</b>	<b>RELATIONSHIP TO NON-BUSINESS INSTITUTIONS</b>
“Pure” market transaction	“Off-the-shelf” purchases	“Off-the-shelf” sales		
Short-term linkage	Once-for-all or intermittent purchases (on contract)	Once-for-all or intermittent sales (on contract)		
Longer-term linkage	Longer-term (contractual) arrangement for the procurement of inputs for further processing  Subcontracting of the production of final or intermediate products	Longer-term (contractual) relationship with local distributor or end-customer  Outsourcing from domestic firms to foreign affiliates	Joint projects with competing domestic firm	R&D Contracts with local institutions such as universities and research centers  Training programmes for firms by universities  Traineeships for students in firms
Equity relationship	Joint venture with supplier  Establishment of new supplier-affiliate (by existing foreign affiliates)	Joint venture with distributor or end-customer  Establishment of new distribution affiliate (by existing foreign affiliate)	Horizontal joint venture  Establishment of new affiliate (by existing foreign affiliate) for the production of same goods and services as it produces	Joint public-private R&D centres/training centres/universities
“Spillover”	<ul style="list-style-type: none"> <li>• Demonstration effects in unrelated firms               <ul style="list-style-type: none"> <li>– Spillover on processes (incl. technology)</li> <li>– Spillover on product design</li> <li>– Spillover on formal and on tacit skills (shopfloor and managerial)</li> </ul> </li> <li>• Effects due to mobility of trained human resources</li> <li>• Enterprise spin-offs</li> <li>• Competition effects</li> </ul>			

Source: *World Investment Report 2001: Promoting Linkages*. UNCTAD, 2001.

## Different types of value chain upgrading and spillover benefits

Innovation is the lifeblood of corporate competitiveness, value creation and sustainable growth. Continuous improvement or upgrading in processes, products and services, operational functions and business relationships, all aimed at providing customers with better quality, reliability, availability, affordability and/or value, lies at the heart of innovation and is an essential feature of companies that remain competitive. As outlined above, the extent to which small enterprises are part of vibrant value chains, production networks and clusters, and the degree of both direct and 'spillover' benefits that they gain from being part of these networks are important factors in supporting innovation, upgrading and ultimately their competitiveness.

UNIDO, drawing on research by the Institute for Development Studies at Sussex, argues that there is the following hierarchy of upgrading based on learning by doing and adaptation and usually requiring a combination of market-driven and government incentives and support:<sup>14</sup>

- Process upgrading – increasing the efficiency of internal processes and adopting international standards;
- Product upgrading – introducing new or improving old products;
- Functional upgrading – increasing value-added by changing the mix of activities or moving the locus of activities along the value chain;
- Chain upgrading – moving to a new value chain; and
- Chain integration – firms working cooperatively to share, plan, implement and manage the flow of goods, services and information within a shared market.

The research points out that the share of knowledge-intensive activities increases along this upgrading hierarchy from process and product upgrading, to chain integration. This has the following two important implications for producers in developing and transition economies, especially small enterprises:<sup>15</sup>

- Acquiring process capabilities is no longer difficult and as a result competition in this area is intense. By contrast, activities such as design, marketing, technology development and strategic repositioning are the most difficult to enter and offer the highest rate of return. To sustain growth and remain competitive, firms must be able to move up the 'upgrading hierarchy'.
- Inputs of knowledge need not be firm and/or location specific, and are in many cases not very sensitive to scale economies. With global markets and electronic communication media, this opens up national, regional, and even worldwide opportunities for small enterprises with marketable knowledge in growth sectors. Having the necessary training and business networks to acquire this knowledge, and the skills, capital and business acumen to apply it, is thus essential to small enterprises in developing and transition countries being able to achieve higher levels of productivity and competitiveness.

In short, there are real advantages – indeed imperatives – for small enterprises to be part of broader value chains, production networks and clusters. Business linkages – especially with larger firms - really matter and can facilitate an important combination of innovation, imitation and adaptation.

In its 2001 *World Investment Report*, which focused on backward, supply chain linkages between foreign companies and developing country suppliers, UNCTAD identified the following key areas where business linkages between large and smaller firms can transfer technology, training, information and financial support to the small enterprises. Although these examples refer to supplier relationships, many are also relevant for supporting the business development of small-scale distributors and retailers that connect with large companies through forward business linkages:<sup>16</sup>

- *Transferring technology* – sharing product and process technologies and/or organisational and managerial know-how.
- *Providing training* – helping to identify and overcome skills gaps through a variety of on-the-job, local and global learning opportunities.
- *Sharing information* – giving access to a broad range of technical, market and business information, including knowledge of international and domestic market potential, market and price trends, and sources of raw materials.
- *Extending financial support* – paying suppliers in a timely manner and providing other types of financial assistance such as provision of foreign exchange, capital, bank loan guarantees, leasing, infrastructure financing and sharing costs of specific products, such as those to upgrade local social and environmental performance.

### **The mutual benefits of business linkages**

The benefits of being part of business linkage arrangements between large and small firms are not all in the direction of the smaller companies. As research by the UK Department for International Development, the International Business Leaders Forum, the World Business Council for Sustainable Development, UNCTAD, UNIDO and others has shown – depending on their nature and ‘spillover effects’, such linkages offer a potential ‘triple-win scenario’ for small enterprises, larger companies, and the host business community more broadly. Some of these potential benefits are summarised in Box 10 – and achieving them is a critical objective of many of the business linkage initiatives and other examples of partnership outlined in Part V of this report.

According to Peter Brew, a Director of the International Business Leaders Forum, “Effective business linkages between multinational corporations and small-scale enterprises can create clear mutual benefits. They help to transfer world-class technology and spread international business standards, creating more competitive, productive and quality-driven business sectors in many countries. They develop the pool of local skills, create market growth opportunities, and decrease

procurement and other input costs for multinational companies. They help to build trust with local business communities and government bodies and to ensure a ‘license to operate’.”<sup>17</sup>

This view is endorsed by UNCTAD’s 2001 *World Investment Report*, which states, “Linkages offer benefits to foreign affiliates and domestic suppliers, as well as to the economy in which they are forged as a whole.”<sup>18</sup>

<b>BOX 10: POTENTIAL BENEFITS OF SUSTAINABLE BUSINESS LINKAGES FOR SMALL ENTERPRISE DEVELOPMENT</b>		
<b>Small enterprises</b>	<b>Local business community</b>	<b>Foreign investors and/or large national companies</b>
Increase in employment and output	Stimulation of economic activity and enhanced local economic development	Broader access to lower cost or more competitive suppliers
Access to cutting-edge knowledge and technology	Increased employment and production	Reduced procurement, production and distribution costs
Enhanced skills, standards and capacity	Long-term increase in local or regional competitiveness	Strengthened supply chains and distribution networks, including increased ability to reach consumers at ‘bottom of the economic pyramid’
Access to new domestic and/or foreign markets	Added local purchasing power	
More diversified client and market structures	Access to more affordable, reliable, or better quality products and services	Improved productivity
More stable relationships to buyer or producer organisations	Increased participation of large scale companies in local business and community development	Increased opportunities for corporate responsibility combined with profitability
Risk-sharing through joint funding and/or operations	Balance of payment benefits when products are exported and/or substitute for imports	Enhanced reputation and local ‘license to operate’
Access to finance		Improved integration in new overseas markets
Opportunities to innovate, upgrade and increase competitiveness		Proactively deal with downsizing

Sources: Adapted from Stanton, D and Polatajko, T. *Business Linkages: Their value and donor approaches to them*. DFID, 2001. Various UNIDO documents and the International Business Leaders Forum.

### **The need for partnership to address market failures**

Despite the potential benefits to both foreign investors and large domestic companies of building linkages with local small enterprises there are often challenges in making a purely commercial ‘business case’ for building such linkages, let alone doing so with large numbers of local small enterprises and/or in a way that deepens or broadens relationships to include the transfer of technology, information, skills and financial support beyond individual value chains. These challenges are due to a variety of market failures, governance gaps and institutional and information constraints in developing countries,

“In many countries the development of linkages is impeded by market failures in the supply of information, skills and infrastructure. These include: lack of awareness of potential business partners; lack of public marketing or research institutions; inadequate awareness of ISO standards, export procedures and regulation; geographical, educational or cultural gaps between SME and big business owners; lack of access to legal, financial and technical aspects of enterprise management; and inadequate physical infrastructure.”

Stanton and Polatajko argue, “In many countries the development of linkages is impeded by market failures in the supply of information, skills and infrastructure. These include: lack of awareness of potential business partners; lack of public marketing or research institutions; inadequate awareness of ISO standards, export procedures and regulation; geographical, educational or cultural gaps between SME and big business owners; lack of access to legal, financial and technical aspects of enterprise management; and inadequate physical infrastructure.”<sup>19</sup>

Government actions to improve the overall macroeconomic conditions, business environment and investment climate are essential in addressing some of these issues, but there is also potential for new types of public-private partnership and collective corporate action to address these market failures, as outlined in Part V.

In addition to their benefits to direct participants, business linkages between large and small companies have strong ‘public goods’ characteristics to the extent they offer spillover benefits to local economies and communities. As such they are a worthy focus of both public policy and new types of public-private partnership and collective action.

The role of policy interventions, public-private partnerships and intermediation is most significant where there are is an ‘information gap’ on the part of both suppliers and buyers about linkage opportunities, a ‘capability gap’ between the requirements of large companies and the capacities of the smaller companies, or where the costs and risks for setting up linkages, deepening them, or increasing their broader community ‘spillover effects’ can be reduced.<sup>20</sup>

Partnerships between larger companies, small enterprises, government bodies, NGOs and research institutes can play a vital role in bridging these gaps. Many of the partnership and collective action examples profiled in Part V have a goal to either deepen or broaden the development impacts or spillover effects of linkages between large and small companies beyond individual value chains.

One of the increasingly important development impacts or spillover effects of such business linkages is their impact on firm-level and national-level performance in the areas of ethics, anti-corruption efforts, worker conditions, including occupational health and safety, and the environment – both in terms of raising minimum standards and innovating around new business and market opportunities in these areas. This is explored in the next section.

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### 3 Implementing responsible business practices in small enterprises

Much of the practitioner experience and academic research on the subject of innovation and upgrading focuses on traditional sources of business competitiveness – options that improve the quality, uniqueness, reliability, availability, affordability and/or value of products and services to the customer, relative to what competitors are able to offer.

In recent years, the emergence of the concept of corporate social responsibility (CSR) and its growing emphasis not only on defensive, ‘do-no-harm’ strategies, but also on competitive, ‘create-new-value’ strategies, has added a new dimension to the strategic choices that companies can make both in managing risks and costs, and in innovation and upgrading.

There is growing recognition of the potential for the business sector to harness its skills, technologies, competencies, and networks to support innovation and upgrading in social and environmental performance, as well as more traditional areas of business performance. This offers companies an opportunity to develop new ideas, new alliances, new products, new services, new processes, and new markets that can enhance their own value proposition – both directly and indirectly – and at the same time make a meaningful contribution to key development objectives such as improved working conditions, better health and safety, sound environmental management, and so on.

Jackson and Nelson have referred to three ways that companies can embed this broader vision of innovation into their core business strategies and activities:<sup>21</sup>

- Analyse the environmental and social impacts of *existing products, services, processes and value chain relationships*, and work on innovative solutions to enhance the positive impacts and minimise any negative impacts that these may have;
- Integrate environmental and social considerations and due diligence into all *new product development, process changes, and new value chain relationships*. Aim to produce better quality products and services and to implement better processes, which meet customer needs with fewer negative impacts for the environment and society;
- Look for opportunities to develop *new products, services, processes and value chain relationships that very specifically address an environmental problem or meet a social need*. For example – eco-innovation and the development of environmentally friendly technologies that meet consumer needs with less of an environmental footprint. Or innovations aimed at better serving low-income communities, through developing new technologies, supply and distribution

systems, or even new business models that extend the availability, the access and/or the affordability of products and services that can improve the quality of peoples' lives.

“... for many companies eco-efficiency has become a major driver of innovation and progress, a vehicle that helps them meet the economic and environmental targets they have set.”

The World Business Council for Sustainable Development (WBCSD) has developed a framework for helping companies, including small enterprises develop strategies to implement eco-efficiency in their own operations, which is summarised in the box below. This framework shares some obvious parallels with the UNIDO upgrading hierarchy outlined on page 90. WBCSD points out, “... for many companies eco-efficiency has become a major driver of innovation and progress, a vehicle that helps them meet the economic and environmental targets they have set.”<sup>22</sup>

#### BOX 11: A FRAMEWORK FOR OPERATIONALISING ECO-EFFICIENCY

There are four key opportunity areas for business to implement eco-efficiency:

- **Re-engineer processes:** Improve monitoring and management practices, change existing technology, amend operating procedures, and make changes to raw material inputs in order to reduce resource use, reduce pollution, improve quality, efficiency and productivity and save operational costs.
- **Re-design products and services:** Facilitate product disassembly, reduce material intensity and promote product recycling and reuse in order to meet customer needs with less environmental impact.
- **Re-valorise by-products:** Turn waste into a resource for other processes or for other companies. At its optimum this may form part of a closed-loop process of “industrial ecology” where businesses work together towards a target of zero waste from their combined industrial activities.
- **Re-think markets:** Develop new markets and meet customer needs in a less material and energy-intensive manner. For example, increase the knowledge intensity of products or provide an equivalent service to replace the product.

Source: *Eco-efficiency*. World Business Council for Sustainable Development. 2000.

All of the CSR options outlined above – from due diligence and minimising the harm of existing and new business activities, to creating new types of business value and market opportunities through social and eco-innovation - have relevance not only for large companies, but also for small enterprises that are aiming to be more competitive and to manage their risks and costs as part of being integrated into broader value chains. Having said this, however, the challenges of prioritizing what are the issues that are the most material to the company's risk and opportunity profile are even greater among small enterprises, most of which lack the time, human capital and other resources to undertake extensive analysis and research.

The implementation of so-called CSR practices (ethical, social and environmental performance and innovation) by small enterprises has rarely been part of the emerging CSR agenda. With some notable exceptions in Europe and Latin America, very little research has been undertaken on the broader ethical, social and environmental performance of small enterprises and even less on the impact of this

performance on the risks, costs and opportunities faced by these small enterprises – in other words the ‘business case’ for small enterprises to implement CSR practices.<sup>23</sup>

If research on the way that small enterprises are implementing CSR practices and their motivations for doing so has been scarce in OECD countries, it is even less available in most developing countries.

As a result, there are several layers of challenges that impede implementation of ethical, social and environmental practices by small enterprises, particularly in developing countries:

With some notable exceptions in Europe and Latin America, very little research has been undertaken on the broader ethical, social and environmental performance of small enterprises and even less on the impact of this performance on the risks, costs and opportunities faced by these small enterprises.

- First, lack of research, credible data and information on the ‘business case’ for doing so;
- Second, lack of knowledge and good practice examples on how to most effectively and efficiently implement these ethical, social and environmental performance criteria and innovations in practice. Linked to this is a lack of clear priorities in terms of what CSR-related issues *have* to be addressed versus what is *desirable* to do, among the many risks, opportunities and options that small enterprises face in what is usually a resource-deprived operating environment;
- Third, even if these two challenges are addressed, lack of finance, technology, skills, capacity and support services make it difficult for many small enterprises to move forward on integrating CSR practices into their operations, combined with the fact that many small enterprises in developing countries face serious short-term competitive and even survival pressures;
- Fourth, linking back to the first challenge, lack of market incentives or regulatory sanctions for failing to implement better ethical, social and environmental standards and practices – and thus the potential of free-rider problems that are even greater than those that exist with large companies that fail to implement these standards and practices.

New types of partnership between large and small companies, and between the private sector, governments, NGOs, business associations, and research institutions will be essential for overcoming these challenges. They will be important not only for demonstrating that the implementation of CSR standards and practices makes good business sense for small enterprises – from either a risk management, cost reduction, relationship maintenance, or business opportunity perspective – but also for helping small enterprises to actually implement these standards and practices and for supporting a broader enabling environment for CSR.

David Grayson, Chairman of the UK’s Small Business Consortium, has called for a more proactive and structured relationship between organisations championing CSR and those that are focused on representing and advising small enterprises. “Responsible entrepreneurship (CSR for small firms) should not be a bolt-on to

operations for small business development organisations. Rather, it should be built into their purpose and strategy. Sustainability has to be a core competence for business advisers and should be part of adviser training. I expect that many of the greatest innovations in CSR in the future will be in dynamic smaller firms.”<sup>24</sup>

In most countries, even where such organisations exist, they tend to operate along parallel tracks.

Several partnership examples in Europe offer interesting models for developing countries to consider at both a national and regional basis. In the United Kingdom, for example, the Small Business Consortium was established in 2004 with the aim of, “raising the competitiveness and profitability of small and medium sized businesses in the UK by promoting effective corporate social, environmental and community management. The Consortium’s objective is to deliver a capacity building programme based on members’ existing strategies”.<sup>25</sup> Actively encouraged by the UK Government’s Department of Trade and Industry, the Consortium’s members include a mix of:

- Corporate responsibility networks, such as Business in the Community, AccountAbility, Arts & Business, and CSR Europe;
- Mainstream business associations, such as the British Chambers of Commerce, the Federation of Small Businesses, the Institute of Directors, and the Forum of private Businesses; and
- Lloyds TSB, a nationwide bank.

More broadly on a European-wide basis, the European Commission is working with, and partly funding, a consortium of ten corporate responsibility organisations from nine member states on a research and awareness raising campaign to identify and promote best practices in social responsibility in small enterprises across Europe. The campaign has already been active in promoting the business case and sharing examples of what works, as well as implementing a web-based how-to-guide on social responsibility for small enterprises, called *SME Key*. This can be accessed by small enterprises around the globe.

The initiative has also published a conceptual framework for helping small enterprises think about the key stakeholders, issues and instruments they need to address to integrate responsible business practices into their operations. This framework, which has relevance for all companies, not only small enterprises, and in all regions, not only Europe, is provided in Box 12.

Surveys in Europe found that the concept and language of CSR can be ‘off-putting’ to small enterprises that see this as a ‘big business’ approach and fear that it will add a high burden of cost, time and bureaucracy to their operations. In part as a response to this, the campaign is promoting the concept of ‘Responsible Entrepreneurship’ as its central theme.

Similar concerns have been raised by recent research by UNIDO and AccountAbility on small enterprise clusters and responsible competitiveness in developing countries. They conclude: “A number of commentators have pointed out that the term ‘corporate’ may be off-putting or confusing for micro, small and medium sized enterprises, especially outside the Anglo-Saxon world. In Latin America, for example, most practitioners use the term RSE or ‘responsibilidad social empresarial’. The word ‘empresarial’ has connotations of entrepreneurialism and is more welcoming for small enterprises than ‘corporate’.”<sup>26</sup>

## BOX 12: CONCEPTUAL FRAMEWORK FOR ‘RESPONSIBLE ENTREPRENEURSHIP’

PILLARS OF SUSTAINABLE DEVELOPMENT				
	Economic	Social	Environment	
	Marketplace	Workplace	Community	
KEY STAKEHOLDER GROUP(S)	<ul style="list-style-type: none"> <li>• Customers/consumers</li> <li>• Contractors/suppliers and business partners</li> <li>• Investors</li> <li>• Public sector</li> </ul>	<ul style="list-style-type: none"> <li>• Employees</li> <li>• Trade unions</li> <li>• Employers</li> <li>• Local community</li> <li>• Business organizations</li> <li>• Public authorities</li> </ul>	<ul style="list-style-type: none"> <li>• Public Authorities</li> <li>• NGOs</li> <li>• Examples: local employers’ organizations. Hospitals, schools, civil society organisations</li> </ul>	<ul style="list-style-type: none"> <li>• Natural environment</li> <li>Spokesmen for the environment: <ul style="list-style-type: none"> <li>• NGOs</li> <li>• local community</li> <li>• citizens/consumers</li> <li>• employees</li> <li>• public authorities</li> </ul> </li> </ul>
ISSUES	<ul style="list-style-type: none"> <li>• Responsible supply chain</li> <li>• Management (from sourcing to final payment)</li> <li>• Quality</li> <li>• Innovation</li> <li>• Product safety</li> <li>• Fair pricing</li> <li>• Customer satisfaction and consumer expectations</li> <li>• Ethical advertising</li> </ul>	<ul style="list-style-type: none"> <li>• Workplace diversity</li> <li>• Equal opportunities</li> <li>• Work/life balance</li> <li>• Health and safety</li> <li>• Training and staff development</li> <li>• Job satisfaction</li> <li>• Pay and benefit</li> <li>• Job creation/preservation</li> <li>• Labour rights</li> </ul>	<ul style="list-style-type: none"> <li>• Social integration (ethnic tolerance, social cohesion)</li> <li>• Healthcare</li> <li>• Education</li> <li>• Quality of life(sports/culture)</li> <li>• Economic regeneration and development/Employment</li> <li>• Local infrastructure</li> <li>• Security</li> </ul>	<p>Relevant for products/processes:</p> <ol style="list-style-type: none"> <li><b>1. Resource use</b> <ul style="list-style-type: none"> <li>• Materials: depletion of resources</li> <li>• Water use: impact on habitat, drought</li> <li>• Energy: climate change, acidification</li> </ul> </li> <li><b>2. Waste</b> <ul style="list-style-type: none"> <li>• Landfill: use of land, contamination of soil, groundwater, etc.</li> </ul> </li> <li><b>3. Pollution</b> <ul style="list-style-type: none"> <li>• Air pollution (climate change, ozone depletion, acidification, smog, health)</li> <li>• Water pollution ( eutrophication, alteration of habitats)</li> <li>• Soil contamination (accumulation of pollutants in ecosystem)</li> <li>• Reduction of biological diversity</li> </ul> </li> </ol>
INSTRUMENTS	<ul style="list-style-type: none"> <li>• Label (product information)</li> <li>• Customer charter</li> <li>• Marketing (in particular, cause-related marketing)</li> <li>• External communication</li> <li>• Standards (e.g. ISO 9000, SA 8000, social labels)</li> <li>• Quality management systems</li> </ul>	<ul style="list-style-type: none"> <li>• Awareness of legislation by employees</li> <li>• Flexible working patterns</li> <li>• Employee participation in decision-making process</li> <li>• (“workplace democracy”)</li> <li>• Trade union relations</li> <li>• Secondment programmes</li> <li>• Partnership with external network/stakeholders</li> <li>• Standards ( e.g. SA 8000, social labels)</li> </ul>	<ul style="list-style-type: none"> <li>• Cash donations</li> <li>• In kind donations</li> <li>• Services provided free of charge</li> <li>• Lending corporate resources</li> <li>• Employee involvement/volunteering</li> <li>• Employer involvement</li> <li>• How (ways of involvement): <ul style="list-style-type: none"> <li>• One-off actions</li> <li>• Partnerships (public and private)</li> <li>• Commercial actions/sponsorships</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• Anticipating future regulation</li> <li>• Environmental management systems: formal (EMAS, ISO 14000) and informal</li> <li>• Design for the environment</li> <li>• Life-cycle assessment</li> <li>• Eco-labels: at national and EU level</li> <li>• Environmental product declarations: certified and self-declared</li> <li>• Cleaner production</li> <li>• Research and development</li> <li>• Spatial planning: clusters, networks, districts</li> <li>• Transport plan</li> <li>• Voluntary agreements</li> </ul>

Source: *Responsible Entrepreneurship: A collection of good practice: Cases among SMEs across Europe*. The European Commission, 2003

Although rigorous empirical analysis is still lacking, and most of the evidence is survey-based and/or case study-based, the above initiatives and others such as those of UNIDO and a variety of European think-tanks, business associations and government bodies, are reaching similar conclusions on the broad ‘business case’ for small enterprises to adopt responsible ethical, social and environmental practices.

The following pages summarise the findings of the current body of research that tests the hypothesis that: “improvements made by small enterprises in their social and environmental performance go hand-in-hand with improvements in risk management, productivity, quality, management and innovation.”

It is essential to note that most of this survey and case study-based research is focused on small enterprises operating in OECD economies, with few of the business environment constraints and capacity gaps faced by their counterparts in most developing economies. There is, however, a limited, but growing body of evidence of similar beneficial linkages in some developing countries, in particular as it relates to small enterprises adopting cleaner production standards and better workplace practices as part of global supply chains.

The motivations for small enterprises to become engaged in adopting responsible business practices tend to fall under the six broad headings outlined in Box 13. Several surveys in Europe at both national and regional levels, as well as a survey by the UN Global Compact, found that personal values/ethics, responding to market or regulatory requirements (especially environmental standards), and reputation and relationship management were the strongest motivators for small enterprises to become engaged in CSR issues.<sup>27</sup>

### **BOX 13: KEY MOTIVATIONS FOR SMALL ENTERPRISES TO ADOPT CSR PRACTICES**

<b>Personal values and ethics of firm leaders</b> – often owner-operators	
<b>Market or regulatory requirements</b>	Global supply chain standards especially in buyer-driven value chains and on workplace and environmental practices Government regulations, especially relating to environmental performance and safety
<b>Improved stakeholder relations and reputation</b>	Employees, leading to greater motivation and morale Customers, leading to increased sales, more stable relationships Regulators, links to ‘licence to operate’ and less regulatory oversight and
<b>Cost savings</b>	Eco-efficiency measures, especially energy and water savings and waste reduction Reduced employee turnover, downtime and absenteeism
<b>Improving productivity</b>	More motivated employees Links to quality initiatives
<b>Innovation and learning</b>	Opportunities to catalyse innovation and to increase or diversify organisational learning

Sources: UNIDO, UN Global Compact, European Commission, International Business Leaders Forum, Gestion de la Empresa Espanola Fundacion Madrid, World Business Council for Sustainable Development, Business in the Community, Foundation Strategy Group, Danish Ministry of Economic and Business Affairs.

The results of a survey of CSR activities carried out by more than 7,500 European small enterprises in 2002 found that:<sup>28</sup>

- 28% of the small enterprises surveyed claim that CSR activities (both regular and occasional) are part of their business strategy.
- There is a strong correlation between CSR activities and company size, with 48% of micro-enterprises, 65% of small enterprises, and 70% of medium enterprises reporting external social activities.
- The highest percentages of CSR activities planned were found among small enterprises with a distinct orientation towards growth, higher quality and innovation.

Luetkenhorst argues that these findings “...would appear to confirm that CSR engagement can be a positive factor in overall strategies that rely on the ‘high road’ towards competitiveness.”<sup>29</sup>

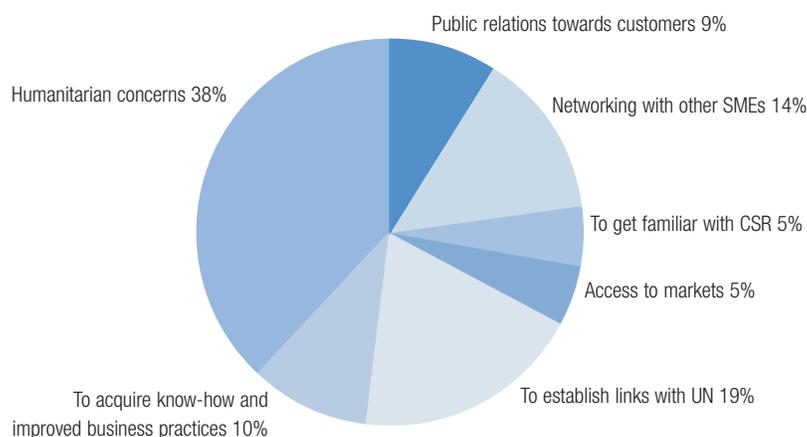
This view is endorsed by a 2005 research study focused on uncovering the economic rationale for CSR among Danish small and medium-sized enterprises. In an analysis of about 50 Danish small enterprises that engage in a variety of CSR practices, Mark Kramer et al found four areas of activity that show potentially significant economic or competitive value. They summarise these findings in their report *Competitive Social Responsibility*, as follows:<sup>30</sup>

- **Innovation** – We identified a number of companies that derive a substantial and growing share of business from socially beneficial innovations that directly address societal problems as part of the customer value proposition. This seems to be an expanding niche well suited to smaller and more nimble enterprises.
- **Workforce development** – We found reduced costs associated with hiring, retention and absenteeism among small enterprises that offer unusually generous employee benefits. None of the small enterprises we studied, however, had actually calculated whether these savings outweighed the costs of the extra benefits.
- **Environmental conservation** – Small enterprises reported reduced costs for energy conservation or waste disposal from their environmental CSR activities.
- **Contextual investments** – Voluntary corporate social investments, when explicitly directed toward factors that influence the company’s competitive context, also demonstrated the potential to contribute to long-term competitiveness.

This research appears to confirm other findings that the ‘up-side’ for CSR practices to contribute to firm productivity and competitiveness lies in measures focused at innovation in new products and processes; employee development; environmental management; and investments in the community that influence the company’s competitive context.

On an international basis, the UN Global Compact has started to engage more proactively on promoting a ‘business case’ for CSR among small enterprises, focusing on the estimated 19% of its participants that are small enterprises, many of them from developing countries. In its own survey of these enterprises, the Global Compact identified the following motivations for engaging in the Compact and adopting its principles in the areas of human rights, labour, the environment and anti-corruption.

**FIGURE 8: WHY SMALL ENTERPRISES JOINED THE UN GLOBAL COMPACT**



Source: *Survey of Small and Medium Enterprises in the Global Compact*. Vienna: UNIDO and the Global Compact, 2004.

“Responsible business practices can help support upgrading in existing [small enterprise] clusters and even create the trust needed for new clusters to form; and businesses working together in clusters and multi-sector partnerships have achieved social and environmental improvements unavailable individually.”

Recent research by UNIDO and AccountAbility in developing countries has highlighted the potential of small enterprise clusters – operating in the same geographic location and/or industry sector – to create mutually reinforcing feedback loops between responsible business practices and business and national competitiveness.

Although the research identifies numerous obstacles, both internal and external to the small enterprises, it illustrates examples of how, under the right conditions, “Responsible business practices can help support upgrading in existing [small enterprise] clusters and even create the trust needed for new clusters to form; and businesses working together in clusters and multi-sector partnerships have achieved social and environmental improvements unavailable individually.”<sup>31</sup> The researchers caution, however, that “...responsibility initiatives will improve overall competitiveness only if they build on existing social networks, build trust and are seen as key to survival.”<sup>32</sup>

The UNIDO/Accountability research cites a survey by the Inter-American Development Bank carried out in 2005 that found encouraging evidence of CSR practices among small enterprises, with over 60% of the Latin American enterprises surveyed claiming to be involved in external CSR activities such as education, health, sports and cultural projects, compared to only 49% of European small enterprises surveyed in Spain, Portugal, France and Italy.<sup>33</sup>

“If CSR is truly going to become a strategic force in contributing to international development and eliminating the negative externalities of business, it must help to develop effective and viable approaches to ‘small business responsibility’.”

In their 2002 report, *Corporate Social Responsibility: Implications for small enterprises in developing countries*, UNIDO argue, “If CSR is truly going to become a strategic force in contributing to international development and eliminating the negative externalities of business, it must help to develop effective and viable approaches to ‘small business responsibility’. It is crucial that:

- CSR supports the role of small enterprises in development, and does not serve as a tool to undermine and disadvantage them;
- Small enterprises are not able to undercut universal CSR standards and become a blind spot in which exploitative and environmentally destructive practices flourish.”<sup>34</sup>

In the same report, UNIDO makes the following five recommendations for policy makers and business leaders to address these two challenges:<sup>35</sup>

- Ensure that CSR standards are not protectionist or discriminatory either in intention or impact.
- Integrate tools to improve social and environmental impact with tools to improve quality management – i.e. make CSR an integral aspect of ‘business excellence’ among small enterprises in developing countries aspiring to become or already part of global value chains.
- Develop a framework for ‘Small Business Responsibility’ – for example developing greater awareness, sharing examples of good practices, training and advisory services, practical how-to guides etc. This can include a more coordinated and integrated approach to donor and corporate initiatives in developing countries that support SME development, as is starting to happen in countries such as Viet Nam, Tanzania, Brazil and South Africa.
- Strengthen the drivers for small business responsibility – supply chain initiatives, government support, regulatory requirements, and market incentives.
- Promote enterprise development as a key CSR issue for multinational companies.

This chapter has highlighted that small enterprises operating in developing countries need to overcome a variety of major obstacles in order to become competitive and responsible members of their local business communities and beyond. These obstacles range from fundamental issues such as improving access to finance, skills and legal rights, to the challenges of upgrading, innovating and integrating into national and global value chains, to the challenge of implementing responsible business practices.

In almost every case, new types of cross-sector partnership and collective corporate action will be essential to overcome these obstacles. So too will be the political will and active leadership of governments – in both developing and donor countries as reviewed in Part IV.

**SUMMARY OF PART III:****OVERCOMING CHALLENGES TO COMPETITIVE AND RESPONSIBLE ENTREPRENEURSHIP**

A sound macroeconomic environment, political stability, rule of law and basic physical and social infrastructure are essential for creating the conditions under which sustained economic growth and private sector development can occur. These are necessary, but not sufficient for the emergence of a dynamic, competitive and responsible small enterprise sector capable of generating wealth, creating jobs, raising productivity, innovating and upgrading, and becoming part of local, regional and global supply chains. While large corporations and micro-enterprises have a key role to play in reducing poverty, it is such small and medium enterprises that offer the best hope for creating a prosperous middle class and sustained growth. Three key stages of support are necessary:

**1. Improving access to finance, skills, business services and legal rights**

There is increasingly strong evidence of the development benefits of providing small enterprises with market-determined access to financial products and services – credit, equity, insurance, leasing etc. – with opportunities to build their human capital, management skills, technical know-how, and entrepreneurial capabilities. These, together with improved access to property rights and other legal rights and business services, are cited by the UN Commission on the Private Sector and Development, among others, as being fundamental pillars for successful entrepreneurship. New types of partnership between governments, donors, nonprofit organizations and commercial enterprises can play a key role in ensuring more affective, efficient and sustainable delivery of these products and services.

**2. Upgrading and integrating small enterprises into value chains**

In order to contribute to increased productivity and sustained income growth, small enterprises need to develop more sophisticated business skills, technological capabilities, market know-how, and quality systems. This is necessary for upgrading products, processes and functions in order to build successful linkages with large domestic companies and foreign investors, and to integrate into broader production networks and value chains. Backward, forward, vertical and horizontal business linkages among small firms, and between small firms and large firms, can result in benefits not only for the participating firms, but also create ‘spillover effects’ and broader benefits for the local business community. Despite the potential benefits, a variety of market failures, governance gaps, and institutional and information constraints in many developing countries make it difficult to create such linkages on a purely commercial basis. Public-private partnerships and specialist intermediary organizations can play an important role helping to overcome these obstacles.

**3. Implementing responsible business practices in small enterprises**

Much of the growth in corporate social responsibility (CSR) over the past decade has focused on large corporations. Minimal research has been conducted on the ‘business case’ for small enterprises to implement ethical, social and environmental practices, or on the obstacles they face in doing so. This is starting to change, and multi-sector partnerships and business linkages can play a useful role in helping to transfer and/or encourage adoption of responsible business practices by small enterprises. To be sustainable over time, this needs to be both supply-driven, for example by the provision of support services and government interventions. It also needs to be demand-driven, for example by customer requirements and by smaller companies themselves recognizing that they can manage risks and costs, improve quality, productivity and innovation, and harness new business opportunities and relationships by adopting responsible practices.



# IV THE IMPORTANCE OF PUBLIC POLICY MEASURES

Developing country and donor governments share a fundamental leadership role in creating the conditions to foster small enterprise, promote economic growth and reduce poverty. In the absence of good governance, underpinned by effective public policies and institutions, there is little that even the largest and most responsible companies can contribute to sustained economic growth and pro-poor development.

Developing country and donor governments share a fundamental leadership role in creating the conditions to foster small enterprise, promote economic growth and reduce poverty. In the absence of good governance, underpinned by effective public policies and institutions, there is little that even the largest and most responsible companies can contribute to sustained economic growth and pro-poor development.

The role of government is especially important in the following areas:

- 1. Creating an enabling framework for private sector development in general** – Supporting a sound investment climate, addressing both macro-stability and micro-economic and regulatory impediments to the mobilisation of domestic capital and the attraction and retention of foreign capital, and investing in physical, social and institutional infrastructure.
- 2. Supporting small enterprise development** – Ensuring that framework conditions, consultation structures and delivery mechanisms for finance and business development services enable rather than exclude small enterprises, helping informal enterprises move into the formal economy and high-potential entrepreneurs upgrade into broader value chains.
- 3. Fostering responsible business practices** – Implementing the necessary policies, regulations, funding mechanisms, market incentives, training, and standardisation and certification programmes to either require or encourage the adoption of sound labour and human rights standards, environmental practices and anti-corruption measures – in small enterprises as well as large companies.
- 4. Improving aid effectiveness** – Improving the effectiveness of bilateral and multilateral aid through increasing national ownership; aligning aid more closely with national development strategies, institutions and procedures; improving harmonisation between donor agencies; managing for results; and ensuring greater mutual accountability for development results.

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# 1 Creating an enabling environment for private sector development in general

Government actions are essential to creating an enabling environment for private sector development that diminishes the risks, lowers the costs and barriers, and raises the rewards and opportunities for competitive and responsible private enterprise.

Over the past few years a number of seminal reports have highlighted the importance of more effective government support for private sector development. These include:

- The World Bank's *World Development Report 2005: A Better Investment Climate for Everyone*;
- The OECD's report: *Accelerating Pro-Poor Growth through Support for Private Sector Development*;
- The report to the Secretary-General of the UN Commission on Private Sector and Development: *Unleashing Entrepreneurship: Making business work for the poor*;
- UNIDO's *Industrial Development Report 2004: Industrialization, Environment and the Millennium Development Goals in Sub-Saharan Africa: The new frontier in the fight against poverty*;
- The Commission for Africa's report: *Our Common Interest*; and
- The launch of the World Bank and International Finance Corporation's 'Doing Business' project, which produces an annual report analysing the operation of selected regulations that either enhance business activity or constrain it and benchmarking regulatory reform in over 140 countries.

## Getting the basic framework conditions right

The *World Development Report 2005* (WDR 2005) makes the following case for the importance of effective government: "What determines the contributions that firms make to society? Mainly the investment climate – the location-specific factors that shape the opportunities and incentives for firms to invest productively, create jobs and expand. Government policies and behaviours play a key role in shaping the investment climate. While governments have limited influence on factors such as geography, they have more decisive influence on the security of property rights, approaches to regulation and taxation (both at and within the border), the provision of infrastructure, the functioning of finance and labour markets, and broader governance features such as corruption. Improving government policies and behaviours that shape the investment climate is fundamental to driving growth and reducing poverty."<sup>1</sup>

The priority areas for improving the investment climate identified by many national Poverty Reduction Strategy Papers are listed in Box 14.

**BOX 14: PRIORITY AREAS FOR IMPROVING THE INVESTMENT CLIMATE\***

PRIORITY AREA	PERCENT
Improving macroeconomic stability	94
Infrastructure	81
Supporting SMEs	78
Governance and corruption	78
Improving the regulatory environment	72
Improving legal systems	72
Finance	72
Promoting FDI	66
Trade policy	63

\*Percentage of PRSPs identifying as a priority area

Source: Adapted from *UNIDO Industrial Development Report 2004*. Original source IMF, 2003a.

These priority areas are similar to those identified by the private sector. In 2005, Goldman Sachs developed a *Growth Environment Score (GES)*, with the aim of ranking countries' abilities to convert their economic growth potential into reality and monitoring progress in growth conditions over time. Summarized in Box 15, the GES identifies five basic sets of conditions and 13 indicators considered to be important determinants of economic growth. Arguing that, "...strong growth is best achieved with a stable and open economy, healthy investment, high rates of technology adoption, a healthy well-educated workforce, and a secure and rule-based political environment," Goldman Sachs has ranked 170 countries against these parameters.<sup>2</sup> The rankings identify those countries that are creating the overall structural conditions and policy environments to turn potential growth into real performance. The rankings also help, on a country-by-country basis, to highlight specific areas where policy improvement is required.

**BOX 15: THE GOLDMAN SACHS GROWTH ENVIRONMENT SCORE**

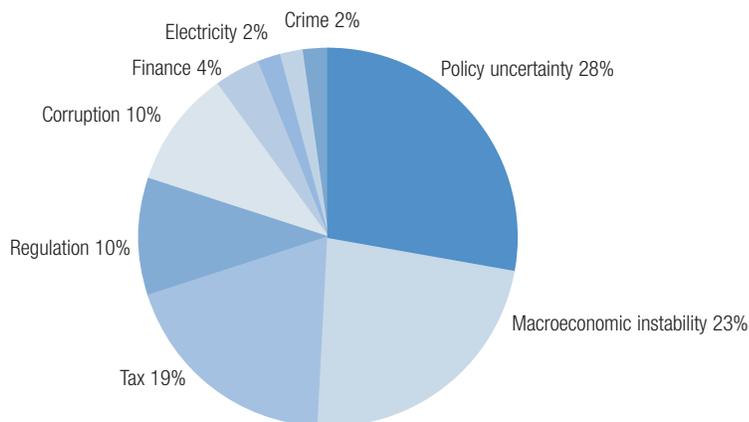
<b>1. MACROECONOMIC STABILITY</b>	<b>Inflation</b> <b>Government Deficit</b> (as % of GDP) <b>External Debt</b> (as % of GDP)
<b>2. MACROECONOMIC CONDITIONS</b>	<b>Investment Rates</b> <b>Openness of the Economy</b> (Share of trade as of GDP)
<b>3. TECHNOLOGICAL CAPABILITIES</b>	<b>Penetration of PCs</b> (PCs per 1,000 people) <b>Penetration of Phones</b> (mainlines per 1,000 people) <b>Penetration of Internet</b> (usage per 1,000 people)
<b>4. HUMAN CAPITAL</b>	<b>Education</b> (average years secondary level) <b>Life Expectancy</b> (as a basic measure of health)
<b>5. POLITICAL CONDITIONS</b>	<b>Political Stability</b> <b>Rule of Law</b> <b>Corruption</b>

Source: *How Solid are the BRICs?* Global Economics Paper No: 134, Goldman Sachs, December 2005.

The World Economic Forum's *Growth Competitiveness Index* shares many of the same criteria as the *Growth Environment Score*. Surveys of private enterprises by intergovernmental institutions also reinforce the message that these conditions are essential for supporting private sector development and economic growth. The World Bank, for example, as part of ongoing efforts to gather data not only from governments, but also citizens and business people, launched a series of *Investment Climate Surveys* in 2001. These surveys interview large random samples of firms to collect assessments of the constraints they face in doing business as well as objective quantitative data on indicators of the investment climate and the performance of firms. WDR 2005 drew on survey results covering more than 26,000 firms in 53 countries and also surveyed over 3,000 microentrepreneurs operating in the informal economy in 11 of these countries.

One of the key messages of these surveys is that policy-related risks – especially policy uncertainty and macroeconomic instability – dominate the concerns of firms operating in developing countries. These risks can seriously undermine the incentives for companies to invest, innovate, upgrade and increase their productivity. The World Bank estimates that improving policy certainty alone could increase the likelihood of new investment by nearly 30 percent.<sup>3</sup>

**FIGURE 9: POLICY-RELATED RISKS DOMINATE THE INVESTMENT CLIMATE CONCERNS OF FIRMS**



Note: Share of countries where firms report issue as top constraint in surveys of 48 countries

Source: *World Development Report 2005: A Better Investment Climate for Everyone*. World Bank, 2004.

The surveys also highlighted the high costs imposed on firms of all sizes, but especially small enterprises, by weaknesses in government performance. Although firms everywhere complain about the cost of paying taxes, these are usually not the major problem according to the survey data. The WDR 2005 concluded, “The Bank’s surveys show that the costs of unreliable infrastructure, contract enforcement difficulties, crime, corruption, and regulation can amount to over 25 per cent of sales – or more than three times what firms typically pay in taxes.”<sup>4</sup> Although the level and composition of these costs vary widely across and sometimes within countries, and between different types and sizes of firms, there

is little doubt that efforts by governments and donors to lower such costs is essential to enabling a vibrant and productive private sector.

A further challenge that governments must address is matching their official statements and policies to actual implementation. Over 90% of the firms surveyed claimed that gaps exist between formal rules and regulations and what actually happens in practice. The WDR 2005 concludes that, “Creating a better investment climate requires governments to reduce these gaps and to tackle deeper sources of policy failure that undermine a sound investment climate.”<sup>5</sup> The report focuses on the following four areas requiring concerted and consistent government action:

- Restrain corruption and other forms of rent-seeking that increase costs and distort policies;
- Build policy credibility to give firms the confidence to invest;
- Foster the social consensus, legitimacy and public trust required to sustain policy improvements by ensuring transparency and consultation in the design and implementation of policies; and
- Ensure that policy interventions are crafted to fit local conditions, including local administrative capacity.

### **Implementing sound business regulations**

Another clear message that is evolving from recent research on the role of government in supporting private sector development is that macro-economic reforms are necessary, but not sufficient. The World Bank’s ‘Doing Business’ project, in particular, is playing a useful role in focusing the attention of policymakers and business leaders on the importance of business laws and regulations. The first report in the series, *Doing Business in 2004*, made the following case, “To create [a vibrant private sector], governments around the world have implemented wide-ranging reforms, including macro-stabilization programmes, price liberalization, privatization, and trade-barrier reductions. In many countries, however, entrepreneurial activity remains limited, poverty high, and growth stagnant. And other countries have spurned orthodox macro reforms and done well. How so? Although macro policies are unquestionably important, there is a growing consensus that the quality of business regulation and the institutions that enforce it are a major determinant of prosperity.”<sup>6</sup>

At the outset of the ‘Doing Business’ project in 2001, there was little systematic analysis across countries of specific business laws and regulations, and how these impact economic outcomes such as productivity, investment, informality, corruption, employment and poverty. To address this gap, the project has identified a set of laws and regulations for more detailed and ongoing assessment and benchmarking. As of 2006, the following ten topics that shape the business environment are being tracked and regulatory reforms benchmarked in a sample of 148 countries:

- Starting a business
- Hiring and firing workers
- Getting credit
- Paying taxes
- Enforcing contracts
- Dealing with licenses
- Registering property
- Protecting investors
- Trading across borders
- Closing a business.

To date, the ‘Doing Business’ project has provided empirical evidence that clearly demonstrates three essential messages for policymakers and legislators in both developing and donor governments:

*First, it is more difficult and costly to do business in poor countries than rich countries:*

“Businesses in poor countries face much larger regulatory burdens than those in rich countries. They face three times the administrative costs, and nearly twice as many bureaucratic procedures and delays associated with them. And they have fewer than half the protections of property rights of rich countries.”

The *Doing Business in 2005* report states, “Businesses in poor countries face much larger regulatory burdens than those in rich countries. They face three times the administrative costs, and nearly twice as many bureaucratic procedures and delays associated with them. And they have fewer than half the protections of property rights of rich countries.”<sup>7</sup> And the 2006 report makes the point that, “Entrepreneurs face more regulatory obstacles in Africa than in any other region. Yet in 2004 reform was slower there than in other regions.”<sup>8</sup>

*Second, cumbersome business regulations hurt the poor in particular:*

The *Doing Business in 2005* report points out, “Heavy regulation and weak property rights exclude the poor from doing business. In poor countries 40% of the economy is informal. Women, young and low-skilled workers are hurt the most.”<sup>9</sup>

*Third, reforms in business regulations can be highly beneficial to economic growth and poverty reduction:*

The *Doing Business in 2005* report makes the case, “A hypothetical improvement on all aspects of the ‘Doing Business’ indicators to reach the level of the top quartile of countries is associated with an estimated 1.4 to 2.2 percentage points in annual economic growth. This is after controlling for other factors, such as income, government expenditure, investment, education, inflation, conflict and geographic regions. In contrast, improving to the level of the top quartile of countries on macroeconomic and education indicators is associated with 0.4 to 1.0 additional percentage points in growth.”<sup>10</sup> The *Doing Business in 2006* report emphasises the potential benefits of regulatory reform to the poor directly, “Improving a country’s ‘Doing Business’ indicators to the level of the top quartile is associated with a 9 percentage point fall in the share of GDP accounted for by informal activity. ...Female and young workers would benefit the most from these changes. Both groups account for a large share of the unemployed and burdensome regulations significantly affect their job opportunities.”<sup>11</sup>

In addition to being able to offer compelling statistics and contrasts of the costs and risks of doing business in one country versus another, the ‘Doing Business’ project is serving to highlight and share numerous good practices in reform efforts being undertaken by governments to create a better enabling environment for private

sector development. A large number of these practices offer relatively simple solutions and yet their impact on economic growth and poverty reduction can be substantial.

### Establishing local capital markets and financial institutions

Another key factor that is now recognized as being essential to private sector development is the existence of a competitive and well-regulated financial sector and capital market. Again government policies and their effectiveness play a crucial role. The UNIDO *Industrial Development Report 2004* stated, "...One of the most striking realities about Africa's failure to industrialise in the last few decades is that it has been a net exporter of capital. For example, around 70% of Nigeria's private wealth is believed to be held outside of Nigeria. ...Four priorities for successful industrial development follow:

- The restructuring of weak, inefficient financial systems;
- The development of domestic capital markets;
- The encouragement of FDI, not only for its contribution to bridging financial or foreign-exchange 'gaps', but even more because of the access it provides to skills, technology, patents, export markets, networking and production-sharing opportunities; and
- The promotion of policies to attract African capital that is held abroad back to the continent."<sup>12</sup>

### Investing in Infrastructure

Efficient, affordable and accessible infrastructure services, such as energy, water and sanitation, transportation, information and communications technology, and good urban planning are essential to private sector development and poverty reduction. In addition to physical infrastructure, social infrastructure such as schools and medical facilities are also important for both economic growth and improving economic opportunities and quality of life.

As noted elsewhere in this chapter, within the private sector itself, small enterprises usually suffer the most from unreliable and inaccessible infrastructure. Ironically, they often end up paying more for such services relative to their size and revenue base than their larger counterparts. They also have far less capacity to provide their own infrastructure. Governments again play a crucial role in ensuring that appropriate policy frameworks and reforms are in place to improve infrastructure services, alongside effective institutions, financial mechanisms and management capabilities – be these public, private, or public-private partnerships. Despite ongoing controversy about the most appropriate balance of public and private ownership and management of infrastructure projects, there are a number of innovative partnership models emerging at the regional, national and local level, especially in the areas of urban development, sustainable mobility and road safety, and access to energy, water, sanitation, and telecommunications.

Despite ongoing controversy about the most appropriate balance of public and private ownership and management of infrastructure projects, there are a number of innovative partnership models emerging at the regional, national and local level, especially in the areas of urban development, sustainable mobility and road safety, and access to energy, water, sanitation, and telecommunications.

## Creating framework conditions rather than intervening directly

An area of ongoing debate relates to the appropriate balance between the establishment of public policies and institutions that create an enabling environment for private sector development in general, covering enterprises of all sizes and from all industries, versus government interventions to provide direct support and subsidies to specific enterprises and industries. There is strong emerging evidence that the contribution of the public sector is likely to be more effective and less likely to distort markets or crowd-out local enterprise if governments focus on creating a suitable enabling environment and investment climate crafted to local needs, conditions and public capacities, rather than trying to deliver direct finance and business development services.

“The new paradigm that is emerging to provide support for private sector development is based on the concept of systemic change, changing the incentives within markets to deliver pro-poor outcomes rather than providing direct support to enterprises.”

The OECD sums up this approach as follows, “The new paradigm that is emerging to provide support for private sector development is based on the concept of systemic change, changing the incentives within markets to deliver pro-poor outcomes rather than providing direct support to enterprises. Systemic change usually involves a combination of institutional change, changing the way market regulating, facilitating, and promoting organisations work (formal and informal) to provide rules of the game that facilitate and promote pro-poor outcomes; and improving access and catalysing the deepening of markets by supporting enterprises through the development of linked markets for goods and services they require.”<sup>13</sup>

The OECD adds, “As country contexts differ widely, it is difficult to arrive at a universally applicable set of policies and forms of institutions that ensure pro-poor growth. What is possible, however, is to provide an analytical framework to assess whether the conditions are in place for the private sector to deliver growth, and to identify changes to institutions and policies that would help to make growth pro-poor.”<sup>14</sup> The OECD proposes a ‘Five Stage Analytical Framework’, which is outlined in more detail in Appendix III, and consists of the following five interlinked factors:

1. Providing incentives for entrepreneurship and investment
2. Increasing productivity, competition and innovation
3. Harnessing international economic linkages
4. Improving market access and financing
5. Reducing risk and vulnerability.

In summary, creating sound macroeconomic conditions, business regulations, capital markets and financial institutions, and investment in physical and social infrastructure are all essential roles for government to play in improving the investment climate and supporting private sector development. Different countries will have different challenges and policy areas that require particular focus, but achieving a combination of the above conditions is necessary in all countries to ensure pro-poor growth.

The Commission for Africa report offers some compelling examples of the benefits of an improved investment climate, “In Uganda, which underwent widespread investment climate reforms, GDP grew by around seven per cent per year during 1993-2002, reducing the share of the population living below the poverty line from 56 per cent in 1992 to 35 per cent in 2000. In Tanzania, an improvement in the investment climate is behind the country’s fastest growth in 15 years. In Mozambique, investment climate improvements resulted in a doubling of private investment as a share of GDP between 1998 and 2002.”<sup>15</sup>

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## 2 Supporting small enterprise development

As outlined in the previous section, the poor, and the small and microenterprises that many of them establish or work for, are often the most constrained by a bad or weak enabling environment for private sector development. They are also the most likely to benefit from improvements in this enabling environment.

Efforts to improve the overall investment climate will tend to deliver disproportionate benefits to smaller firms. This is encouraging news, particularly given the poor track-record of many schemes intended to confer special benefits on smaller firms.

Warrick Smith who led the team preparing the *World Development Report 2005*, comments, “The survey data show that there are some systematic differences between firms based on their size, with smaller firms generally facing the most severe constraints. Larger firms are typically better equipped to deal with distorted financial markets (due to sources of internal finance, assets to pledge as collateral and established reputations); to cope with poor infrastructure through self-provision; and to cope with potential policy uncertainty through better access to politicians and officials. One implication is that efforts to improve the overall investment climate will tend to deliver disproportionate benefits to smaller firms. This is encouraging news, particularly given the poor track-record of many schemes intended to confer special benefits on smaller firms.”<sup>16</sup>

This is an important first step in ensuring that pro-poor growth occurs. Given the central role, however, of small enterprises in providing livelihood opportunities for the poor, ongoing and targeted attention is needed by governments and donors to ensure that small enterprises are indeed benefiting and not excluded from improvements in the overall enabling environment for private sector development.

Three areas of action that warrant government and donor attention are:

- Efforts to ensure that reforms to the overall investment climate or framework conditions for private sector development take into consideration the constraints and opportunities faced by small enterprises and do not create impediments to or biases against small enterprise;
- Targeted support for small enterprise development in areas such as business development services, access to finance, small enterprise cluster development and business linkage initiatives, aiming to play a facilitative or enabling role

rather than direct service delivery role – ensuring wherever possible that these initiatives are demand-driven, market-oriented and either private sector-led or public-private partnerships, and that they address the lessons of previous less-effective direct government interventions in these area; and

- Concerted efforts to engage in regular dialogue and consultations with small enterprise owners, workers and their representative bodies, to ensure that their perspectives and needs are better integrated into policy development and implementation, and not only the views of large, well-connected companies.

### Ensuring that overall framework conditions benefit small enterprise

The Donor Committee for Enterprise Development (previously called the Committee of Donor Agencies for Small Enterprise Development) reported in 2004 that, “Small enterprise development has been acknowledged as a useful mechanism for economic development and poverty reduction by both governments and donor agencies. While there have been hard questions asked about the efficacy of financial and business development services in this field (leading to substantial improvements in the way small enterprise development programmes are designed and assessed), many donor agencies have turned to the broader conditions in which small enterprises operate in the search for ways to affect a larger number of firms and, hence, expand the benefits of their interventions.”<sup>17</sup>

“Small enterprise development has been acknowledged as a useful mechanism for economic development and poverty reduction by both governments and donor agencies. While there have been hard questions asked about the efficacy of financial and business development services in this field (leading to substantial improvements in the way small enterprise development programmes are designed and assessed), many donor agencies have turned to the broader conditions in which small enterprises operate in the search for ways to affect a larger number of firms and, hence, expand the benefits of their interventions.”

Hallberg makes a strong argument for improving overall framework conditions for small enterprise development, rather than providing direct and often subsidised support for selected enterprises, clusters or industries. In her discussion paper for the International Finance Corporation, *A Market-Oriented Strategy for Small and Medium-Scale Enterprises*, she recommends four areas where governments and donors can most effectively support small enterprise development:<sup>18</sup>

- *Addressing the market failures* that create cost disadvantages for small enterprises, restrict their access to markets, and inhibit the development of markets for a diverse range of financial and non-financial services appropriate for small firms;
- *Improving transactional efficiency* in financial, product and input markets relevant to small enterprises, by facilitating access to information and developing mechanisms to manage risk;
- *Reconsidering public policies and regulations* that discriminate against small firms or produce fixed costs that create a competitive disadvantage for them; and
- *Investing in public goods* that open market access and build enterprise competitiveness – including infrastructure (information, communications, power, water, and transport) as well as education and technology development.

She argues that, “This approach contrasts with traditional SME promotion strategies, which rely heavily on the direct and subsidised provision of financial and non-financial services to small enterprises. It places much greater emphasis on creating an enabling environment for SME competitiveness, and on developing markets for SME-relevant services rather than substituting for them.”<sup>19</sup>

Government interventions to improve the overall business environment for the private sector in general and the small enterprise sector in particular can in turn result in a series of outputs and outcomes that have a positive impact on broader development objectives. Research by The Donor Committee for Enterprise Development identifies a number of causal links as outlined in Box 16.

**BOX 16: THE CAUSAL LINKS BETWEEN IMPROVING THE BUSINESS ENVIRONMENT FOR SMALL ENTERPRISES AND ACHIEVING BROADER ECONOMIC DEVELOPMENT**

	INTERVENTIONS	OUTPUTS	OUTCOMES	IMPACTS
<b>The private sector in general</b>	<ul style="list-style-type: none"> <li>Removal of obstacles to private sector investment</li> <li>Improving organisational capacities and governance</li> </ul>	<ul style="list-style-type: none"> <li>Fewer obstacles and bottlenecks to private sector activity</li> <li>Government is more aware of influence of policies and laws on the private sector</li> <li>Improved governance – in general as well as regulatory authorities</li> </ul>	<ul style="list-style-type: none"> <li>Greater investment in the private sector</li> <li>More signs of growth from micro to small to medium to large sized enterprises</li> <li>More partnerships between the public and private sector</li> <li>Government interventions are more precise</li> </ul>	<ul style="list-style-type: none"> <li>More competitive, efficient and functioning markets</li> <li>More diverse, resilient and entrepreneurial national and local economies</li> </ul>
<b>The small enterprise sector in particular</b>	<ul style="list-style-type: none"> <li>Removal of anti-small enterprise biases</li> <li>Improving the advocacy and representation of small enterprises</li> </ul>	<ul style="list-style-type: none"> <li>The policy, legal and regulatory framework is ‘size-neutral’ (without parallel frameworks for small enterprises)</li> <li>Fewer obstacles to small enterprise activity</li> <li>Small enterprises participate more effectively in policy, legal and regulatory reforms</li> </ul>	<ul style="list-style-type: none"> <li>Greater participation by small enterprises in domestic and international markets</li> <li>Improved competitiveness among small enterprises</li> <li>Growth and improvement in small enterprise employment</li> <li>Greater participation by the poor in markets (through small enterprises)</li> </ul>	<ul style="list-style-type: none"> <li>Bigger private sector with more demand for employment</li> <li>Economic growth</li> <li>Poverty Reduction</li> </ul>

Source: White, Simon. *Donor Approaches to Improving the Business Environment for Small Enterprises. Working Group on Enabling Environment*, The Donor Committee for Enterprise Development, 2004.

**Ensuring that targeted interventions are demand-driven and market-oriented**

Targeted interventions and institutions are still needed to improve the access of small enterprises to finance, business development services and business linkage opportunities. There is growing agreement, however, that as much as possible they should be demand-driven, market-oriented and delivered by private firms, business-like nonprofit intermediaries, or public-private partnerships rather than through the more traditional approach of direct intervention by publicly-funded, highly-subsidised and supply-driven public bureaucracies.

In the area of delivering financial services to small enterprises, for example, a growing number of development experts argue for market-oriented strategies that aim to increase the number and diversity of financial institutions that can make a profit by serving small enterprises and thereby provide what is likely to be a more sustainable and scalable service over time. Hallberg and others argue that governments can support this approach through policy, legal and regulatory interventions that create a viable market for delivering such services, rather than trying to provide subsidised credit and financial services directly to small enterprises. Such public sector interventions can help to reduce the barriers of entry and risks associated with lending to small enterprises. They can improve access to information on the exact financing needs and creditworthiness of small firms. In some cases they can encourage innovation in new financial instruments and delivery technologies to enable private financial institutions to serve these clients in a cost-effective and profitable, or at minimum cost-recovery manner.<sup>20</sup>

The dramatic growth in market-oriented approaches to deliver microfinance services to entrepreneurs offers a good example of this new approach in practice. A variety of other innovative financing mechanisms are emerging, many of which use a 'blended value' approach, a term coined by Jed Emerson to describe investment strategies and instruments that explicitly include social and/or environmental factors into investment decisions, as well as an expectation of financial return.<sup>21</sup>

A 'blended value' approach can include a combination of commercial or philanthropic funding from private sector enterprises, as well as a combination of public funds and private funds.

For example, some commercial banks are starting to establish microenterprise or small enterprise programmes that are being driven by business units, but include some philanthropic money as 'seed funding' for initial pilot projects or as capacity building and technical assistance support, with the aim of achieving sufficient economies of scale over time to make the programmes commercially viable. Equally, there are a growing number of financing mechanisms to support small enterprise development that consist of both public funds and private funds, ranging from challenge funds to business linkage facilities and natural resource revenue-sharing mechanisms. Some of these emerging public-private funding partnerships are profiled in Part V of the report. Although many are still at an early stage of development and implementation, they offer encouraging models for a more market-oriented, demand-driven approach, but one that is still facilitated by public sector support. Such an approach offers great potential to provide small enterprises with access to financial services such as credit, insurance, equity, savings and remittance services on a more affordable, but also more sustainable basis.

The same type of argument is being made for the delivery of small business development services. The Donor Committee for Enterprise Development describes such business development services as including: "training, consultancy

and advisory services, marketing assistance, information, technology development and transfer, and business linkage promotion.”<sup>22</sup> The Committee differentiates between what it terms as ‘operational services’ needed for day-to-day operations, such as information and communications, management of accounts and tax records, and regulatory compliance, and ‘strategic services’, to help small enterprises identify and service new markets, design products, set up facilities and seek financing.

As with financial services, the traditional model has often been to deliver these business development services, even the more transactional operational services, through supply-driven, heavily subsidized or free public sector programmes. The Donor Committee for Enterprise Development comments that, “Traditional approaches have failed to achieve high outreach, since the numbers of small enterprises served is limited by the amount of subsidies available. In addition, institutional sustainability has been low, since programmes often cease when public funds are exhausted.”<sup>23</sup> At the same time, these approaches have often ‘crowded out’ existing or potential commercial providers of business development services, distorting the markets for such services that do exist and discouraging new market entrants and innovation.

This is not to suggest there is no role for direct public sector intervention, especially in cases where markets for such services are seriously underdeveloped or there are severe market failures. There is growing agreement, however, that the role of government should increasingly be to ‘facilitate market development’ for these services rather than ‘substitute for the market’.

A key challenge is determining when business development services have a strong public goods nature, which will require some level of donor or government support if they are to be delivered. The Donor Committee for Enterprise Development argues for example that, “Accelerating structural change in nascent markets may require support for services in areas such as information, dissemination of best practices and technologies, and human resource development. Research and development and quality assurance (e.g. through certification of trainers) are market-enhancing activities whose costs may be difficult to fully recover.”<sup>24</sup>

In such cases, new ‘blended value’ approaches or public-private partnerships can play a valuable role either as a transitional mechanism before services can be delivered on a cost-recovery or profitable basis, or in some cases as intermediaries on an ongoing basis. At all times, the aim should be to ensure that products and services are appropriate to the demands and needs of local small enterprises, viewing them as active clients rather than passive beneficiaries, and are delivered in the most cost-effective way with the least market distortions.

One key area where such public-private approaches can play a role is in addressing some of the information and capability gaps that undermine business linkages

between large companies and small enterprises. UNIDO's Wilfried Luetkenhorst argues that, "...large corporations usually cannot justify bearing alone the expense of upgrading entire local productive systems, which is often required to reduce capability gaps. Also, the benefits of such efforts cannot be completely appropriated at the firm level, thus assuming significant elements of a public goods character. ...Hence there is a case for an intermediary to intervene and complement market mechanisms in creating sustainable business linkages. Any such linkage programme initiated by an impartial broker will need to adopt a sector-wide approach, strengthen existing service institutions, work with local partners, and arrange for world-class expertise to be delivered to SME suppliers."<sup>25</sup>

UNCTAD and others have proposed that public sector support in this area can include: the provision of information; matchmaking initiatives such as trade fairs and databases; and either requirements or incentives for foreign companies and large national companies to transfer technology to their SME business partners, and/or support training and capacity building initiatives for small enterprises.<sup>26</sup>

### Ensuring that small enterprises have a 'voice' in policy making

Governments and donors can play a crucial role in this process by ensuring that small enterprises or their representative bodies (if these exist) are more systematically included in the process of consultation for policy making.

Giving small enterprises a formal 'voice' in economic policy making and implementation is vital to ensuring that they are not disadvantaged by or excluded from legal and regulatory reforms to support private sector development in general and that financial services and business development services are appropriate to their needs. Governments and donors can play a crucial role in this process by ensuring that small enterprises or their representative bodies (if these exist) are more systematically included in the process of consultation for policy making.

This can be achieved through:

- Carrying out regular and systematic surveys of small enterprises;
- Hosting dedicated dialogues and consultations with small enterprises;
- Ensuring small enterprises are represented at key public-private sector dialogues, alongside their large company counterparts.

In the development of Tanzania's National Growth and Poverty Reduction Strategy Paper, for example, surveys were sent out to hundreds of small enterprises around the country and a series of consultations held with this sector.

## Ensuring that vulnerable population groups are not excluded

Small enterprise development is also crucial in terms of providing livelihoods, economic opportunity and hope for vulnerable and marginalized groups in society. Economically or politically marginalized groups include women, indigenous peoples' groups, ethnic and religious minorities, small-scale farmers, artisanal miners, and youth – and especially those living in rural areas, which are home to the majority of the people living on less than \$1 a day.

Although it is essential for governments to create an enabling environment for the types of small enterprise that are most likely to be sustainable and productive over time and most able to create jobs, revenues and exports, small enterprise development is also crucial in terms of providing livelihoods, economic opportunity and hope for vulnerable and marginalized groups in society. Economically or politically marginalized groups include women, indigenous peoples' groups, ethnic and religious minorities, small-scale farmers, artisanal miners, and youth – and especially those living in rural areas, which are home to the majority of the people living on less than \$1 a day. As UNIDO points out, “A staggering 75 per cent of the world’s poor live in rural areas. And yet, resources and policies continue to be biased in favour of urban development. An imbalance in development is the consequence, with detrimental effects on both rural and urban people.”<sup>27</sup>

At a minimum, effective enterprise development among marginalized and vulnerable groups can have an important impact on poverty reduction and on improving social conditions, even if it is not a major contributor to sustained productivity gains and economic growth. In many cases, especially in post-conflict, post-disaster or conflict-prone locations, there is also an additional potential benefit of improving national or community-level security and resilience by giving marginalized youth, ex-combatants or entrepreneurs who have lost everything in either man-made or natural disasters, some stake in the future and a reason to rebuild or protect stability, rather than destroy it.

Addressing challenges of gender inequity and the lack of economic empowerment of women is one increasingly well-documented and demonstrated approach to supporting small enterprise development in targeted groups. As is now well-known, many of the world’s most successful micro-enterprise initiatives have a predominantly female client base and there are also growing examples of women entrepreneurs in both developed and developing countries establishing successful small and medium enterprises. The UN’s Commission on Private Sector and Development concluded that from Latin America and the Caribbean to SE Asia and Africa, between 25% and 50% of formal sector micro-enterprises and small and medium enterprises are owned and operated by women, and figures are usually higher in the informal sector and rural areas.<sup>28</sup> Yet women find it particularly difficult to get access to finance and secure property rights. A multi-faceted approach is needed to improve framework conditions, provide direct affordable access to finance and other key resources, and ensure that women have more of a profile and voice in private sector networks and public policy forums.

In December 2004, the International Finance Corporation, which is the biggest multilateral provider to private sector projects in developing countries, established Gender-Entrepreneurship-Markets (GEM). This initiative has a mandate to mainstream gender throughout the IFC’s operations and to design women-oriented

projects and technical assistance programmes. Among other things, GEM has established a network of over 180 women's business associations and is supporting capacity building workshops, policy analysis of business regulations to identify and rectify gender constraints, and gender audits of private sector development projects.

UNIDO's Rural and Women Entrepreneurship Development Programme is another example of an integrated effort to increase rural productivity, non-farm economic activities and economic security by tackling urban-rural disparities and gender inequalities. The programme focuses on three key strategies, all of which are normally implemented in partnership with larger companies, non-governmental organizations and local and cross-border business networks:<sup>29</sup>

- Strengthening the public administration to make the regulatory and administrative environment more conducive for rural and women entrepreneurs.
- Human resource development for increased competitive entrepreneurship, technology absorbing capacities and women's control over asset management.
- Development of the policy advocacy and the collective self-help capacities of rural and women entrepreneurs. Examples of such collective or common initiatives include projects such as collective marketing mechanisms, bulk purchasing, group-owned enterprises, group lending schemes, joint training programmes, and common facilities, for example sharing machinery and equipment, office or warehouse facilities, and transportation and communications capabilities.

The Diamond Development Initiative (DDI) is another interesting public-private sector example, which focuses on small enterprise development and greater economic security among a marginalized group, this time small-scale miners. Initiated by a coalition of two NGOs, Global Witness and Partnership Africa Canada, and two companies, De Beers and the Rapaport Group, and supported by the World Bank, DDI focuses on understanding and addressing the challenges and lack of alternative livelihoods faced by artisanal diamond mining communities, which are usually extremely poor, marginalized and prone to conflict situations. The Sierra Leone Peace Diamonds Alliance focuses on similar communities and brings together similar partners, as well as USAID and the UK's Department for International Development.

As outlined in Part I of this report, lack of employment and enterprise opportunities among young people is a particularly important public policy issue in many developing countries. Even those who are fortunate enough to have received some education often find it impossible to get jobs in the formal economy and they face serious obstacles establishing their own businesses and becoming self-employed. Despite the burgeoning of micro-enterprise initiatives around the world, for example, almost none of these offer services targeted at youth entrepreneurs.

Failure to provide young people with opportunities to find meaningful work or self-employment is not only a waste of human potential and missed opportunity for sustainable development, but can lead to social alienation, drugs, crime and violence. In many conflict situations it is disenfranchised groups of youth, both educated and poorly educated, who are the key source of new recruits for warring factions, terrorist groups and organized crime.

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The World Bank's *World Development Report 2007* focuses on this important subject for the first time in the Bank's history. Entitled *Development and the Next Generation*, it examines young people between the ages of 14 and 24 and discusses five key 'transitions' that shape their potential, as well as the risks, opportunities and priorities for government action in each of these transitions: learning; working; staying healthy; forming families; and exercising citizenship.<sup>30</sup>

The UN's Youth Employment Network, established in 2001, identifies the following top priorities for providing young people with better access to economic opportunity:

- **Employability** – invest in education and vocational training for young people to facilitate the school-to-work transition;
- **Equal opportunities** – give young women the same opportunities as young men;
- **Entrepreneurship** – make it easier for young people to start and run enterprises and/or engage in social entrepreneurship and other forms of self-employment;
- **Employment creation** – place employment creation at the centre of macro-economic policy.

Given the lack of sufficient jobs estimated to be available in the formal sector, supporting youth enterprise is likely to be an increasingly important option for policy makers and business leaders to consider. A number of innovative networks and partnerships between governments, donor agencies, NGOs, companies and foundations are underway in the areas of youth enterprise, three of which are briefly profiled in Box 17, but further efforts are needed to achieve greater scale and coverage in order to address this challenge.

## BOX 17: PARTNERSHIPS TO INVEST IN YOUTH ENTERPRISE

**UNIDO and ILO** – Recognizing the critical importance of tackling youth unemployment, UNIDO organized a ministerial roundtable on the subject with ILO in 2006. A result of this roundtable a decision was taken to develop a new programme within UNIDO to address the issue, beginning with an initiative for the countries of the Mano River Union in West Africa. UNIDO organized a series of meetings leading up to a High Level Consultative Meeting on youth employment in Accra, Ghana, in February, 2007. The outcome of this will be a programme framework to promote and coordinate a range of interventions to ameliorate the problems of youth in the region. It is expected that this will lead to the establishment of projects by several donors and agencies within this overall programme framework, which would promote coherence, cooperation, and where feasible, joint implementation and fund-raising. UNIDO and ILO are also looking at the possibility of other joint initiatives on Youth Employment.

**Youth Business International** – An initiative of the International Business Leaders Forum, YBI works with companies, individual business executives, governments, other youth organizations, the UN and other donors to establish national-level programmes that support youth entrepreneurship. Although adapted to local needs and circumstances, these programmes share a common approach based on a combination of start-up funding and business mentoring. In many cases the funding is provided by a combination of public and private funds, including growing support from the banking sector. Business people, who share their skills and experiences on a voluntary basis, usually provide the mentoring support to the young entrepreneurs. The programme also aims to share international lessons in the area of youth entrepreneurship and is currently working in almost 40 countries around the world, with more than 14,000 young people having been set up in business and over 72% of them still in business in their third year, having created an average of 3 new jobs.

**The ImagineNations Group** – ING is a global alliance of social entrepreneurs, investors, financial institutions, corporations and media working together with young people to inspire positive change in society and support achievement of the Millennium Development Goals. In particular, it aims to influence public policy and to catalyse innovative programmes in the areas of youth employment and youth entrepreneurship and in media alliances to explode myths about young people and build bridges between young people across cultures, faiths, politics, gender, age and language. The network is partnering with a variety of organizations ranging from the World Bank and UNDP, to MTV, Boston College, and the Nike, Amelior and Gates Foundations to undertake action research, pilot youth enterprise programmes, support media exchanges and conduct ‘Seeing-Is-Believing’ visits by potential supporters, in southern and north Africa, Asia and the Middle East.

Corporate social responsibility (CSR) is widely viewed as a set of voluntary actions that companies take above and beyond regulatory requirements to improve their ethical, socio-economic and environmental performance. There is growing debate, however, on other interventions that governments and donors can take, beyond traditional ‘command and control’ regulatory approaches, to create an enabling environment that fosters responsible business practices.

## 3 Fostering responsible business practices

Corporate social responsibility (CSR) is widely viewed as a set of voluntary actions that companies take above and beyond regulatory requirements to improve their ethical, socio-economic and environmental performance. There is growing debate, however, on other interventions that governments and donors can take, beyond traditional ‘command and control’ regulatory approaches, to create an enabling environment that fosters responsible business practices

Two of the conceptual frameworks that have been developed to think about the role that governments and donors can play in this area suggest a wide range of potential interventions and the opportunity for increased policy innovation in this area. These frameworks are summarised in Boxes 18 and 19.

## BOX 18: PUBLIC SECTOR ROLES IN STRENGTHENING CSR

**Mandating** – Laws, regulations and penalties and associated public sector institutions that relate to the control of some aspect of business investment or operations.

**Facilitating** – Setting clear overall policy frameworks and positions to guide business investment in CSR; development of non-binding guidance and labels or codes for application in the marketplace; laws and regulations that facilitate and provide incentives for business investment in CSR by mandating transparency or disclosure on various issues; tax incentives; investment in awareness raising and research; facilitating processes of stakeholder dialogue.

**Partnering** – Combining public resources with those of business and other actors to leverage complementary skills and resources to tackle issues within the CSR agenda – whether as participants, convenors or catalysts.

**Endorsing** – Showing public political support for particular kinds of CSR practice in the marketplace, or for individual companies; endorsing specific metrics, indicators, guidelines and standards or award schemes, and 'leading by example', for instance through public procurement practices.

Source: Ward, Halina. *Public Sector Roles in Strengthening Corporate Social Responsibility: Taking Stock*. World Bank Group, 2004.

## BOX 19: CREATING THE ENABLING ENVIRONMENT FOR RESPONSIBLE BUSINESS

### Establishing 'RULES OF THE GAME'

- **Command and control regulations** – Legally binding laws and regulatory frameworks for enforcing responsible business practices at the local, national and international level.
- **Government-driven market mechanisms** – Economic instruments that create incentives for responsible business practices and penalise bad practices. For example, taxes, grants, subsidies, fines, fees, social and eco-labelling schemes, stock market listing criteria and indices, government procurement, tendering and export credit schemes, environmental trading permits and enterprise zones.
- **Government support for voluntary approaches** – Mechanisms and negotiated agreements which enable voluntary action by business, such as guidelines and codes of conduct (developed by industry itself or jointly with government and civil society actors), with systems to measure, monitor and certify their implementation and to sanction or remediate non-compliance.

### Building PUBLIC-PRIVATE RELATIONSHIPS

- **Public policy consultation mechanisms** – Government appointed commissions, task forces, councils and advisory initiatives focused on addressing socio-economic or environmental policy issues.
- **Multi-stakeholder corporate accountability structures** – Relationship intermediaries focused on increasing dialogue and accountability between business and its stakeholders, including governments. Usually focused on a particular issue, industry sector or stakeholder group.
- **Donor programmes for business partnerships** – Specific programmes targeted at bringing the business sector into partnership with the UN system and other multilateral and bilateral governmental bodies to tackle key development challenges.

### Mobilising PUBLIC-PRIVATE RESOURCES

- **Financial resources** – Innovative funding and investment vehicles such as social funds, debt swaps, public-private financing facilities, social investment funds and indices, cause-related or social marketing, matched-giving schemes, venture philanthropy, challenge funds, micro-finance intermediaries, community banks and community or social-venture capital.
- **Skills and managerial resources** – Programmes that combine business and public sector skills to support development objectives or that build future managerial and organisational skills for cross-sector partnerships and responsible business.
- **Information and advisory services** – Initiatives to provide companies with information and advice on how to implement better business practices.

### Giving PUBLIC RECOGNITION

- **Government award programmes** – Initiatives that recognize and publicise responsible business practices.
- **League tables and reputation surveys** – Efforts to rank the economic, social and/or environmental performance of companies relative to their peer group in selected geographies or industry sectors.

Source: Nelson, Jane. *Creating the Enabling Environment: Mechanisms to promote global corporate citizenship*. Executive Summary. International Business Leaders Forum, 2000.

Government interventions to foster responsible business practices can range from broad efforts to create an overall enabling environment for such practices, including market development, to more direct interventions such as the creation of special financing facilities or public sector-led initiatives to support CSR-related training and capacity building, identify and disseminate good practices, and share information and technical guidance.

Government interventions to foster responsible business practices can range from broad efforts to create an overall enabling environment for such practices, including market development, to more direct interventions such as the creation of special financing facilities or public sector-led initiatives to support CSR-related training and capacity building, identify and disseminate good practices, and share information and technical guidance. Several governments have taken a proactive stance in a number of these areas.

The British Government, for example, has appointed a Minister for Corporate Social Responsibility and established a CSR Academy as a business support initiative of its Department of Trade and Industry, with a focus on providing training and competency frameworks for companies of any size or sector wanting to develop their CSR skills. The UK's Foreign Office and its Department for International Development (DFID) have also played an important convening role in the establishment of some major corporate accountability frameworks aimed at monitoring and improving business practices in developing countries, such as the Ethical Trading Initiative, the Extractive Industries Transparency Initiative, and the Kimberley Process.

The US State Department has played a similar convening role in initiating programmes such as the Voluntary Principles on Human Rights and Security and what is now called the Fair Labour Association. It has an award programme to recognize good practices of US companies operating in developing countries and in 2001 established the Global Development Alliance (GDA), an innovative programme in the US Agency for International Development (USAID) aimed at leveraging public funds with private sector and foundation resources to achieve development goals. As of May 2006, GDA had leveraged more than \$1.4 billion of its own funds with over \$4.6 billion of other partner funds through nearly 400 public-private alliances in developing countries, a number of which are focused on small enterprise development and on spreading responsible business practices to small enterprises.<sup>31</sup> In a 2005 study of Federal Government departments in the United States, the Government Accountability Office (GAO) concluded, "Although there is no broad federal CSR mandate, we identified 12 U.S. agencies with over 50 federal programmes, policies, and activities that generally fall into four roles of endorsing, facilitating, partnering, or mandating CSR activities."<sup>32</sup>

The Danish, French and Australian Governments have implemented requirements for listed companies to publicly disclose certain social and environmental information and their bilateral development agencies have established a variety of partnership initiatives with the private sector, as have those of Germany, Canada, Sweden and the Netherlands. The South African government has required the establishment of industry charters in key industry sectors such as financial services and mining, and the Brazilian government has launched a number of national initiatives aimed at engaging business and other actors in efforts to tackle poverty.

“...although codes of conduct are a force for positive change in terms of labour and environmental performance, current approaches are far likelier to bring sustainable improvements when implemented within a comprehensive, public sector governed framework. ...Developing country governments are likely to be successful in improving social and environmental standards if they develop coherent strategies that address all critical elements of the enabling framework: transparent and efficient legal and market-based drivers, robust capacities, and useful tools and skills.”

Of equal interest has been the growth in CSR-related initiatives in the United Nations and other multilateral agencies.

One of the best-known initiatives is the UN’s Global Compact, which works with over 2,000 companies (many of them from developing countries), trade unions, NGOs and several major UN agencies to promote the implementation by business of ten principles. In the areas of human rights, labour, anti-corruption and the environment, these principles are all based on internationally agreed conventions. Some 20 per cent of the Global Compact’s participating companies are small enterprises.<sup>33</sup>

The World Bank played a pioneering role with its Business Partners for Development initiative launched in 1999 and more recently has focused efforts on building the capacity of developing country governments to create an enabling environment for promoting more responsible business practices at the country level.

In a 2004 study on *Public Sector Support for the Implementation of Corporate Social Responsibility (CSR) in Global Supply Chains*, the World Bank notes that, “...although codes of conduct are a force for positive change in terms of labour and environmental performance, current approaches are far likelier to bring sustainable improvements when implemented within a comprehensive, public sector governed framework. ...Developing country governments are likely to be successful in improving social and environmental standards if they develop coherent strategies that address all critical elements of the enabling framework: transparent and efficient legal and market-based drivers, robust capacities, and useful tools and skills.”<sup>34</sup>

The World Bank study makes a strong case for governments in developing countries to support collaborative, industry-focused and multi-stakeholder initiatives, which the authors argue hold the greatest potential for improving labour and environmental standards in global supply chains. The study recommends that public sector interventions focus on the following four main areas to support such efforts:

- Establishing and enforcing clear and effective standards;
- Supporting capacity building – including the creation of networks of local experts and centres of excellence, support for training efforts, and reorientation of inspectorates from a compliance-driven model to a capacity-building model;
- Creating positive and negative incentives; and
- Empowering workers – educating them about their rights and removing barriers to worker participation and representation.

Government interventions of this nature can play a crucial role in fostering responsible business practices among companies operating in developing countries, but as outlined in Part II of this report, a major challenge has been to implement such practices among small enterprises, not only large corporations. Notable

examples of donor-led efforts that focus specifically on promoting local wealth creation and fostering social and environmental responsibility in small enterprises, as well as larger companies, include:

- UNIDO's Business Partnerships programme;
- The International Finance Corporation (IFC's) Business Linkages Programme;
- UNCTAD's Business Linkage Programme;
- The World Bank Institute's programme on Implementing Environmental and Social Accountability and Governance in SMEs;
- GTZ's Public-Private Partnership programme;
- DFID's Business Linkage Challenge Funds;
- USAID's Global Development Alliance;
- UNIDO and UNEP's Cleaner Production Centres; and
- UNDP's Growing Sustainable Business Initiative.

These initiatives all cooperate with private companies, and in some cases other partners, such as business associations, trade unions, universities and non-governmental organisations. They are briefly profiled in Part V.

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## 4 Improving aid effectiveness

Since 2000 there have been several major initiatives by the international community to increase the quantity of official development assistance and to emphasise the mutual accountability of both donor and recipient governments in ensuring that aid is used effectively. In 2005, the G-8 Gleneagles Summit made commitments to new levels of aid and debt relief and the *Paris Declaration on Aid Effectiveness* called on developing country governments, donors and the multilateral development banks to achieve 12 global targets to improve aid effectiveness. These targets are summarised in Appendix IV.

Although some progress has been made, much remains to be done. The *2006 Global Monitoring Report* stated, "...these commitments risk remaining unfulfilled. Aid commitments may fall victim to donor-country efforts to cut deficits. Debt relief is intended to be additional but may be counted toward fulfilling aid targets. Moreover, even if aid commitments are met, donors may not fulfill pledges to lift the quality of aid. Recent history suggests that this will be an uphill struggle – aid remains poorly coordinated, unpredictable, largely locked into 'special purpose grants', and often targeted to countries and purposes that are not priorities for the MDGs."<sup>35</sup>

The effectiveness of aid is clearly influenced by the standards of governance in partner countries where the aid is being disbursed, by the global governance system and by the harmonisation, alignment, flexibility and results-orientation of aid commitments made by the international donor community.

As outlined in Part I of the report, governance gaps and failures are a major obstacle to achieving economic growth and reducing poverty. The central importance of good governance at both national and global levels is increasingly recognized in major reports and commissions and in frameworks such as NEPAD's Africa Peer Review Mechanism. Requirements and in some cases indicators for good governance are being integrated into new donor approaches such as the United States' Millennium Challenge Account, the UK Department for International Development's Drivers for Change analytical framework, and the European Union's Cotonou Agreement. Donor countries and international financial institutions are also publicly acknowledging their own responsibility for improving global governance systems. Yet, as the *Global Monitoring Report* (GMR) and others observe, "...there is not yet a consensus as to how to approach governance and its measurement."<sup>36</sup>

While recognising the enormous complexity of governance – given the variety of actors, institutions and processes involved even at the national level, let alone on a global basis – the GMR is one of a number of initiatives that is developing governance monitoring frameworks, with the aim of identifying indicators that will enable more effective and empirically rigorous assessment and monitoring of progress over time.

A key element of better global governance is the need for donors to ensure that their aid is more harmonised and is aligned and responsive to the genuine development needs and constraints in recipient countries. The OECD argues that donors should improve their procedures and practices in three broad functional areas: between donors and partner governments; between donor agencies themselves; and within individual donor systems.<sup>37</sup>

In the area of private sector development and the fostering of competitive and responsible small enterprises there are some encouraging examples of coordination in these three areas, both at a global level and in a growing number of developing countries. Examples of such efforts include the following:

- Better coordination between donors and partner governments – Viet Nam and Tanzania offer two examples where country-level coordination efforts are well underway.
- Better coordination between donors – The Donor Committee for Enterprise Development and the Consultative Group to Assist the Poorest (CGAP).
- Better coordination within donor systems – UNIDO and UNDP.

### **Coordination between donors and partner governments**

Viet Nam and Tanzania offer two promising examples of increased donor coordination with host government agencies, business and other partners, including local and foreign companies and business associations, in the area of private sector development. In both cases, joint efforts are helping to tackle

challenges associated with lack of synchronised and integrated planning and project implementation by donors and government agencies, lack of common national data, lack of public sector administrative and managerial capacity, and lack of ongoing and systematic stakeholder consultation.

### Viet Nam

In Viet Nam, for example, the World Bank Group played a key role working with the Ministry of Planning and Investment to establish the Viet Nam Business Forum (formerly the Private Sector Forum). This serves as a consultative group and includes domestic companies, foreign investors, public sector enterprises, the Vietnam Chamber of Commerce and Industry (VCCI), various foreign business chambers, the Young Entrepreneurs Association, and the Viet Nam Women Entrepreneurs Association. It plays an important role in ensuring that business perspectives are listened to and taken into account in national development planning processes, and has been particularly active in efforts to improve the investment climate. The forum has also facilitated the creation of a series of Partnership Groups to address issues of common concern to business and government, ranging from trade and small business development to HIV/AIDS.

The SME Partnership Group supports a regular process of consultation, shared learning, capacity building and planning between donors active in the area of small enterprise promotion and the government's Agency for SME Development (ASMED). Jointly chaired by UNIDO and the Embassy of Japan, with the secretariat function being provided by ASMED, the SME Partnership Group involves 15-20 donors on a voluntary basis. Different government agencies, donors and business entities have taken a lead in establishing working groups, which operate between twice yearly meetings of the whole group. Current working groups focus on: business development services; business regulation reform; SME finance; local economic governance; business research and monitoring; sustainable business practices (including CSR); and collective or sectoral approaches such as promoting cluster development and linkages between large firms and SMEs.

Specifically in the area of responsible or sustainable business practices the donor community in Viet Nam has worked with both government and local and foreign companies on some innovative initiatives. These include the creation of the Viet Nam Business Links Initiative (VBLI) and the Viet Nam Cleaner Production Center, which are profiled in Part V, and the more recently established CSR Roundtable. Led by the German GTZ and the Vietnam Chamber of Commerce and Industry, the CSR Roundtable brings together a network of business associations, companies, donors and NGOs on a regular basis to learn about specific tools, processes and auditing systems for implementing sound labour and environmental practices in business operations. Among other goals, it aims to help build the local capacity and profession of social and environmental auditors and research empirical evidence on the business case for responsible entrepreneurship.

## Tanzania

In Tanzania, UNIDO has worked with the government to help establish a National Business Council. Launched in 2001, the Council is chaired by the country's President, with a business leader serving as the Vice-Chair, and equal participation of some 20 government representatives and 20 private sector representatives. The Council aims to provide a forum for frank public-private dialogue aimed at promoting the goals of pro-poor economic growth, with a focus on issues related to the investment climate and regulatory and policy reform. It has also created an Investors Roundtable, which includes a number of international business leaders and investors who meet with the President, some of his ministers and domestic business leaders to offer advice and discuss ways to overcome constraints to foreign investment.

Building on previous coordination mechanisms the donor community in Tanzania established a Development Partners Group in 2004, which meets on a monthly basis to coordinate donor agencies' activities with the government in a range of areas including private sector development. A more focused joint effort, the Private Sector Support Programme, has been established between UNIDO, UNDP and the International Labour Organisation (ILO) aimed at providing technical assistance to Tanzanian suppliers aimed at overcoming some of the capacity constraints they face in building linkages with large companies and integrating into global supply chains.

## Coordination between donor agencies

The Donor Committee for Enterprise Development offers a longstanding example of donor coordination at the global level. Established in 1979 at a meeting convened by the World Bank, over the past 27 years the Committee has served as a forum for member agencies to exchange information about their programmes, share experiences and lessons learned, explore areas for joint action and better coordination at the country level, and publish common guidelines and standards on key issues associated with small enterprise development. Members also helped to establish a well-regarded and widely distributed quarterly journal *Small Enterprise Development*. Membership is comprised of some 40 agencies, mostly bilateral and multilateral development agencies, but also some private foundations with an interest in small enterprise development, such as the Ford and Soros Foundations. The World Bank chaired the Committee and acted as the Secretariat until 2004, when the UK's Department for International Development became as a co-chair. In addition to regular conferences and informal exchanges between members, the Committee carries out its core activities through the following working groups: impact measurement and performance; business development services guidelines; SME finance; strategy; enabling business environment for SMEs; and business linkages and value chains.

The Consultative Group to Assist the Poorest (CGAP) is another example of coordination among 33 leading bilateral and multilateral donors, international financial institutions and private foundations, working together with the aim of expanding access to microfinance services in developing countries. Established in 1995 at the convening of the World Bank, today CGAP serves as a resource centre for the burgeoning microfinance industry and provides a range of support services such as training, research and development, and consensus building on standards for development agencies, financial institutions, including microfinance institutions, government policymakers and regulators and other service providers such as auditors and rating agencies. Over the past decade, it has played an important role in mobilising political support and financial resources, both public and private, around the concept and practice of microfinance. Key areas of focus include work on enabling policy environments, institution building, financial transparency and better donor coordination and effectiveness.

### **Coordination within donor agencies and the UN system**

In September 2004, UNIDO and UNDP concluded an agreement to develop joint programmes of technical cooperation in the area of private sector development, with a key aim to implement the recommendations of the UN Commission on Private Sector and Development. Although still in its early stages, this UNIDO-UNDP Initiative on Private Sector Development offers an interesting model for how agencies within the UN system can potentially leverage their core competencies and synergies, minimize duplication of resources and effort, provide a common voice on the importance of private sector development through global forums, workshops and research projects, and develop new models of joint field representation at the country level.

The initiative focused on implementing the Commission's recommendations in the following key areas, with an initial focus on 12 pilot countries: Afghanistan, Burundi, Ecuador, Ethiopia, Ghana, Jordan, Laos, Nicaragua, Nigeria, Rwanda, Sierra Leone, and Tanzania, :<sup>38</sup>

- Identify clear roles in private sector development for government, civil society, the business community and development agencies;
- Fully mobilize domestic entrepreneurial capacities in developing countries by improving the enabling environment, enhancing access to finance and strengthening the knowledge and skill base;
- Reduce economic informality by stimulating the move of entrepreneurs into the formal economy;
- Develop sustainable markets and new business models for poor population segments (the so-called 'base-of-the-pyramid' markets);

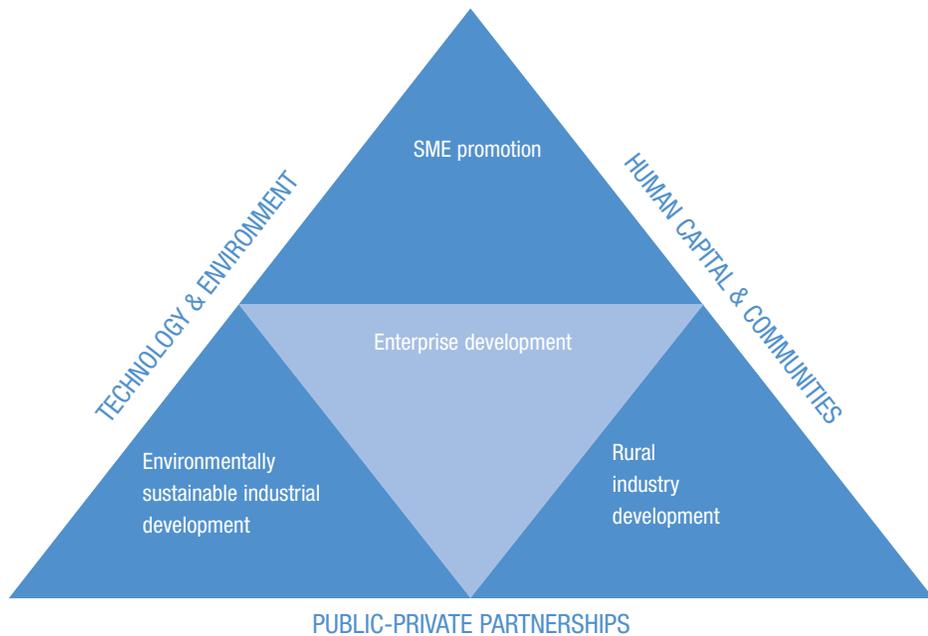
- Effectively link domestic small and medium-sized entrepreneurs with foreign investors and large domestic companies by integrating them into broader value chains; and
- Promote public-private partnerships and responsible business practices.

The process of developing these country-level joint programmes has been varied, with more rapid progress being achieved in some countries than in others owing to divergent local conditions and varying levels of donor interest. In overall terms, however, a joint assessment of the programme undertaken by the two organisations in mid-2006, two years after its launch, indicated that its implementation should be sustained for the full five-year period as originally envisaged. In addition, the assessment recommended that the programme of cooperation should be expanded beyond private-sector development to other substantive areas, such as energy and environment, that had been provided for in the cooperation agreement but not yet pursued.

Within UNIDO itself an ongoing process is underway to develop ‘Integrated Programmes’ in close consultation and cooperation with its partner governments that shift the agency’s operational modality from, “...a portfolio of individual projects to integrated packages of mutually supportive service modules designed to help overcome the critical industrial development problems of a country at the national level or those of a particular geographic area within a country.”<sup>39</sup> In addition to a commitment to align these Integrated Programmes with partner government’s own planning processes and timetables, UNIDO is also working with other donors, NGOs and business associations in selected countries to ensure greater coordination in its programming efforts. These Integrated Programmes of cooperation are under implementation in some 50 countries, of which about 15 are in their second phase.

Figure 10 illustrates the three core objectives defined by UNIDO and Viet Nam’s policymakers in the 2003 – 2005 Viet Nam Integrated Programme: the economic objective to enhance the delivery of resources to SMEs by developing the institutional and policy support for SME development; the socio-economic objective to generate incomes and employment in rural areas through the advancement of women’s entrepreneurship in rural industries; and the environmental objective to mitigate adverse impacts of rapid industrialisation on the ecosystem through the promotion of cleaner production in manufacturing activities.<sup>40</sup>

**FIGURE 10: UNIDO'S INTEGRATED PROGRAMME OF COOPERATION WITH VIET NAM (2003-2005)**



Source: *Integrated programme of cooperation between the Socialist Republic of Vietnam and UNIDO 2003-2205*, Annual Report 2004

In summary, there are a number of encouraging initiatives underway where donors are achieving more coordinated approaches to private sector development, both between donor agencies, within donor agencies, and between donors and their partner governments. A growing number of these efforts also have an explicit focus on engaging directly with domestic and foreign companies and business associations with objectives ranging from improved policy dialogue and consultation, to joint mobilisation of financial and technical resources, to the creation of commercially viable business linkages between large and small firms. Surprisingly, such proactive and explicit engagement with the private sector has not always been a feature of donor-funded private sector development projects in the past.

While pitfalls exist, most notably the need to balance development objectives of the donors with commercial objectives of companies, there is great potential for increased public-private cooperation in the area of responsible and sustainable enterprise development. Some of these emerging alliances are profiled in Part V. In all cases, however, no matter how responsive and responsible the private sector is, good governance, effective public institutions, and sound public policy measures by governments will remain absolutely essential in ensuring pro-poor economic growth and enterprise development.

**SUMMARY OF PART IV:****THE IMPORTANCE OF PUBLIC POLICY MEASURES**

Developing country and donor governments share a fundamental leadership role in creating the conditions to foster small enterprise, promote economic growth and reduce poverty. In the absence of good governance, underpinned by effective public policies and institutions, there is little that even the largest and most responsible companies can contribute to sustained economic growth and pro-poor development.

The role of government is especially important in the following areas:

**1. Creating an enabling framework for private sector development in general**

Supporting a sound investment climate, addressing both macro-stability and micro-economic and regulatory impediments to the mobilisation of domestic capital and the attraction and retention of foreign capital, and investing in physical, social and institutional infrastructure. Research by the World Bank and others demonstrates that small enterprises are often more adversely affected by constraints in the enabling framework than larger companies and so efforts to improve the overall investment climate will tend to especially benefit small enterprises.

**2. Supporting small enterprise development**

Ensuring that framework conditions, consultation structures and delivery mechanisms for finance and business development services enable rather than exclude small enterprises, helping informal enterprises move into the formal economy and high-potential entrepreneurs upgrade into broader value chains. Efforts are needed to ensure that targeted interventions to support small enterprise development are demand-driven and market-oriented and do not 'crowd-out' existing or potential commercial service providers or distort markets, but at the same time recognize where 'blended value' or public-private partnership approaches are needed. One area where governments can play an important role is improving the enabling environment and supporting enterprise development among vulnerable and marginalized groups such as women, indigenous peoples', ethnic and religious minorities, small-scale farmers, artisanal miners, and youth – and especially those living in rural areas, which are home to some 75 per cent of the people living on less than \$1 a day.

**3. Fostering responsible business practices**

Implementing the necessary policies, regulations, funding mechanisms, market incentives, training, and standardisation and certification programmes to either require or encourage the adoption of sound labour and human rights standards, environmental practices and anti-corruption measures – in small enterprises as well as large companies. Governments can help to ensure more responsible business practices among small enterprises as well as major corporations by using a variety of public policy measures, instruments and tools. Four key government roles in strengthening responsible business practices, identified by the World Bank, are: mandating; facilitating; partnering; and endorsing.

**4. Improving aid effectiveness**

Improving the effectiveness of bilateral and multilateral aid through increasing national ownership; aligning aid more closely with national development strategies, institutions and procedures; improving harmonisation between donor agencies; managing for results; and ensuring greater mutual accountability for development results. In the area of private sector development, and small enterprise development specifically, a variety of encouraging initiatives are underway aimed at improving coordination between donor agencies, within donor agencies and between donors and partner governments. A growing number of these include an explicit commitment on the part of donors and/or governments to engage more proactively with the private sector.



# V MULTI-SECTOR PARTNERSHIPS AND COLLECTIVE ACTION MODELS

## DEFINING PARTNERSHIP

Partnership is a voluntary and collaborative agreement in which all participants agree to work together to achieve a common purpose or undertake a specific task and to share risks, responsibilities, resources, competencies and benefits.

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Source: Adapted from Nelson, J. *Building Partnerships: Cooperation between the UN system and the private sector*. 2002

Over the past decade there has been a dramatic increase in the number, scope, diversity and reach of *multi-sector partnerships* between business, governments, civil society and other actors, and of *collective corporate action* between groups of companies on either an industry sector or geographic basis. Some of the key drivers for this development were outlined in Part I and II of the report.

There is no commonly agreed categorisation of such alliances. A comprehensive study of UN-business partnerships carried out in 2005 by the UN Global Compact and Global Public Policy Institute offers one of the most useful frameworks. Although this framework focuses specifically on UN-business alliances, it has relevance for many types of multi-sector partnership and is adapted below for the purpose of this report:<sup>1</sup>

- **Advocacy** – Partnerships aimed to advance a specific cause and/or draw attention to a particular issue by leveraging the reputation and networks of its participants.
- **Developing norms and standards** – Partnerships aimed at developing codes of conduct, reporting guidelines, or other norms and standards to guide the conduct of participants – and sometimes aiming to have wider impact on the conduct of non-participants. These can serve as reference frames that define desirable and inappropriate behaviour and thereby help to facilitate market transactions.
- **Sharing and coordinating resources and expertise** – Partnerships that aim to benefit from complementary resources, competencies, assets and networks of different partners and/or to coordinate contributions to particular development projects. The strategic allocation and sharing of funding, information, knowledge and technology is often of particular importance in such partnerships.
- **Harnessing markets for development** – Partnerships created for the purpose of supporting the development and expansion of sustainable markets at a local,

regional and global level. Such partnerships can either help provide access to markets (such as producer networks) or help to bridge or deepen markets (for example by providing incentives for business to invest in and/or build linkages between large and small companies).

Each of these different types of partnership have great relevance for promoting more competitive and responsible small enterprises and in particular for achieving the following goals outlined in Part III of this report:

- **Improving access to the basics**, especially ensuring better access to different types of finance, skills, knowledge, and legal rights;
- **Integrating, innovating and upgrading into value chains**, especially building linkages between large and small companies and integrating into regional and global value chains;
- **Implementing responsible business practices**, in areas such as ethics, the environment, consumer safety, and working conditions, especially health and safety.

There are market failures, governance gaps and/or institutional constraints that make it difficult, and in some cases impossible, for even the most creative, innovative and risk-taking 'opportunity entrepreneurs' to succeed. It is ever more difficult for the millions of 'necessity entrepreneurs' – men, women and youth who are self-employed because they have no other alternative to meeting the basic needs of their families.

In all three of the above areas there are market failures, governance gaps, information asymmetries and/or institutional constraints that make it difficult, and in some cases impossible, for even the most creative, innovative and risk-taking 'opportunity entrepreneurs' to succeed. It is even more difficult for the millions of 'necessity entrepreneurs' – men, women and youth who are self-employed because they have no other alternative to meeting the basic needs of their families.

As outlined in Part IV, policy reforms and interventions undertaken by governments and supported by donors can make a vital contribution in each of these areas. A growing number of such measures are underway, but the process is often slow, challenging and long-term. Neither policy reform nor public sector funding, however, are sufficient by themselves to solve all these challenges. Nor can markets solve these challenges alone. There are too many public goods issues and market externalities involved for fully market-driven solutions.

In short, government policies and markets are both essential, but insufficient given the urgency and scope of the challenges. They can both be enhanced and supplemented by hybrid models – new types of public-private or multi-sector partnership, collective corporate action, and intermediary organisations. These cannot and should not replace efforts that are either 100 percent market-driven or 100 percent public sector-driven, but in many cases they can play a valuable bridging or intermediary role in addressing some of the major constraints to competitive and responsible entrepreneurship.

## Revisiting the 'case for partnership'

Part II of the report reviewed the general case for new types of partnership between government, business and civil society. It argued that such alliances play a role in helping to overcome market failures, governance gaps and institutional constraints and in supporting both development and business objectives through facilitating:

- Improved Effectiveness – greater leverage, scale and systemic impact;
- Greater Efficiency – minimising duplication and optimising resource use;
- Increased Legitimacy – greater participation, consultation and accountability.

In the more specific case of alliances to support small enterprise development and in particular to build linkages between large and small companies, it is possible to identify a number of core obstacles or barriers that such alliances can help to overcome.

Research carried out by the Ascend Group, for the Canadian International Development Agency (CIDA) and UNDP, for example, reviewed hundreds of small enterprise projects around the globe and identified three particular market failures, costs or constraints that make linkages between large and small companies difficult and that new types of partnerships or intermediaries can help to overcome:<sup>2</sup>

First, *helping prospective business partners to overcome risk* – both real and perceived. Ascend makes the case that, “Perceived risks to larger firms may emerge out of a lack of familiarity with a region, its business environment and culture, but real risks also exist due to SME gaps in, for example, reliability, or quality control, as well as poor regulatory environments, including dispute-resolution mechanisms. Risks, both real and perceived among small enterprises looking to partner with others may be based on latent conflicts, mistrust, or simply lack of understanding of the potential benefits of collaboration.”<sup>3</sup>

Second, *overcoming SME isolation*. Small enterprises may be isolated from foreign and domestic markets, from each other, and from basic knowledge and information. Examples outlined in the CIDA-UNDP report include:

- *Isolation from markets* due to lack of knowledge about contract opportunities, lack of marketing channels in which to promote products and services, or lack of intermediaries to facilitate links;
- *Isolation from other entrepreneurs* for historical, geographic, ethnic reasons or due to lack of incentives for seeking out partners; and
- *Isolation from market information* due to lack of access to information technology, networks and other sources of information sharing.

Third, *cutting down transaction costs*. The CIDA/UNDP report points out that, “The commercial attractiveness of a business partnership may often be overridden by the investment costs to implement, particularly if these include capacity

building, or other small enterprise development investments. In many cases, public funds are sought to support these costs in order to make business partnerships or opportunities attractive.”<sup>4</sup>

These three rationales for business linkage programmes and new types of partnership and collective action are reinforced by the findings of a comprehensive eight-year programme supported by the Ford Foundation in the United States.<sup>5</sup> From 1995 to 2003, the Ford Foundation’s Corporate Involvement Initiative explored a wide variety of partnerships, market mechanisms and policy options to demonstrate how business and communities can collaborate to generate ‘win-win’ outcomes – creating competitive advantage for business and gains in income, assets and wealth for low-income people.

The initiative focused on the following four key areas of economic development:

- Financial Services: expanding opportunities to build financial assets
- Workforce Development: improving labour skills and earnings
- Enterprise Development: Supporting sustainable livelihoods
- Regional Economic Development: creating thriving and diverse communities.

The Ford Foundation invested over \$45 million in supporting some 50 intermediary organisations and partnerships active in tackling the above challenges, mainly but not exclusively in the United States. In addition to exploring models that work, the initiative identified the most important barriers that cause what it described as “poor alignment between profit-making market goals and asset-building outcomes for low-income individuals.”<sup>6</sup> The central barriers identified by all the participants included the following:

- **Information:** Misperceptions of risk of low-income people as consumers or employees; and lack of adequate information about low-income markets.
- **Production costs and pricing:** High costs for serving low-income markets due to low transaction sizes; high levels of industry concentration or outright monopolies; and the ability of businesses to externalise the social costs of their activities.
- **Consumption preferences:** Lack of market mechanisms to integrate preferences of firm stakeholders; low business interest in the low-income market segment because of low purchasing power.
- **Organisation culture:** cultural biases and prejudices toward low-income and minority communities.
- **Market environment:** poor business operating conditions such as political instability, lack of infrastructure and poor factors of production.

The initiative concluded that the ability to mobilise business networks, build effective partnerships, and engage a variety of different stakeholders were among some of the key success factors in initiatives aimed at overcoming the above barriers.

There are strong arguments for large companies, governments, NGOs, research institutes, and small enterprises themselves, to form or support new types of alliance that aim to overcome obstacles to competitive and responsible enterprise development. A growing number of such alliances exist. Some are multi-sector in nature, while others are alliances between groups of companies. Some are industry sector-based; others are location-focused – local, national, regional or global. Some focus on addressing a particular ‘gap’, such as access to financing, or access to information and knowledge. Others combine these services. Some operate at a more systemic level, aiming to influence the broader enabling environment.

Research by practitioner organisations such as UNIDO, UNDP, the World Business Council for Sustainable Development, International Business Leaders Forum, AccountAbility, USAID’s Global Development Alliance and others corroborates the findings of these two research projects – new types of alliance between large companies, small enterprises, governments, donor agencies, NGOs and research institutes can play an important role in helping to overcome some of the major obstacles and barriers to competitive and responsible entrepreneurship.

A growing number of such alliances exist. Some are multi-sectoral in nature, while others are alliances between groups of companies. Some are industry sector-based, others are location-focused – local, national, regional or global. Some focus on addressing a particular obstacle or barrier, such as access to financing, or access to information and training. Others combine these services to address several barriers in a more integrated manner. Some are operational in nature while others focus on advocacy. A growing number operate at a systemic level, aiming to influence the broader enabling environment – either public policies, institutions or market frameworks – while many are focused on the practicalities of implementing business solutions and building business linkages on-the-ground.

Many of these emerging alliances are still new and experimental. As such, it is early to assess their overall impact and effectiveness on enterprise development and on development more generally, although a growing body of anecdotal evidence exists. There is also relatively little empirical evidence of what works and what does not work in terms of the governance structures and operational modalities of such alliances. Despite the lack of existing empirical evidence and longitudinal analysis of their efficacy and impact, these emerging models offer a new set of tools that are worth serious consideration by developing country governments, donor agencies, companies, NGOs and research institutes that are operating in developing countries.

The following pages illustrate **six key models of multi-sector partnership or collective corporate action** that harness a combination of market-driven and public policy approaches to support more competitive and responsible small enterprise development. They are summarised in Figure 11:

- 1 Individual corporate value chains and ‘hybrid’ business models
- 2 Collective business linkage initiatives
- 3 Enhanced trade and industry associations
- 4 ‘Blended value’ financing mechanisms
- 5 Institutionalised enterprise support services
- 6 Multi-stakeholder public policy structures.

All six models are positioned on a spectrum between purely commercial business-to-business (B2B) linkages and fully government-funded services. They are not mutually exclusive. Indeed, they should be viewed as inter-related components of a dynamic enterprise ecosystem, all of them contributing to the expansion of more sustainable and equitable patterns of economic growth.

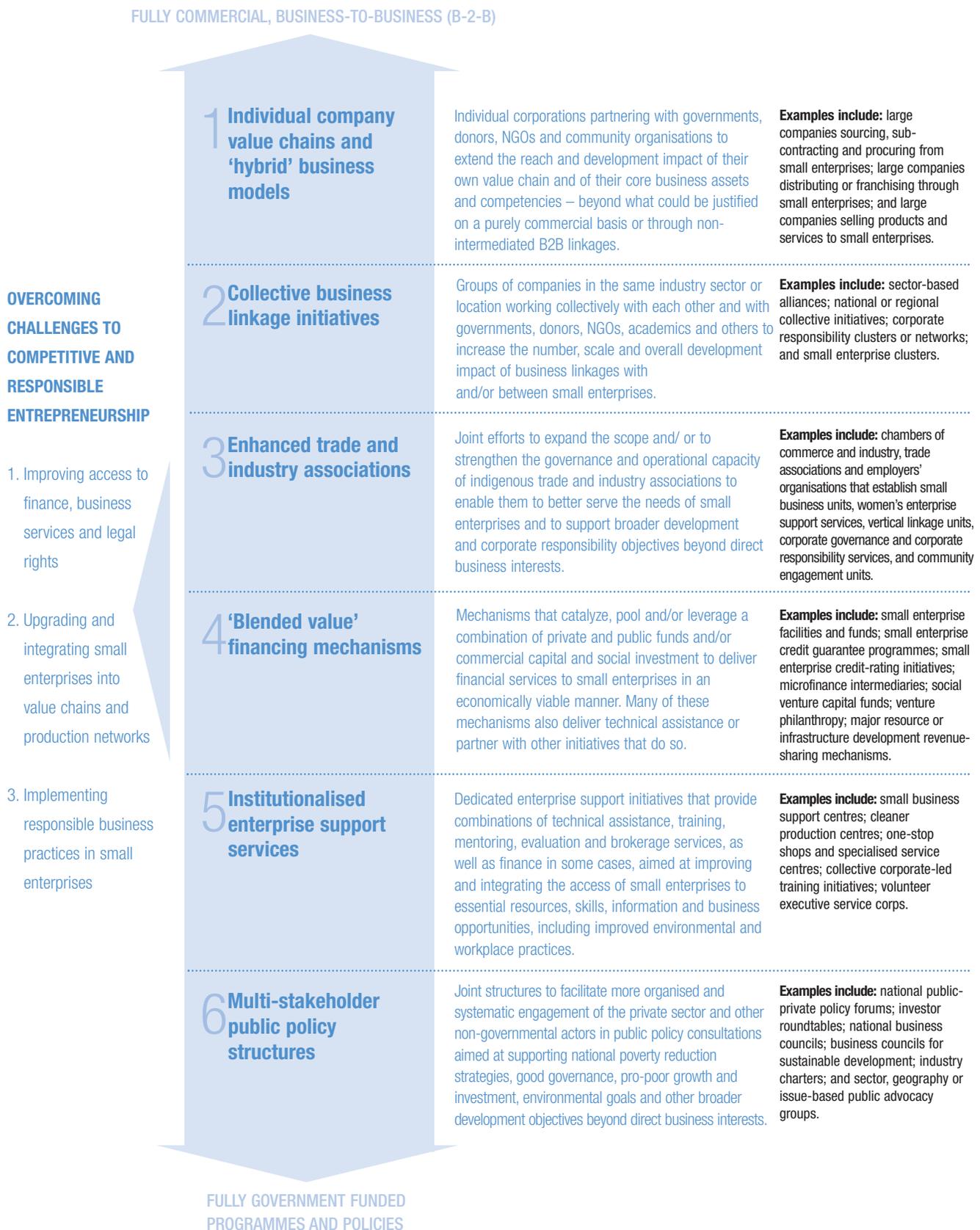
Some of these partnerships are driven by the private sector, others initiated by NGOs, donors and government bodies – but they share two common characteristics. First, they harness a combination of private and public resources or commercial and philanthropic funding. Second, they pursue a combination of direct economic self-interest and broader development objectives. They illustrate new models of doing business that focus on both profitability and achieving broader development goals. In some cases they illustrate new models of governance and policy-making that emphasise greater participation from the private sector and civil society organisations.

The first two models of partnership and collective action are the most market-driven. They focus on building direct business linkages between large companies and small enterprises that explicitly and systematically aim – in addition to being profitable – to transfer competitive and responsible business practices along corporate value chains and to optimise the development impacts of any ‘spill-over effects’ of these value chains and linkages between large and small enterprises.

The next three models of partnership and collective corporate action focus primarily on delivering essential products and services directly to small enterprises – in particular finance, skills and information. In most cases they employ both private and public resources and they pursue both commercial and social objectives. The relative balances vary from case to case, often driven by the nature of the initiating organisation or managing partner.

The sixth and final model is focused on influencing the broader enabling environment in which competitive and responsible small enterprises can flourish.

**FIGURE 11: MULTI-SECTOR PARTNERSHIP AND COLLECTIVE ACTION MODELS TO SUPPORT COMPETITIVE AND RESPONSIBLE ENTREPRENEURSHIP**



## The role of intermediary organisations or partnership brokers

Prior to analysing the different models of partnership and collective action, it is useful to look at the important role that intermediary organisations are playing in helping to broker, facilitate and in many cases manage and sustain such partnerships. As outlined in Part II, establishing and sustaining alliances between non-traditional allies is not easy. There are both operational or management challenges and strategic or policy-related dilemmas associated with building such alliances, especially those that achieve large-scale impact and influence and reach many different stakeholders.

### Operational challenges

There are often high transaction costs and operational or reputation risks associated with bringing together different types of organisations with diverse missions, perspectives and *modus operandi*, and sometimes mistrust and hostility towards each other. A 2001 study undertaken by the United Nations on partnerships with business concluded, “By their very nature, partnerships between the United Nations and the private sector bring together actors that have different interests, incentives and timeframes, offer different types and levels of resources and competencies, and look for different outcomes and benefits. These differences are not necessarily obstacles to reaching agreement on common goals and objectives. [In fact] it is the differences that actually add value to the process of joint problem solving. These differences do, however, have to be acknowledged and managed.”<sup>7</sup>

There are also operational challenges in terms of undertaking due diligence and analysis of potential partners, communicating progress and problems both internally and externally, adapting to changing circumstances, managing expectations, developing exit strategies and building the necessary skills and capacities of employees to enable them to be effective in working with non-traditional partners.

### Strategic challenges

In the case of large-scale and influential partnerships there may also be questions associated with the governance and accountability of the alliance. The United Nations study on partnerships stated, “the question of accountability is one of the most complex challenges associated with building cooperative cross-sector relationships, especially those that are not legally binding. Accountability can be viewed in terms of delivering on commitments made by different participants in a particular partnership and in terms of representation of and responsiveness to different stakeholder groups affected by a particular partnership.”<sup>8</sup> Rigorous governance mechanisms and processes for communication, reporting and stakeholder engagement need to be established to address these challenges.

In the case of alliances between private companies and public sector bodies, be they government agencies or bilateral and multilateral development bodies, there is also

the challenge of ensuring that these individual companies do not receive unfair advantage relative to their competitors or do not gain undue influence on political and policy processes relative to other private sector actors. Conversely, there is the challenge of ensuring that business or NGO-led alliances don't substitute for, replicate, or undermine the roles and responsibilities of government, for example by hiring away the best public sector officials at higher salaries or by enabling governments to abrogate key duties to their citizens.

These operational and strategic challenges are not insurmountable and are likely to be worth tackling when weighed against the potential benefits of effective partnerships – but they do need to be addressed in a realistic and transparent manner. Intermediary organisations or individuals who play a brokerage or facilitation role can be essential in ensuring that these challenges don't undermine the potential benefits of non-traditional alliances between business, government, and civil society organisations or between companies that are normally competitors.

In the specific case of business linkages to support small enterprise development, the Ascend Group's research for UNDP and CIDA describes, "brokerage roles that range from a light-touch approach through to a heavy-touch approach. The broker can simply be a central information resource (e.g. product database), or it could create channels through which these enterprises could communicate (e.g. connecting networks, holding conventions), or it could convene parties to examine common issues and build partnerships, or it could link enterprises directly in line with specific market or contract opportunities. The broker's role can also include identifying opportunities, and providing or ensuring access to the provision of services associated with small enterprise development."<sup>9</sup>

Third-party organisations have played an essential role in facilitating or brokering either direct commercial links – both supply chain and distribution linkages – and more general corporate support for small enterprises. Such facilitative partners include special units of development agencies or government departments, business associations, specialist NGOs and private sector facilitators.

Research undertaken by Deloitte for UNIDO, UNDP and the UN Global Compact, also highlights the important role of what the researchers describe as 'facilitative partners'.<sup>10</sup> Focused on identifying innovative partnership approaches by large corporations to support small and medium enterprises, the research identifies many cases where third-party organisations have played an essential role in facilitating or brokering either direct commercial links – both supply chain and distribution linkages – and more general corporate support for small enterprises. Such facilitative partners include special units of development agencies or government departments, business associations, specialist NGOs and private sector facilitators.

The International Business Leaders Forum and the UK-based Overseas Development Institute offer a professional Partnership Brokers Accreditation Scheme targeted at building the skills of individuals. They define a partnership broker as, "a 'go-between'. He or she acts as an intermediary within or between different parties in an active rather than passive manner, guiding a partnering process, interpreting one party to another or negotiating some kind of agreement. A partnership broker inspires others to work together, building collaboration

between partners, encouraging the adoption of behaviours that enable the partnership to function effectively, and developing or protecting the principles and vision of the partnership.”<sup>11</sup>

The programme identifies two main categories of broker:

- **Internal brokers** – Individuals from or working for an organisation who take on the role of preparing their organisation for working in multi-sector partnerships, negotiating their organisation’s involvement in a partnership, and/or playing a key role in maintaining a partnership arrangement, tracking performance or securing mutual benefits.
- **External brokers** – Independent third parties contracted to plan or facilitate consultation or negotiations to develop a partnering arrangement, and/or to research, maintain, monitor, review or evaluate partnerships over time.

Many of the new partnership mechanisms and alliances described in the following pages have benefited from the work of such individual brokers, facilitative partners or intermediary organisations. In different ways they have played a crucial role in researching, designing, brokering, evaluating and scaling-up business linkage initiatives and general support programmes for small enterprises. Some of the intermediary organisations or partnership building programmes that have played a key role in the area of building business linkages and promoting competitive and responsible entrepreneurship are listed in Box 20.

#### BOX 20: EXAMPLES OF PARTNERSHIP PROGRAMMES, FACILITATORS AND INTERMEDIARY ORGANISATIONS

Type of intermediary organisation	Examples of partnership facilitators focused on supporting socially and environmentally responsible entrepreneurship, building responsible business linkages between large corporations and small enterprises, and supporting pro-poor business models	
Multilateral development agencies	<ul style="list-style-type: none"> <li>• UNIDO’s Business Partnerships programme</li> <li>• UNCTAD’s Business Linkages programme</li> <li>• International Finance Corporations (IFC’s) Business Linkages programme and Grassroots Business Initiative</li> </ul>	<ul style="list-style-type: none"> <li>• World Bank Institute’s programme on Implementing Environmental and Social Accountability in SMEs</li> <li>• UNDP’s Growing Sustainable Business initiative</li> <li>• UNIDO and UNEP’s Cleaner Production Centres</li> </ul>
Bilateral development agencies	<ul style="list-style-type: none"> <li>• USAID’s Global Development Alliance</li> <li>• GTZ’s Public-Private Partnership programme</li> <li>• DFID’s Business Linkages Challenge Fund</li> </ul>	
Non-governmental organisations	<ul style="list-style-type: none"> <li>• TechnoServe</li> <li>• Endeavor</li> <li>• Youth Business International</li> </ul>	<ul style="list-style-type: none"> <li>• Kickstart</li> <li>• Ashoka</li> <li>• Enablis</li> </ul>
Business association or networks	<ul style="list-style-type: none"> <li>• International Business Leaders Forum</li> <li>• World Business Council for Sustainable Development</li> <li>• Global, regional and national chambers of commerce</li> </ul>	<ul style="list-style-type: none"> <li>• Small enterprise representative associations</li> <li>• National corporate responsibility networks</li> </ul>
Private sector consultancies and facilitators	<ul style="list-style-type: none"> <li>• Accenture Development Partners</li> <li>• Deloitte’s Business Equity Initiative</li> <li>• Dalberg Global Development Advisers</li> </ul>	<ul style="list-style-type: none"> <li>• A growing number of other specialist, for-profit enterprises</li> </ul>
Academic Institutions	<ul style="list-style-type: none"> <li>• Copenhagen Business School</li> <li>• Catholic University of Valparaíso, Chile – Corporate Social Leadership Centre</li> </ul>	<ul style="list-style-type: none"> <li>• University of Cape Town, South Africa – Entrepreneurship Institute</li> </ul>

## PARTNERSHIP MODEL #1:

### Individual company value chains and 'hybrid' business models

TYPE OF PARTNERSHIP OR COLLECTIVE ACTION MODEL	EXAMPLES
Individual corporations partnering with governments, donors, NGOs and community organisations to extend the reach and development impact of their own value chain and of their core business assets and competencies – beyond what could be justified on a purely commercial basis or through non-intermediated, direct business-to-business (B2B) linkages, by investing in development orientated joint ventures and 'hybrid' business models that combine core corporate competencies and assets with social investment and philanthropy, or private sector assets with public funds or NGO assets.	<ul style="list-style-type: none"><li>■ Large companies sourcing, sub-contracting and procuring from small enterprises</li><li>■ Large companies distributing or franchising through small enterprises</li><li>■ Large companies selling products and services to small enterprises</li></ul>

The UN estimates that the number of multinational corporations increased from 37,000 in 1990 to over 60,000 in 2001, with the number of their foreign affiliates growing from 170,000 to over 800,000 in the same period, in addition to millions of suppliers and distributors operating along their value chains. The potential economic multiplier effect of these global, national and local value chains is large and relatively untapped, ranging from job creation and income generation to technology transfer and the spread of competitive and responsible business practices and standards. The different opportunities for linkages between large and small enterprises along these value chains were listed on pages 71 to 74 and pages 86 to 93, as were some of the key benefits of such linkages.

While it is possible to develop many business linkages between large individual corporations and small enterprises on a purely commercial basis, thousands if not millions of additional linkages could be developed or enhanced by partnerships that leverage core corporate assets and activities with combinations of either private philanthropic funds (individuals, private foundations or corporate foundations); social investment and social venture capital funds; donor funding (bilateral and multilateral donors); and/or technical support from NGOs, academic institutions and development experts. Such alliances of funds, other assets and competencies can help to increase the 'spill-over' development benefits and opportunities for small enterprises in each of the following types of business linkage:

- Large companies sourcing, sub-contracting and procuring *from* small enterprises
- Large companies distributing or franchising *through* small enterprises
- Large companies selling products and services *to* small enterprises

A growing number of research studies and case studies have been undertaken to describe and analyse the development impacts of such business linkage initiatives along individual company value chains. Figure 12 illustrates a small number of examples. Although they involve very different industry sectors and different combinations of commercial and philanthropic funds, or public and private resources they all share the common characteristics of widening the development

impact or spill-over benefits of a major corporate value chain and helping to increase the number, capacity and quality of small enterprises operating along this value chain.

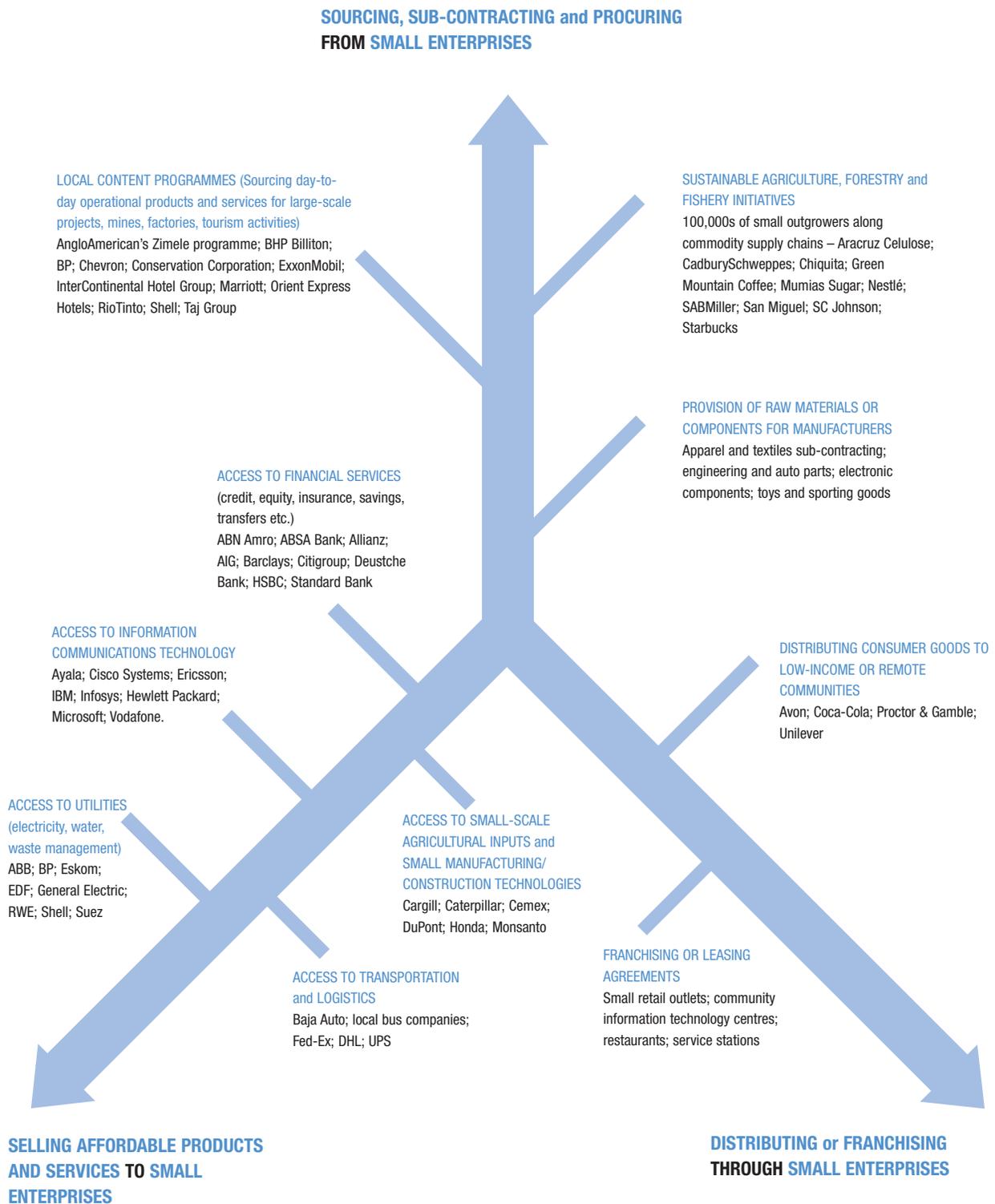
The opportunity and challenge of optimising the economic spill-over and development benefits of individual corporate value chains is well summarised by a joint three-year study undertaken from 2003-2005 by Unilever, Oxfam Great Britain and Indonesia, and Novib, which explored the links between international business and poverty reduction using Unilever in Indonesia as a case study. The researchers concluded:

*“Perhaps the most significant insight of this research was the importance of taking into consideration the overall value chain of a company, the cash-value distribution, and jobs supported within it, when exploring poverty impacts. ... Participants at either end of the value chain are predominantly large numbers of small-scale producers and retailers. For them Unilever Indonesia’s value chain provides an opportunity to participate in the formal economy, gaining skills and experience while supplementing and diversifying their incomes.*

*However, participation in such value chains does not automatically guarantee improvements in the lives of people living in poverty. For supply and distribution chains to benefit poor people even more, there need to be other social institutions and resources in place, such as credit and saving schemes, marketing associations, and insurance schemes, as well as diversification of income streams to reduce dependency on any single company or market. Understanding and responding to this analysis represents an opportunity for companies, governments and civil society organisations to explore how to distribute benefits further in each direction along the value chain, particularly to the poorest people who are working at the very ends of it.”<sup>12</sup>*

New types of partnership are often necessary to extend the development benefits of individual value chains beyond what a particular company can justify or achieve through its own resources. Intermediary organisations can play an important role in facilitating these linkages in a way that makes both business sense for the individual corporation and has development impact for the small enterprises along its value chain and beyond. The following pages illustrate innovative intermediary models – all of them relatively new – from both government agencies and NGOs.

**FIGURE 12: OPPORTUNITIES FOR EXTENDING THE DEVELOPMENT IMPACT AND SUPPORTING SMALL ENTERPRISES ALONG CORPORATE VALUE CHAINS**



SOURCES: Adapted from *Business as Partners in Development* (IBLF, UNDP, World Bank, 1996); *Building Competitiveness and Communities* (IBLF, UNDP, World Bank, 1998); *The Business of Enterprise* (IBLF, 2001); *Business for Development* (WBCSD, 2005); and *Partnerships for Small Enterprise Development* (UNIDO, UN Global Compact and UNDP, 2004).

## IFC'S BUSINESS LINKAGES PROGRAMME

In 2003, the International Finance Corporation established a dedicated Business Linkages Programme. The programme provides technical assistance aimed at strengthening and increasing the number of small enterprises linked to individual IFC investment projects with the overall goals of bringing employment and other income generating opportunities to the local communities where these projects are located, while at the same time increasing local sourcing opportunities, reducing costs and risks, and enhancing the corporate responsibility of major IFC clients – mostly large corporations and joint ventures.

In particular, the Business Linkages programme focuses on:

- Improving the technical and business skills of local small enterprises in order to qualify them for contracts to generate new sources of income;
- Facilitating access to finance for local suppliers;
- Strengthen local supply and distribution networks; and
- Supporting community development projects such as health, education and infrastructure.

Between December 2004 and March 2006, the number of active linkage projects supported by the IFC more than doubled to 37 initiatives in 24 countries, linked to nearly \$2 billion in IFC investments. At the same time, the programme has leveraged almost three times as much from its clients, donors and other sources and co-funding by project sponsors (IFC's corporate clients) has grown from an average of 15% to average 50% per project. The programme is experimenting with different implementation models and starting to replicate some of them with different clients and or with the same client in different regions. Examples of projects include:

**Chad-Cameroon Pipeline – electronic procurement:** This initiative has resulted in the roll-out of a comprehensive local supplier programme in partnership with ExxonMobil, including the establishment of an Enterprise Centre in Chad, a one stop business development training service and an electronic procurement system and training programme enabling local suppliers to bid electronically and thereby ensuring greater fairness and less corruption in bidding processes.

**BTC pipeline, Azerbaijan – small enterprise linkages programme:** Working with the recently established BP Enterprise Centre in Baku, the IFC is increasing supply opportunities for small enterprises with BP and its partners and developing business opportunities outside energy. In particular, the programme is piloting an innovative supplier finance model

involving BP, the Microfinance Bank of Azerbaijan and local oil and gas suppliers. If successful the model, launched in July 2006, could be replicated in other large infrastructure and extractive sector projects.

**Orient Express Hotels – rural community outreach:** IFC is working with this tourism industry client to develop a comprehensive community outreach strategy, including sourcing food from local farmers and enabling local cultural groups to develop income-generating tourist activities.

**Mozal Aluminium Smelter, Mozambique – local supplier development:** Launched in 2002, this programme has been designed and implemented in partnership with BHP Billiton, IFC's Africa Project Development Facility and the Mozambican Investment Promotion Centre, with the goal of strengthening local business capacity and enabling small enterprises to compete for contracts at different stages of the Mozal's process, from construction to ongoing operations.

**Yanacocha Gold Mine, Peru – diversification and local economic development:** The IFC has worked with its client to build a more diversified and sustainable economic base extending beyond small enterprise linkages with the mine to opportunities in agribusiness, light industry and construction. It is now working with Newmont Mining to replicate some of the models and lessons learned to its activities in Ghana.

**POEMA project, Brazil – linking agro-producers to manufacturers:** The IFC worked with a Brazilian NGO and Daimler Chrysler to strengthen community-based agro-industries in Brazil and enable them to supply coconut fibres to the company for use in manufacturing car seats. The company has since replicated this approach in other countries.

## UNDP'S GROWING SUSTAINABLE BUSINESS (GSB) INITIATIVE

The GSB programme grew out of a UN Global Compact Policy Dialogue in February 2002 on 'business and sustainable development' and was officially launched at the World Summit on Sustainable Development in South Africa in September 2002.

The objective of the programme is: "To facilitate business-led enterprise solutions to poverty in advancement of the Millennium Development Goals." The programme works with large corporations along their value chains and is focused on identifying and implementing solutions that accelerate and sustain access by the poor to needed goods and services and/or employment and livelihood opportunities.

A network of UNDP staff, business advisers and partnership brokers work with individual corporations to:

- Identify business opportunities and partners
- Undertake market research
- Develop appropriate business models that combine both profitable or cost-recovery opportunities with development benefits and small enterprise linkages
- Bridge access to finance from both public and private sources and in the form of loans, equity and/or grants
- Support implementation through technical assistance and building the capacity of local partners
- Improve the enabling environment for the specific projects by working with governments to actively resolve barriers and support relevant policy reforms
- Undertake evaluation and monitoring with the goal of assessing both business and development impacts and learning lessons to support replication or scaling of good practices.

To-date, GSB has launched linkage initiatives in over ten countries including Tanzania, Madagascar, Ethiopia, Kenya, Zambia, El Salvador, Serbia and Montenegro, in partnership with some 20 companies from a variety of industry sectors, several other multi-sector or industry alliances and other UN and bilateral development agencies. Examples include:

### GSB in Tanzania

Launched in September 2003, GSB is working in Tanzania on projects such as:

**Rural telephony:** GSB has worked with Ericsson, Celtel, the Ministry of Communications and Transport and several donor agencies to undertake market research and a socio-economic impact study to identify a cost-effective business model for delivering telecommunications services to the rural poor.

**Sustainable agriculture:** GSB is also working with Unilever on a project to source indigenous AllanBlackia nuts from small-scale farmers as a substitute for palm oil in spreads and soap manufacturing, with the goal of building sustainable rural livelihoods and improving environmental conservation.

**Improved milk production and nutrition:** It is working with Tetra-Pak, local dairies, the Tanzania Investment Center, the Tanzania Dairy Board, and the Ministry of Livestock and Water to develop a more integrated approach to address constraints and introduce new safety and nutrition technologies along the milk value chain, from supply to processing, marketing and consumption, aimed not only at increasing the production and quality of local milk supplies and improving rural incomes, but also reducing malnutrition.

**Biomass energy:** Working with Holcim and Tanga Cement, GSB is developing a project with small-scale farmers and the cashew industry to develop biomass as a viable alternative fuel source for the company's cement production, aiming to cut both energy costs and the use of fossil fuels.

### GSB in Madagascar

Launched in November 2003, GSB's activities in this country include projects on eco-tourism, rural electrification, water and sanitation and the production of indigenous plants as inputs to anti-malarial treatments. It is working, for example, with EDF, RWE and Hydro Quebec, electricity companies that are all members of the E7-Fund (itself an innovative collective industry initiative to support sustainable development), to facilitate the provision of electricity infrastructure to serve rural communities, small enterprises, and social service providers in remote rural regions through the construction of a hydro-power plant and related distribution network composed of local small enterprises. In the country's capital, Antananarivo, GSB is working with Water and Sanitation for the Urban Poor (WASUP), itself a public-private sector alliance, UN Volunteers and others to improve access to affordable water and sanitation for over 100,000 urban poor.

## UNCTAD'S BUSINESS LINKAGES INITIATIVE

Established in 1964, UNCTAD's role is to promote the development-friendly integration of developing countries into the world economy. It carries out this mission by acting as a forum for intergovernmental deliberations aimed at consensus building, undertaking research, policy analysis and data collection, and providing technical assistance tailored to the specific requirements of developing countries.

UNCTAD has identified linkages between transnational corporations (TNCs) and small enterprises (SMEs) as potentially one of the fastest and most effective ways of upgrading and enhancing the competitiveness of domestic enterprises by increasing their access to international markets, finance, technology, management skills, and specialized knowledge. It has established a 'Business Linkages Programme' with the goal of creating and strengthening sustainable TNC-SME business linkages. Working closely with other UNCTAD programmes, such as the EMPRETEC network that provides capacity-building for SMEs in some 30 countries, the programme focuses on the following activities:

- Policy advice on improving the environment for sustainable business linkages
- Identification of specific business linkage opportunities
- Encouragement of TNCs to establish beneficial business linkages
- Assistance to upgrade SMEs in order to meet foreign affiliates' requirements
- Sharing of good practices in sustainable business linkages.

A key element of this programme have been the analysis and sharing of lessons from existing business linkage initiatives through a combination of field-based research, surveys, workshops, and development of good practice guidelines, case studies, tools and training materials. At the same time, UNCTAD has worked in partnership with other donors, developing country governments, chambers of commerce, NGOs and large corporations to implement new business linkages programmes in several countries.

### Business Linkages – Brazil

In Brazil, UNCTAD has joined forces with GTZ, Instituto Ethos, and Fundacao Dom Cabral to develop a new concept for promoting business linkages with financial and operational support from the Government of Germany. A key element of the initiative has been the active and strategic engagement of major corporations at senior executive levels through a combination of consultations, other shared learning opportunities, and specific

cooperation agreements. These corporations have been able to share good practices directly with each other in the area of supplier development, and at the same time they are supporting institution building for small enterprise support services, and engaging in dialogues on the most effective public policies for enabling more business linkages.

### Business Linkages – Uganda

In Uganda, UNCTAD is working with Enterprise Uganda, which hosts the country's EMPRETEC Centre, in collaboration with the Uganda Investment Authority (UIA), UNDP and the Government of Sweden on an initiative to durable business linkages between large foreign and domestic companies and small enterprises. Enterprise Uganda and EMPRETEC are responsible for identifying small enterprises, assessing and helping to address their capacity gaps, and brokering and implementing specific business linkage deals with larger corporations. The UIA contributes to improving the business policy environment and also helps to identify and broker links with major corporations, and UNCTAD provides technical expertise and helps to analyse and share lessons learned.

Similar country-level initiatives are being explored in other countries and offer useful models of a more systemic collective approach to supporting business linkage efforts, bringing together key stakeholders from the private sector, host governments, donors, and intermediary institutions.

## USAID'S GLOBAL DEVELOPMENT ALLIANCE

In May 2001, the United States Agency for International Development (USAID) established a new unit to work directly with corporations, foundations, the faith-based community, indigenous organisations and other non-traditional partners in order to better harness diverse resources and perspectives to enable it to fulfil its development objectives. In less than five years, the GDA has conceived, developed and implemented over 400 new alliances between public, private and civil society organisations and leveraged about four dollars in resources from its partners for every one dollar committed by USAID itself.

GDA's former Director, Daniel Runde points out, "...not all partner resources come in cash. New technologies, intellectual capital, market presence, and business expertise are equally as important in addressing the development problems we face today. The comparative advantage that USAID brings to partnerships include our development expertise, convening and coordinating authority, financial resources, and global presence in more than 80 country and regional missions. ...Whether you work to generate shareholder value or advance a social mission, we can and must work together to achieve more robust and sustainable development outcomes."<sup>13</sup>

GDA represents a useful model for any donor agency or major foundation on the value of having a dedicated unit that serves as both an innovator and partnership broker, in addition to providing funds, technical assistance and evaluation of development projects. Among its innovations, the GDA has created a dedicated funding instrument – the Collaborative Agreement – to facilitate partnership arrangements. Runde also emphasises the fact that the GDA model represents, "... a shift in the way USAID executes its foreign assistance mandate. For its entire history, USAID has acted either as a direct donor or through a client-vendor relationship with organisations that carry out projects defined by USAID. With the advent of GDA, however, USAID welcomes companies and NGOs as equals in the development project."<sup>14</sup>

Partnerships with companies and other actors cover a wide range of geographies, industry sectors and development challenges and a large number of them have a local income generation and wealth creation element in the countries and communities where they are implemented. This ranges from microfinance alliances to comprehensive supply chain initiatives aimed at creating sustainable livelihoods, raising social and environmental standards and building trade along

commodity value chains such as coffee, cocoa, sugar, forest products, diamonds, and along apparel and textile value chains.

Two examples of innovative and potentially replicable or scalable alliances that GDA has played a leadership role in designing and implementing are as follows:

### Angola's Enterprise Development Alliance

Chevron is one of America's largest investors in Africa and has a long-standing presence in Angola, one of the continent's most resource-blessed and yet conflict-torn countries. The company has a strong tradition of building partnerships and sees these as a hallmark of its success in a capital-intensive, technology-driven business that must often operate in difficult conditions. In November 2002, GDA worked with the company, the UN and the Government of Angola to create a ground-breaking public-private alliance aimed helping Angola restart its economy after years of civil war by investing in education, vocational training, agribusiness development, and locally-owned micro, small and medium-sized business development. Funding is currently set at \$25 million from Chevron, to be matched by \$25 million from other donors. To date the project has provided agricultural and livelihood development services to over 80,000 people, created a development bank, NovoBanco that has given loans to over 800 small businesses, and supported nutrition and HIV Aids training to some 775,000 people.

### Remittances for Economic Growth Alliance

Over the past decade remittances made by immigrants or migrant labour to their families in developing countries have become recognised as an increasingly important and high-potential source of funds to reduce poverty, fund essential health and education needs, and support enterprise development. Yet, it is often expensive and/or difficult to send personal remittances through the banking system and at the other end, it is equally expensive and/or difficult for the poor to access and use financial services. To address this challenge, with an initial focus on Mexico, USAID has joined forces with the World Council of Credit Unions, Mexico's credit union network, the California Credit Union League, and the Texas Credit Union System to lower the costs of personal remittances and improve access to financial services. In a one year period from mid-2003 to mid-2004, over 25,000 remittance transfers were sent through the alliance totalling nearly \$11 million, transaction costs were reduced, and some 92 percent of the recipients in Mexico were women.

## GTZ'S PUBLIC-PRIVATE PARTNERSHIP PROGRAMME

In 1999 the German Federal Ministry for Economic Cooperation and Development (BMZ) established a special fund to support a Public-Private Partnership (PPP) programme. Managed by the Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ), the programme has mobilized over 350 PPPs in a variety of countries and mobilised more than 100 million Euros in private contributions. The cooperation strategy is based on several clear criteria relating to:

- **Complementarity** – public and private contributions must complement each other and achieve their objectives at a lower cost, more effectively or more quickly as a result of the cooperation.
- **Subsidiarity** – partnership is only possible if the private partner can demonstrate that it would not take the measure without the public funds and that the measure is not required by law.
- **Fair Competition** – the GTZ must be open to cooperation with all firms without any restrictions. Information on all PPPs must be made public, and the selection process must be transparent.
- **Contribution of the private sector** – the firm must make substantial financial, human resources and/or in-kind contributions to the PPP that go beyond the core business interests of the firm and serve general interests.

A large number of the PPPs that have been implemented through this programme have a small enterprise development component and/or serve to spread responsible business practices along global supply chains. There tend to be three main types of private partner categories;

- Companies that are involved mainly in trade and retail and who source manufactured products or commodities in GTZ's partner countries and who need suppliers that are able to upgrade when it comes to processing and packaging, and who need to ensure high quality social and environmental standards;
- Companies that are involved in technology transfer that are looking for new markets for their technology, machinery and equipment and need to identify identify local business partners, service providers and training facilities, raise awareness of their products and train local workers; and

- companies that are producing or offering services locally in developing countries and who need qualified personnel and service providers, a sound enabling environment and supportive institutions such as local business associations.

Based on these business needs and the development challenges that underpin them, PPPs developed through the programme range from joint efforts to upgrade training facilities and strengthen local distribution networks in developing countries, to projects aimed at helping small-scale farmers, aquaculture producers, and manufacturers to improve the quality, labour and environmental standards of their operations.

Examples include the following:

### Social standards in the garment industry

GTZ has worked with the German Retailer Association (AVE) to implement a programme aimed at improving working conditions in the factories that supply to AVE members. It has also supported country-level public-private dialogue structures to improve the overall framework conditions for social standards.

### Organic Aquaculture

GTZ is working with a major German fish importer and a German Association for Organic Food to help establish standards for organic catfish production and to help pilot fish farms to improve their production methods both in terms of productivity and quality, and environmental standards.

### Global coffee standards

GTZ is working with other donors, the major coffee producing countries, traders, roasters and NGOs to develop minimum quality, environmental and social standards that can be implemented throughout the global coffee value chain.

## TECHNOSERVE

Established in 1968 by an American businessman to provide technology to the rural poor in developing countries to improve their productivity, TechnoServe have evolved in recent years into a market-driven, business-oriented NGO with the mission: To help entrepreneurial men and women in poor rural areas of the developing world to build businesses that create income, opportunity and economic growth for their families, their communities and their countries. Today TechnoServe works with a large number of major corporations, development agencies, foundations, NGOs and government bodies in Africa and Latin America to identify and work with entrepreneurs who have the potential to raise productivity, employ the latest relevant technology, produce high-value products for local or export markets, integrate into corporate value chains, and significantly raise jobs and incomes in a manner that has a positive impact on poverty. At the heart of its strategy is a commitment to pro-poor growth.

The organisation employs a variety of staff with business, consulting and agricultural expertise, over 90 percent of whom are citizens of the countries in which it works. They work in partnership with companies and other groups to achieve the following goals:

- Help to identify, build or strengthen businesses that will be competitive in a global economy – ranging from individual entrepreneurs to small business clusters to large local companies.
- Help entrepreneurs to identify unmet market demand,

uncover high-value products and business opportunities and produce to the quality and standards necessary to serve customer needs, using the Internet and sophisticated marketing research and technologies where possible.

- Encourage and mentor emerging entrepreneurs through activities such as school-based enterprise education and the high-profile competitions for business plans.
- Deliver world-class advice and support to entrepreneurs to enable them to build the necessary managerial capacity, business acumen and market insights, including advisers from some of the world's leading consultancy and marketing firms such as McKinsey & Company, Bain & Company, Ernst & Young, Morgan Stanley and Young and Rubican.
- Strengthen the leadership skills of the entrepreneurs so that they can engage proactively and constructively in public policy dialogues, serve as a voice for local business and take a lead on issues of corporate responsibility. To this end, TechnoServe is working with the Aspen Institute and others to support leadership development programmes in Africa and Latin America.

The organisation is now active in a variety of agri-business projects, ranging from traditional food commodities to new initiatives such as biofuels and the production of Artemisia, used to tackle malaria. It uses a robust evaluation system and is starting to replicate successful programmes in different countries and engage with new industries.

## ASHOKA and KICKSTART

Two other innovative NGOs that are working proactively and strategically with major corporations to build competitive and responsible small enterprises along global and national value chains are Ashoka and KickStart.<sup>15</sup> Although they have very different origins, they are both led by social entrepreneurs who combine innovative and market-driven approaches to solving complex social problems, who focus on building the capacity and influence of local entrepreneurs and change-makers in developing countries, and who are increasingly working in partnership with large companies.

Founded in 1980 by Bill Drayton, **Ashoka** has pioneered the concept of social entrepreneurship and supported hundreds of such entrepreneurs around the world. In recent years it has developed an approach that it calls the Hybrid Value Chain™

(see page 72) through which it links with major corporations such as Cemex to develop new business models and partnerships aimed at delivering affordable products and services to the poor and creating sustainable local livelihoods in low-income communities.

**KickStart** was founded in 1991 by two agronomists, Nick Moon and Martin Fisher, with the aim of developing and mass-marketing low-cost but reliable and efficient capital equipment to rural entrepreneurs enabling them to increase productivity and profitability. To date it has helped to create nearly 40,000 new small enterprises in Africa and is working increasingly with major corporations such as SC Johnson and John Deere to scale up its activities and support more small enterprises.

## PARTNERSHIP MODEL #2:

### Collective business linkage initiatives

TYPE OF PARTNERSHIP OR COLLECTIVE ACTION MODEL	EXAMPLES
Groups of companies in the same industry sector or location working collectively with each other and with governments, donors, NGOs, academics and others to increase the number, scale and overall development impact of business linkages with and/or between small enterprises.	<ul style="list-style-type: none"><li>■ Sector-based alliances</li><li>■ National or regional collective initiatives</li><li>■ Corporate responsibility clusters or networks</li><li>■ Small enterprise clusters</li></ul>

A growing trend over the past decade has been the emergence of collective action by large companies to address complex social, economic and environmental challenges that are beyond the capacity of any individual company to tackle on its own. A number of these new initiatives are focused either explicitly on supporting small enterprise development and spreading responsible business practices along value chains, or have these outcomes as one of a number of broader objectives.

In some cases collective corporate action is taking place amongst major competitors on an industry-sector basis. In others they are geographic or issue-based, bringing together companies from different industry sectors in the same location or around a common challenge such as responsible trade, improving access to clean energy, or spreading labour standards. The rationale for such business-led alliances includes the opportunity to:

- Achieve greater leverage and influence than individual companies can gain on their own through their individual resources and relationships;
- Share risks and burdens and create a more level-playing field;
- Learn from each other what works and what doesn't;
- Increase legitimacy, especially when such alliances are engaged in public policy dialogue and shaping rules and standards; and
- Take a leadership role to shape an emerging market opportunity or risk.

Although not the focus of this report, small enterprise clusters and networks represent another important and growing form of collective action by private enterprises that can not only improve competitiveness, productivity and quality, but also support the spread of responsible business practices amongst small enterprises. UNIDO's Cluster and Network Development Programme supports the design, implementation, evaluation and replication of such clusters and networks through technical cooperation and research.<sup>16</sup>

The following pages offer a range of examples of collective business linkage initiatives led by large companies, most of them focused on a particular industry sector, issue or location.

## INTERNATIONAL TOURISM PARTNERSHIP

Travel and tourism is one of the world's largest industries, responsible for some 200 million jobs, over 10% of global GDP and with high, and most cases untapped potential in many developing economies. According to the Overseas Development Institute (ODI), "There is great debate over the extent of linkages in the tourist sector. Tourism is praised as a pro-poor growth sector that offers opportunities to small, medium and micro enterprises, while also condemned for the leakages that leave most of the tourist dollars in the hands of firms far away from the destination."<sup>17</sup>

ODI identifies the following five types of linkages that can help to generate more local jobs, small enterprises and economic impact while supporting the commercial objectives of major travel and tourism companies:<sup>18</sup>

- Boosting procurement from local enterprise
- Increasing recruitment, training and progression of local staff
- Engaging in partnerships with neighbouring communities, including legal, equity-based joint venture partnerships and operational agreements
- Supporting local cultural and heritage projects and excursions, led by small enterprise operators
- Encouraging tourism expenditure in the local economy beyond the immediate facility, for example in local restaurants, retail outlets and charities.

One example of collective action within the tourism industry to address these issues, which is not a traditional trade and industry association, is the International Tourism Partnership (ITP). ITP works with some of the world's leading companies such as American Express, Hilton, Carlson Hotels, Rezidor SAS, InterContinental Hotel Group, Starwood, Four Seasons, Marriott, and the Taj Group, to help them define and play a leadership role in spreading responsible business practices.

Having focused initially on environmental practices in hotels, ITP has now expanded its mandate to look more broadly at the role travel and tourism can play in supporting the Millennium Development Goals and upholding human rights along global value chains. In 2006 it launched a poverty alleviation initiative in partnership with GTZ with the aim of defining and promoting the best ways for hotels and other tourism companies to tackle poverty through increased job creation, supply chain linkages and local economic development. The initiative will profile existing good practice, publish guidelines and build transferable models for wider international use within the industry. ITP has also collaborated with UNICEF in Thailand to develop a Youth Careers Initiative, training and employing disadvantaged youth in the industry. This model is now being replicated in Ethiopia, Brazil, Australia, Romania and Poland.

## INFORMATION TECHNOLOGY SUPPLY CHAIN INITIATIVE

The electronics industry is one of the fastest growing in the world and increasingly its manufacturing is done and its components sourced from thousands of enterprises based in developing countries from India to Malaysia to Latin America. In late 2004, with support from Business for Social Responsibility, Cisco Systems, HP, Microsoft and Intel joined together to form a new supply chain working group with the aim of adopting a more integrated approach along their global supply chains to implementing the Electronic Industry Code of Conduct (EICC).

Today, the EICC is supported by over 20 of the world's leading ICT companies. It has also formed a strategic alliance with the Global e-Sustainability Initiative, a group of about 17 ICT providers and suppliers such as BT, Deutsche Telecom, Alcatel, Ericsson, and Vodafone, that is supported by the United Nations Environment Programme (UNEP) and the International Telecommunication Union. A key focus of the joint initiative has been to develop a comprehensive 'supplier engagement model' aimed at helping

thousands of suppliers, including many in developing countries, to undertake self-assessments of their labour, health, safety, environmental and ethics practices and to build their capacity to identify and mitigate risks in these areas, aim for continuous improvement and report on progress.

Although voluntary in nature, this collaboration across the industry to spread responsible business practices along global supply chains using the purchasing power, influence and technical capability of many of the industry's leading corporations, offers a useful collective model for other industry sectors.

## BUSINESS ACTION FOR AFRICA (BAA)

Launched in 2005 as the business community's response to the recommendations made by The Commission for Africa, BAA is not a formal institution, but a network of corporations and business associations from Africa, Europe, the United States and elsewhere taking collective action to support corporate responsibility and pro-poor economic growth in Africa. They are focused on achieving three core objectives:

- To positively influence policies needed for growth and poverty reduction, by creating a platform for a clear African and international business voice
- To promote a more balanced external view of Africa, by highlighting business success stories and promoting balanced reporting
- To develop and showcase good business practice, by facilitating new partnerships and communicating business actions.

BAA has some 50 corporate partners that commit to specific actions in support of the network's objectives, as well as to sharing good practices. Among them are many of the largest investors in Africa: Abbott, Anglo American, BHP Billiton, BP, Cadbury-Schweppes, De Beers, Diageo, InterContinental Hotels Group, Merck, Microsoft, Monsanto, Nestlé, Rio Tinto, SABMiller,

Shell, Starbucks, Unilever and Visa. In addition, BAA works with 17 business organizations and civil society, government, and international financial institutions in a variety of partnerships. These include the Africa Business Roundtable, the Global African Diaspora Coalition, the International Finance Corporation, the UK Department for International Development, the World Economic Forum and UNDP. Served by a secretariat within the International Business Leaders Forum, the companies participating in BAA have identified the following six priority themes, which they believe are essential to achieving the above objectives: governance and transparency; trade; the climate for business; enterprise and employment; human development; and perceptions of Africa.

In the area of enterprise and employment, the network is focused on developing new business models and cross-sector partnerships to support small enterprise development and in particular, to encourage youth enterprise and employment. About 21% of young people in sub-Saharan Africa are unemployed, in addition to many more youth who are under-employed and the participating companies have identified this as a key risk area for long-term growth and stability.

## ETHICAL TRADING INITIATIVE

The past decade has seen growing consumer, activist and business interest in the concept of responsible trade, both as a mechanism to address global environmental issues and also to share the economic benefits of globalisation more broadly along global value chains. A 2006 report by UNIDO states, "Responsible trade covers the broad range of market-mediated approaches, which aim to improve the social and environmental impacts of international trade and production by concentrating on global supply chains."<sup>19</sup> The report distinguishes between fair trade, green trade and ethical trade, and provides a comprehensive overview of the challenges and opportunities for small enterprises to link into growing niche export markets in these three areas, in addition to illustrating the range of supply-side and demand-side interventions that can be taken by governments, donors, business associations, larger companies and others to support this integration process.

Collective action by major retail, food and beverage and apparel and textile companies has an important role to play in supporting this process – not only in terms of creating a more consistent and level playing field with respect to codes and standards, thereby cutting transaction costs for small enterprises, but also by helping to build capacity of small enterprises and their trade

associations. A number of such business-led or multi-sector initiatives have been established over the past decade, especially in the areas of agribusiness/food and apparel – and at both the global level, national level in some developing countries and commodity level.

One of the best known examples and useful models at the global level is the Ethical Trading Initiative, a UK-based tripartite initiative convened originally by the UK's Department for International Development, which brings together many of the country's leading retailers with trade unions and development NGOs to improve working conditions along global supply chains through promoting good practice in the implementation, monitoring and independent verification of codes of labour practice. As of 2004, the initiative was covering over 20,000 suppliers in countries such as China, Kenya, Zimbabwe and South Africa. Despite the challenges of sustaining such a cross-sector alliance, ETI and the Fair Labor Association in the United States, which brings together major apparel and footwear companies with universities and NGOs, both offer useful models of how groups of major competitors can come together with others to spread more responsible business practices.

## VIET NAM BUSINESS LINKS INITIATIVE (VBLI)<sup>20</sup>

VBLI was established in 1999, to provide a collective action mechanism through which international brand owners in the footwear industry could work with factory owners in Viet Nam, industry associations, government ministries and domestic and international NGOs to achieve more sustainable and systemic improvements in working conditions in Viet Nam's footwear industry. At the outset of the initiative the UK Department for International Development provided seed funding and convening support, and the International Business Leaders Forum (IBLF) supported the Viet Nam Chamber of Commerce and Industry (VCCI), which facilitated the process and provided day-to-day management. A multi-sector steering committee of 23 stakeholder organisations was established, most of which remain active participants. Despite challenges in implementation capacity and monitoring, over the past six years the initiative has

demonstrated a number of benefits deriving from collective action models. It has created a joint code of conduct, management support system and training process making it easier for local factories to meet global requirements and to date over 60% of factories in the Viet Nam footwear industry have participated in the process to some extent. At the same time, VBLI has extended its coverage from safe chemical use to other labour, health, safety and environmental practices. It is also being used as a model to transfer good practice to the garment sector and is now working with government and other bodies to institutionalise health and safety standards within the country to ensure greater scale and sustainability. Different members of the steering group have played leadership roles in taking the process forward depending on their competencies and resources.

## THAI BUSINESS INITIATIVE FOR RURAL DEVELOPMENT (TBIRD)

Established in 1988, TBIRD combines commercial business linkage initiatives with corporate philanthropy and donor funding to transfer skills, resources and market opportunities to rural communities thereby enabling them to create local businesses and income generating opportunities with the goal of improving the overall quality of rural life and reducing rural-urban migration. Today TBIRD is supported by over 100 Thai and foreign companies in addition to foundations and donor agencies and

has facilitated a range of agribusiness, craft and small manufacturing enterprises, in addition to education, health and environment projects and several initiatives to strengthen local institutions. It has been effective in leveraging millions of dollars in development assistance and demonstrated a variety of ways that large companies can support national development objectives in a mutually beneficial manner.

## TANZANIA'S PRIVATE SECTOR INITIATIVE (PSI)<sup>21</sup>

In 2003, the Small Business Project, a South Africa-based business linkages initiative, worked with BP to establish a similar model in Tanzania aimed at helping large corporations improve the quality, quantity and reliability of local suppliers. The PSI is now supported by over 15 local and foreign companies in industries ranging from mining, cement and agribusiness to food, beverages, packaging, telecommunications and banking. Several local companies have become regional suppliers as a result of

their support from this initiative, while its large member companies have been able to increase their level of local sourcing by some 40%, share good practices in supply chain management, and provide mentoring support to high-potential suppliers. A key success factor has been the role played by local business champions within Tanzania, both companies and individual business leaders, as well as being able to adapt a tried and tested approach with an existing track record in South Africa.

## MEXICO SUPPLIER DEVELOPMENT PROGRAMME

Since the late 1990s, a group of six major Mexican and foreign companies have worked with UNDP, the Mexican Ministry of Economy, the country's National Association of Manufacturers and Nacional Financiera, Mexico's largest government-controlled development bank, to develop a network of over 100 professionally trained and certified supply chain consultants. These consultants were selected from different states with the goal of advising large companies and clusters of small

enterprises on business linkage opportunities and providing the small enterprises with technical assistance to enable them to achieve the standards of quality required by large manufacturers. By working together the large companies were able to pool supply chain management methodologies and their development partners were able to provide additional technical assistance and financial support beyond what could have been justified on a purely commercial basis.

## INDIAN AUTOMOTIVE PARTNERSHIP<sup>22</sup>

Although there are a growing number of collective business linkage initiatives along agribusiness value chains in tourism and in light manufacturing, they are less common in the engineering and industrial sectors. In India, UNIDO's Partnership Programme has worked with the Government, national and foreign automotive companies, led initially by Fiat and its principal supplier, the Automotive Component Manufacturers Association of India, several local and foreign research institutes and the

International Business Leaders Forum to enhance the quality and performance of local Indian suppliers, especially in plastics, rubber and metalworking. The initiative has resulted in a variety of both quantitative and qualitative improvements with both business benefits to the small enterprises and larger companies and in some cases improved working conditions for employees in the local companies.

## PHILIPPINE BUSINESS FOR SOCIAL PROGRESS (PBSP)

Created by a small group of Filipino business leaders over 30 years ago, PBSP is one of the oldest and largest business-led social development initiatives in the world operating at a national level. Since 1970, its membership has grown from about 50 companies to over 180 local and foreign corporations who are able to leverage a combination of financial resources, extensive in-kind support, business linkage opportunities, and political influence through their joint efforts. In addition, PBSP has worked with some 2,900 partner organisations since 1970, ranging from local community-level groups to international foundations and

donor agencies, to support over 4,900 different projects. It estimates that it has benefited close to 2.8 million poor households through these projects, many of which have focused on creating local income generating opportunities and small enterprise development. Poverty Alleviation is a central pillar of PBSP's current strategy and it operates a range of regional development activities, in addition to managing a Small and Medium Enterprise Credit Programme, supported by a number of the country's commercial banks, and a variety of business linkage programmes with selected member companies.

## INSTITUTO ETHOS and SEBRAE in BRAZIL

Instituto Ethos is a collective action initiative of over 900 companies in Brazil, which account for annual revenues of approximately 30% of the country's GDP and employ about 1.2 million people. The companies are working Ethos to implement and spread more responsible business practices. They are achieving this through a variety of mechanisms and tools, ranging from the development of social responsibility indicators and programmes to identifying and sharing good practices in areas such as supply chain management and engaging in public policy dialogues relating to corporate responsibility. In order to

spread responsible business practices more effectively to small enterprises, the Ethos Institute has also formed a strategic alliance with Sebrae – a nonprofit nationwide organisation that is dedicated to supporting micro and small business development in Brazil and is supported by government, donors, academic and research institutions and the business community. The Ethos/Sebrae CSR Programme for Micro and Small Companies has adapted the Ethos Social Responsibility indicators for use by smaller enterprises and supports a range of research, publications and training activities.

## NATIONAL BUSINESS INITIATIVE, SOUTH AFRICA

The National Business Initiative was launched in 1995 with the aim of bringing together progressive South African companies and foreign investors to work collectively with each other and in partnership with national, regional and local governments in order to promote the role of business in helping to build social, economic and environmental stability in the new democracy. Corporate leaders identified a set of major challenges that the country faced, ranging from poor quality and unequal education systems to lack of public sector capacity in local authorities and high levels of crime and unemployment – and then focused on creating programmes targeted at mobilising private sector

resources and competencies to address these. Today NBI has over 200 member companies and supports a variety of programmes aimed at creating jobs, supporting business linkages and enterprise development and improving human capital through its Educational Quality Improvement Programme (EQUIP) which reaches several hundred schools. NBI also launched the Business Trust as a joint business-government dialogue mechanism and operational initiative targeted specifically at education and job creation, with a focus on the tourism sector.

## PARTNERSHIP MODEL #3:

### Enhanced trade and industry associations

TYPE OF PARTNERSHIP OR COLLECTIVE ACTION MODEL	EXAMPLES
Joint efforts to expand the scope and/or strengthen the governance and operational capacity of indigenous trade and industry associations to enable them to better serve the needs of small enterprises and to support broader development and corporate responsibility objectives beyond direct business interests.	Chambers of commerce and industry, trade associations and employers' organisations that establish: <ul style="list-style-type: none"><li>■ Small business units</li><li>■ Women's enterprise support services</li><li>■ Vertical linkage units</li><li>■ Corporate governance and corporate responsibility units</li></ul>

Another more traditional type of business-led 'collective action' comes from business associations such as global, national and local chambers of commerce, trade and industry groups and employers' organisations. These have a longstanding history in many successful economies and are usually one of the essential institutional mechanisms that underpin a vibrant, diverse, competitive and responsible private sector.

Former Secretary General of the International Chamber of Commerce, Maria Livanos Cattauí, comments, "Business associations from all parts of the world share a common goal to promote, develop and further the economic well-being of member companies – which are predominantly small and medium-sized enterprises – by providing a collective voice in advocacy for members' interests, as well as by providing quality services to help members enhance their competitiveness and succeed in their businesses locally and abroad."<sup>23</sup> Yet, she goes on to argue, "Faced with high demands and difficult operating circumstances, associations and chambers of commerce in many countries are inadequately prepared to respond effectively to the challenges they face. Factors such as low membership, insufficient financial resources and limited or non-acceptance by governments all affect their ability to achieve these tasks."<sup>24</sup>

The challenge for many developing country business associations is fourfold:

- First, how to strengthen their governance, management and operational capacity to provide even basic, traditional business advocacy and support services for their members;
- Second, how to extend their services to provide more targeted and effective support for the least-served small enterprises – for informal sector and rural enterprises and for women and in some cases youth entrepreneurs;
- Third, how to be more proactive in encouraging and facilitating business linkages between their larger members and small enterprises; and
- Fourth, how to be more proactive in spreading responsible business practices amongst small enterprises in areas such as anti-bribery and corruption, environmental management, labour practices and social impact.

The following examples look at a small sample of country-level good practices.

## CONFEDERATION OF INDIAN INDUSTRY

Founded over 100 years ago, CII has an indirect membership of almost 100,000 companies and an explicit mandate to play a proactive role in India's development process, in addition to serving its members' direct business interests. In 1995 it established a Social Development Council, aimed at engaging its members and building cross-sector partnerships to ensure that the benefits of industrial reforms and economic growth start to reach the poor. A key element of this is supporting community

economic development, women's empowerment and youth enterprise, as well as vocational training. CII also provides environmental advice and certification support to small enterprise clusters and it operates a Subcontracting and Partnership Exchange to encourage business linkages between large and small enterprises, in addition to hosting the National Council for SME development.

## ALEXANDRIA BUSINESS ASSOCIATION

Established in 1983, this Egyptian business association has become a leading intermediary for mobilising private sector resources, networks and skills to tackle broader socio-economic challenges, in addition to providing traditional member services and undertaking public policy advocacy for business. It is now considered one of the country's leaders in promoting and funding small and micro-enterprises, offering a range of credit options and

technical assistance and creating several hundred thousand new jobs. Since 1999, it has also spearheaded a national programme in partnership with the Government to create a more labour-oriented technical education system strengthening the quality and relevance of training and linking it more directly to entry-level jobs. In addition ABA engages its corporate members in a variety of environmental and community development projects.

## UGANDA SMALL SCALE INDUSTRY ASSOCIATION

This business association offers a good example of a business-led organisation dedicated to providing both a voice and targeted services and technical assistance to small scale businesses. The association has been effective in forming alliances with other business bodies to build linkages between large and small enterprises and extend services to some of the poorest rural communities in the country. Among other initiatives it has

worked with UNIDO to launch a Master Craftsman Programme to train experienced and successful entrepreneurs as advisers, who in turn assist other small-scale enterprises, including marginalised groups such as orphans. Like other business associations in the country, it has also played a role in raising awareness about HIV/AIDS within the private sector.

## JEDDAH CHAMBER OF COMMERCE & INDUSTRY

JCCI offers a good example of how a business association can take a national leadership role on tackling challenging socio-economic issues. It has been a pioneer in supporting women in business. In 2004, it established a Centre for Businesswomen and within 18 months the centre had been able to raise the profile of some 40,000 women-owned businesses, including

3,000 that are registered members of the chamber. In addition to raising awareness, and training and networking women entrepreneurs, the centre also advises young women graduates on employment opportunities. In 2005, JCCI elected the first two women to serve on its Board of Directors, setting a role model for other organisations.

## PARTNERSHIP MODEL #4:

### 'Blended value' financing mechanisms

TYPE OF PARTNERSHIP OR COLLECTIVE ACTION MODEL	EXAMPLES
Mechanisms that catalyze, pool and/or leverage a combination of private and public funds and/or commercial capital and social or philanthropic investment to deliver financial services to small enterprises in an economically viable manner. Many of these mechanisms also deliver technical assistance or partner with other initiatives that do so.	<ul style="list-style-type: none"><li>■ Small enterprise facilities and funds</li><li>■ Small enterprise credit guarantees</li><li>■ Small enterprise credit-rating agencies</li><li>■ Microfinance intermediaries</li><li>■ Social venture capital funds</li><li>■ Venture philanthropy</li><li>■ Major resource or infrastructure project revenue-sharing mechanisms</li></ul>

Affordable access to financial services – loans, equity, insurance, savings, transfers and remittances, leasing arrangements, project finance etc – has been highlighted throughout this report as essential for small enterprise development. Access to such services is also essential for enabling small enterprises to invest in better environmental and labour practices in their operations. Much has been written here and elsewhere about the fact that governments, international financial institutions and private banks all provide funds for large scale companies and increasingly for micro-enterprises, but that ironically governments, donor agencies, nonprofits and private banks mostly neglect the 'missing middle' – the small and medium-size enterprises that have the greatest potential of raising productivity, creating jobs and generating wealth, and that have limited interest to implement responsible business practices in the absence of external requirements, incentives, funds or technical assistance.

The concept of 'blended value' investing or 'private investing for social gain' has gained growing acceptance and financial support over the past decade attracting the attention of traditional financial institutions such as private banks, investors, development agencies and international financial institutions, as well as private and corporate foundations, corporations, individual philanthropists and an emerging asset-class or sector consisting of social loan and venture funds and microfinance institutions. Defined on page 73 of this report, the 'blended value' concept represents a market-based approach to funding that includes social and environmental factors into investment decisions and lies on the spectrum between pure philanthropy or grants, and purely profit-driven financial investments.

This is an increasingly complex agenda, consisting of a wide and growing variety of different financial instruments, mechanisms, asset classes and institutions. It is not within the scope of this report to provide a comprehensive overview of the full range of options, but these have been covered by several seminal reports produced in recent years.<sup>25</sup> The following examples offer a small sample of the emerging good practice in this area with a focus on 'blended value' mechanisms for responsible small enterprise development.

## **BOX 21: FINANCIAL INNOVATIONS IN THE DONOR AND DEVELOPMENT BANK COMMUNITY**

### **DFID's BUSINESS LINKAGE CHALLENGE FUND**

The UK's Department for International Development (DFID) has used the mechanism of Challenge Funds to engage more proactively with the private sector, leverage private resources in funding key development objectives, and learn from practical business experiences. One of these funds was its Business Linkages Challenge Fund (BLCF) which aimed to serve as a catalyst for business-to-business linkages between firms in developed and developing countries, thereby improving access for small enterprises not only to finance, but also to potential business partners, technology and new markets. The fund was administered by Deloitte and the Emerging Markets Group and was open to any registered private sector enterprise, as well as to business associations and NGOs in the UK, and selected African and Caribbean countries. It was run as a cost-sharing, competitive scheme based along market-driven principles, with simple, transparent application procedures, relatively rapid approval processes and flexibility in terms of the type of business linkage and industry sector – as long as it could demonstrate real innovation, business linkages, market development and potential to benefit the poor. The BLCF funded a wide variety of business linkage initiatives ranging from fair trade and pro-poor tourism to projects aimed at increasing the distribution of essential health products to sustainable agriculture.

### **THE IFC's ENTERPRISE FACILITIES**

Over the past decade the IFC has introduced a variety of regional project development and specialist facilities that aim to promote private sector development – often small enterprises, and support more sustainable and responsible business practices. The facilities usually support some combination of: access to finance, helping local financial institutions deliver innovative new products to smaller companies; business linkages, aiming to strengthen local firms and communities linked to major IFC investment projects; business development services, technical assistance and technology; and in some cases investment climate reform. In addition to over 10 regional or country-focused facilities, the IFC has also established a Small Enterprise Capacity Building Facility that works closely with its Linkages Programme, an Environmental Opportunities Facility, to support clean production initiatives and innovative projects, and a Corporate Citizenship Facility to support projects with positive social impacts.

### **INVESTMENT CLIMATE FACILITY FOR AFRICA**

The vast majority of reform efforts in terms of improving the investment climate in developing countries are donor funded and government-led, with minimal input from the private sector beyond traditional business association advocacy and consultation. In 2004, a group of leading corporations with interests in Africa worked together with support from DFID and DANIDA to develop the framework for a public-private mechanism that would be jointly funded, governed and implemented by business and public agencies and aimed at actively supporting a suite of investment climate reforms in Africa. The result is the Investment Climate Facility (ICF) for Africa, which has been supported by major companies such as Anglo American, Unilever, Shell and the Shell Foundation and is looking to create a fund of some \$550 million consisting of both private and public investors. The ICF will fund proposals that offer the highest rate of return in terms of improving the investment climate, particularly those that have the greatest impact on small business, job creation and poverty reduction.

### **THE SME RATING AGENCY OF INDIA (SMERA)**

The lack of credit and risk information about small enterprises is one of the major impediments to their ability to access commercial financial services. In July 2005, the Small Industries Development Bank of India (itself a relatively new institution established in 1990 with a commitment to meeting the financing needs of small enterprises) joined forces with Dun and Bradsheet, the global financial information company, the Credit Information Bureau of India, and some of the country's major domestic and foreign banks, including Citigroup, to launch SMERA. It is the first rating agency in India dedicated to the large and vibrant small enterprise sector, which consists of some 8 million usually labour-intensive enterprises, that account for a growing percentage of India's exports and manufacturing, wholesale and distribution services. SMERA offers a useful public-private partnership model for other countries to consider.

## BOX 22: NEW FUNDING APPROACHES BY CORPORATE AND PRIVATE FOUNDATIONS

The growth in blended public-private funding mechanisms being experimented with by the donor and development bank community is also starting to gain traction in a small number of major corporate and private foundations. Although it is still early days, and expectations must be managed in terms of the level of resources available from such foundations relative to government funding, these developments offer another source of innovation and potential when it comes to funding pro-poor growth in developing countries and supporting the emergence of responsible and competitive small enterprises.

### SHELL FOUNDATION<sup>26</sup>

The Shell Foundation has been one of the corporate pioneers in this area. Launched in 2000, the Foundation is an independent, grant-making charity that is separate from the company's commercial interests, but able to leverage its relationship with Shell's employees and on-the-ground convening power and local knowledge around the world. The Foundation's overall goal is to support efforts to reduce the impact of fossil fuels and to help poor communities gain access to modern energy and to generate income. Over the past five years the Foundation has developed a range of strategic partnerships with local and international financial institutions and with for-profit and nonprofit organisations, to invest in innovative, usually market-driven pilot projects with the potential to go to scale. The Foundation has been particularly active in establishing more market-oriented and demand-driven small enterprise investment funds working with a combination of commercial and donor funds, and linking the provision of business development assistance to non-collateralised finance. It has launched Investment Partnerships in Uganda and South Africa, and in 2005 worked with its existing partner the Africa-based GroFin Capital, to establish a Small and Medium Enterprise Fund for East Africa. Other investors include the British Commonwealth Development Corporation, the Netherlands Development Finance Company (FMO), the Deutsche Bank Foundation, the Skoll Foundation, the Syngenta Fund for Sustainable Agriculture, Triodos Bank and several African commercial banks. Also in 2005, the Foundation launched another innovative partnership with UK retailer Marks and Spencer aimed at tackling another obstacle that many small enterprises face in developing countries – lack of access to export markets. This initiative will provide small enterprises that are being supported by the Foundation's investment funds in Africa with more reliable and predictable market access to Marks and Spencer's retail outlets.

### CISCO SYSTEMS, GOOGLE, OMIIDYAR and SKOLL FOUNDATIONS

Other increasingly wealthy and influential corporate foundations that are adopting an innovative 'blended value' approach to their funding activities are some of the recently created entities that have benefited from the massive wealth generated by the technology boom. In different ways the Cisco Systems, Google, Omidyar and Skoll Foundations have all been pioneering more market-based and demand-driven approaches to solving social and environmental challenges. In addition to the traditional route of philanthropic giving to nonprofit organisations, these foundations are also experimenting with programmes to fund social entrepreneurs, which in many cases are also legally constituted as nonprofits, but in some cases are for-profit enterprises pursuing explicit social or environmental goals. It is still too early to determine whether other corporate and private foundations will adopt this approach, which may represent fiduciary and legal challenges for some funders or too high a risk for others, but these new models of funding offer potential for the development of socially responsible small enterprises in both developed and developing countries.

### ROCKEFELLER and GATES FOUNDATION – 'THE ALLIANCE FOR A GREEN REVOLUTION IN AFRICA'

The Rockefeller Foundation has a longstanding tradition of funding innovation in science, technology and agriculture. In recent years it has been joined by the Bill & Melinda Gates Foundation, which has launched programmes to support more scalable and sustainable financial services for the poor, and agricultural development through funding new technologies and improving the access of small farmers to seeds, fertilizer and irrigation, as well as markets. In September 2006, the two Foundations launched an initial \$150 million joint effort to provide capital, credit, training and research funds aimed at dramatically increasing the productivity of small farmers, developing a network of at least 10,000 small agro-dealers in rural communities, and increasing market-driven wealth generating opportunities to lift people out of poverty and reduce hunger.

## **BOX 23: PRIVATE SOCIAL VENTURE CAPITAL AND INVESTMENT FUNDS**

The following examples offer a brief overview of some innovative for-profit and nonprofit venture capital and investment funds that are aiming to tackle social and/or environmental challenges in developing countries through adopting market-driven approaches and a blend of commercial and philanthropic, or private and public capital to fund sustainable, profitable and responsible small enterprises.

### **SMALL ENTERPRISE ASSISTANCE FUNDS (SEAF)**

Created in 1989, SEAF is a global investment firm that provides growth capital and operational support to small enterprises in emerging markets that are underserved by traditional sources of capital. Initially established as a private investment subsidiary of CARE, an international development NGO, today SEAF operates for-profit investment funds in over 20 countries, which include social and environmental as well as commercial selection criteria, and it counts among its investors international finance institutions, pension funds, insurance companies, banks and foundations. In 2003, with support from several donor agencies, SEAF launched an initiative to explore the pro-poor development impact of its investments in small enterprises on local economies and low-income employees and communities. The first study was published in 2004 and among other findings, concluded that on average every dollar invested in the companies assessed generated an additional ten dollars in the local economy. SEAF is now implementing quantifiable Development Impact Indicators across its global portfolio of small and medium enterprises.

### **S3IDF (SMALL-SCALE SUSTAINABLE DEVELOPMENT INFRASTRUCTURE FUND)**

S3IDF describes itself as a 'social merchant bank'. It has a mission to foster pro-poor, pro-environment small scale infrastructure services necessary for poverty alleviation, with financing, business development and technical assistance for energy, water, sanitation, transportation and telecommunications. The fund works with local nonprofit, commercial and academic partners to select projects that are likely to be financially and environmentally sustainable, and can also demonstrate development linkages by mobilising local savings, using local renewable energy and water resources and proactively involving the poor themselves as infrastructure owners, operators and consumers. It currently has a portfolio of about 50 active investments in South Asia, mainly India.

### **ACUMEN FUND**

This is a nonprofit venture fund that identifies innovations with high potential to solve development challenges in the areas of health, housing and water, which may operate in the profit or nonprofit arena. The fund then supports these initiatives through a combination of financial capital, in the form of loans, equity or grants, and intellectual capital and technical assistance, which are delivered through a network of local partners. It works with each enterprise or investment project in its portfolio to help them improve the design, pricing, marketing and distribution of goods and services to the poor and to do so in an economically viable manner. Current investments range from A to Z Textile Mills in East Africa, which produces anti-malarial bednets (currently 3 million a year with plans to expand to 7 million) to IDE in India, which has sold more than 30,000 affordable drip irrigation units to poor farmers. The core of Acumen's business model is to combine the flexible capital of philanthropy, the skills of business and the rigour of the market to help build enterprises that have the potential to serve the poor on a large scale.

### **E&Co**

E&Co describes itself as a public-purpose investment company that empowers clean energy entrepreneurs in developing countries through providing a combination of business development support and capital. Like similar organisations, it is funded by a combination of public, private and foundation funds and offers its investors a 'blended value' return consisting of financial, social and environmental results. Since its launch in 1994, E&Co has leveraged millions of dollars in capital and approved some 200 investments ranging from rural electrification and biomass to wind turbines and hydro facilities. In the process it has also supported the development several hundred small enterprises and local business linkages, while offering a respectable return to its investors. Among other projects E&Co has also been selected as the manager of renewable energy facilities for several bilateral donors, multilateral development banks and foundations.

## PARTNERSHIP MODEL #5:

### Institutionalised enterprise support services

TYPE OF PARTNERSHIP OR COLLECTIVE ACTION MODEL	EXAMPLES
Dedicated enterprise support initiatives that provide combinations of technical assistance, training, mentoring, evaluation and brokerage services, as well as finance in some cases, aimed at improving access of small enterprises to essential resources, skills, information and business opportunities, including improved environmental and workplace practices.	<ul style="list-style-type: none"><li>■ Small business support centres</li><li>■ Cleaner production centres</li><li>■ One-stop shops and specialised service centres</li><li>■ Collective corporate-led training initiatives</li><li>■ Volunteer executive services corps</li><li>■ On-line training programmes</li></ul>

Alongside affordable access to financing, access to skills, information and knowledge is widely recognized as being another essential pillar in supporting competitive and responsible small enterprise development. As outlined on pages 83 to 86 of the report, the development of management and technical skills and ability to access important market information and make connections with potential business partners, suppliers or clients is particularly important for the small enterprises with the greatest potential to upgrade and integrate into regional and global value chains.

Having readily available and affordable access to technical assistance, training and information in the area of social and environmental practices is also important if small enterprises are going to have any likelihood of adopting such practices and integrating them into their business operations.

Having said this, as outlined on pages 115 to 118, the provision of free services in these areas has proven to be a generally inadequate solution to ensuring long-term or large-scale adoption. The development of more demand-driven and market-oriented approaches is needed, aiming towards commercially viable service providers wherever possible, utilising ‘blended value’ approaches that combine public and private or commercial and philanthropic resources where they can be effective in achieving a combination of both business and development benefits, and relying on government support or private philanthropy and donor grants in situations where even ‘blended value’ options are difficult to justify, for example with the most vulnerable, poorest and marginalized low-income communities.

The following examples illustrate a range of business service delivery options that fit under the category of ‘blended value’ or public-private approaches. Donor agencies and governments have taken the lead of some of these initiatives and companies or private institutions on others. Most of them offer a range of business development services and some combine both skills, training and information services with access to finance.

## UNIDO AND MICROSOFT COLLABORATION

On 10 July 2006, the United Nations Industrial Development Organization (UNIDO) and Microsoft signed a strategic cooperation agreement aimed at tackling the root causes of poverty by promoting innovative uses of information and communication technologies (ICTs) in Africa. By sharing expertise and intellectual property, this strategic partnership intends to stimulate the knowledge base and growth of businesses in the African continent, a key way to help foster a thriving economy that creates wealth and brings down poverty levels. To this end, the partners intend to support entrepreneurship development, investment promotion, and the creation of business opportunities, especially for small and medium-sized enterprises (SMEs) in Africa.

Specifically, the UNIDO – Microsoft cooperation agreement provides for joint activities in the following areas:

### 1) Supporting the promotion of foreign direct investment (FDI) through AfriPAnet

As part of its efforts to encourage increased flows of FDI into Sub-Saharan Africa, UNIDO has supported the establishment of a network of African Investment Promotion Agencies (IPAs). This network, known as AfriPAnet, helps to develop coordinated regional strategies for enhancing the inflows and effectiveness of FDI. To provide an empirical basis for the formulation of these strategies, UNIDO conducts biennial surveys of foreign investors, which shed light on the increasing diversity of foreign investors and enable policy makers to focus their investment promotion policies more effectively. Under their cooperation agreement, UNIDO and Microsoft are developing an e-portal for AfriPAnet, which intends to bring the most up-to-date and relevant investment-related information to foreign investors, investment agencies and governments at the click of a button, and allow its users to interact directly with each other. Once the prototype version is finalized, the e-portal will be rolled-out throughout the African continent.

### 2) Rural Business Information Centers

Access to ICTs has become a crucial prerequisite for a sustainable agenda of economic development and poverty reduction. In response, UNIDO and Microsoft have decided jointly to assist rural SMEs in sub-Saharan Africa to improve their competitiveness and productivity through access to ICTs. A pilot project, which was launched on 16 January 2007 in Uganda, provides access to integrated information solutions and services

for rural businesses in eight districts throughout Uganda. In addition, the centres will provide training in ICT and entrepreneurship, and offer fast and reliable access to the Internet. Ultimately, this project intends to tailor technology to the needs of small-scale businesses in developing countries.

### 3) Entrepreneurship Education Curriculum

UNIDO has developed an Entrepreneurship Education Curriculum for the Secondary Education system. The main aim of the curriculum is to assist graduates to change their attitudes towards business, create their own jobs, become self-employed and employ others. By integrating ICT into the Entrepreneurship Curriculum, the UNIDO-Microsoft initiative provides students with the opportunity to acquire entrepreneurship skills through an interactive teaching method, while at the same time exposing them to basic ICT skills during their secondary education. Further, the project will facilitate the provision of quality refurbished PCs to schools

## UNIDO-UNEP NATIONAL CLEANER PRODUCTION CENTERS

One of the enduring institutional mechanisms that resulted from the Rio Earth Summit in 1992 is the global UNIDO-UNEP network of national cleaner production centres. Cleaner Production is the continuous application of an integrated and preventative environmental strategy to processes, products and services that aims to identify and limit risk to humans and the environment. Its effective implementation, especially on a national level requires a combination of public policy, incentives for businesses including small enterprise clusters and small enterprises, which in some industries can be major polluters, changing attitudes and behaviour, and building the appropriate set of skills, technologies and locally appropriate capacities among policy-makers, technical specialists and business managers. The goal of the

UNIDO/UNEP joint initiative has been to establish institutions in different countries that are supported by both the public and private sector to address these challenges. There are now over 20 of these centres located in countries around the world with some 50 additional bilateral centres that are part of the network. The partners, funding, governance and operations of each centre vary from country to country, as do their impact and results, but a number have been effective in creating the enabling conditions, local technical expertise and awareness and capacity within important industry sectors to make the concept of cleaner production a reality. Several have been especially effective in spreading sound environmental practices along corporate value chains and via supplier programmes.

## SAUDI-JAPANESE AUTOMOBILE HIGH INSTITUTE (SJAHI)

An ongoing challenge for many vocational, technical and small business training initiatives is to ensure that the process and content is demand-led and relevant to the needs of the economies in question. One way of addressing the gap that often exists between labour market needs and national training efforts, is to create public-private alliances where both business and government have a say in determining what is delivered and share both the costs and the follow-up responsibilities for such programmes. SJAHI offers an innovative industry-specific model based on this approach. The Saudi-based ALJ Group, which is one of the world's largest distributors of Toyota vehicles recognized the need to train young Saudis in technical skills and where possible, to give them opportunities for establishing their own businesses in the automotive and other sectors. ALJ brought together the other Japanese automobile distributors in the

country and together they worked with their business partners in Japan, the Saudi Government and Japan's International Cooperation Agency to develop a partnership that offers useful lessons for other countries and industry sectors. Today several hundred of young Saudis are participating in a comprehensive programme that combines classroom and on-the-job learning, integration of environmental and ethical issues into the broader technical agenda, and direct opportunities for job placements with the participating companies after graduation. ALJ is also supporting a taxi-owner initiative enabling young Saudis to establish their own small enterprises. The company is also developing a similar public-private partnership for the healthcare sector and exploring options in other industry sectors, such as electronics.

## ATYRAU BUSINESS DEVELOPMENT CENTRE, KAZAKHSTAN

Chevron is one of the major foreign investors in Kazakhstan and recognizes the need to help the economy diversify beyond the energy sector. As such, it has worked in partnership with Citigroup, another of the country's key foreign investors, the Government, UNDP and the United Nations Volunteers programme to support the establishment of the Atyrau Business Development Centre. The centre's mission is to promote and support a dynamic and efficient small enterprise sector that contributes increasingly to equitable economic growth, employment creation and income generation in the region of Atyrau. Staffed by national professionals, with advisory support from international experts and technical support services through established UNDP projects, the centre provides business counselling, information and training for private entrepreneurs,

as well as a pilot microfinance scheme and provision of incubator space and support services for new businesses. The project also has the objective of building local capacity and expertise in the area of providing support services for small enterprise development. It is expected to attain sustainability by the end of the project period and operate as an independent non-governmental body. Subsequently, the centre is expected to train and impart practical knowledge to other consultants in different parts of the country to ensure a multiplier effect and maximum leverage of the resources that have been committed to the alliance.

## CISCO NETWORKING ACADEMIES

The Cisco Networking Academies offer one of the best examples around the globe of the potential for scaling up and replicating a public-private partnership by harnessing a company's global network of corporate subsidiaries and business partners, with the local country-offices of major donors and development agencies, alongside local partners. Started in the United States in 1997, there are now over 10,000 Networking Academies operating in over 150 countries around the world, including some of the world's poorest and least-developed economies. A key focus in some of the latter group of countries has been

supporting technical training and through this, greater economic empowerment for women. Although Cisco Systems does not operate in all of these countries itself, by developing a replicable model for delivering technology-based training services to individuals and small enterprises and then using partnerships with a variety of public, private and non-governmental organisations to deliver these, the company has been able to leverage its impact, while still ensuring some consistency in quality and delivery.

## WORLD BANK INSTITUTE (WBI)

The World Bank Institute is the capacity development arm of the World Bank. Its Business, Competitiveness and Development Programme seeks to build a deeper understanding of the role business can play in meeting today's development challenges. Through targeted capacity building and dialogues, the program works to strengthen corporate governance, transparency and social responsibility measures as integrated components of corporate strategy. It also convenes groups of companies and other stakeholders to facilitate private sector action in support of poverty reduction, improved competitiveness, good governance and fighting corruption.

"Sustainable SMEs" is one of the core learning initiatives of the Business, Competitiveness and Development Programme. This initiative focuses on strengthening the capacity of local companies and small enterprise clusters to develop and

implement appropriate management and reporting structures. The overall aim is to improve the environmental and social performance and communication of small enterprises with the goal of also increasing competitiveness. WBI has developed an online toolkit for small enterprises, which is being piloted with firms in Russia, and is supporting capacity building workshops in a number of countries in Africa working with small enterprise owners and managers, as well as supply chain and network managers from larger companies and representatives of business associations. In particular, the initiative aims to target those industry sectors heavily dominated by women, helping develop and fine-tune relevant environmental and social impact management tools.

## ENDEAVOR

Endeavor is a nonprofit organization that identifies promising and innovative entrepreneurs in selected emerging markets and then provides strategic support to help them take their companies to the next level, where they can integrate into national or global value chains, increase productivity, expand and create more jobs. Supported by a wide-ranging alliance of public and private institutions such as the International Finance Corporation, Inter-American Development Bank, Citigroup and several private foundations, Endeavor adopts a five-pronged strategy.

First, it targets emerging-market countries transitioning from international aid to international investment and seeks out local partners to build country boards and benefactors to launch local affiliates. Second, through a multi-step selection process, it screens thousands of emerging-market entrepreneurs. Candidates with the most innovative, high-growth ventures and greatest promise to become future leaders are selected as

Endeavor Entrepreneurs. Third, it provides customized local and global business advice and connections for those selected and fourth, it partners with leading media and universities to promote their stories, with the aim of helping to build a more entrepreneurial culture generally. Finally, Endeavor partners with governments and multilateral institutions to examine policy changes that countries can make to promote entrepreneurship and venture capital. It also aims to inspire a tradition of social responsibility where local entrepreneurs serve as community leaders, donating time, money and knowledge back to their communities.

## THE WORLD ENVIRONMENT CENTER

The World Environment Center (WEC) is a non-profit organization that works in partnership with global and national corporations, donor and developing country governments, NGOs and academic institutions to spread environmental, health and safety standards along global supply chains and build small business capacity for sustainable development in developing and transition economies.

In 2003, for example, it launched a 'Greening the Supply Chain' initiative aimed at driving environmentally sustainable practices among small and medium sized enterprises. The initiative focuses on implementing cleaner production measures along large corporate supply chains to help small enterprises reduce water and energy consumption, generate less waste and

pollution, increase efficiency and thereby become more profitable and competitive. Working with companies such as Alcoa, Johnson & Johnson, General Motors and Dow Chemical, and with support from USAID, the initiative is reaching small enterprises in countries as diverse as Mexico, China, Romania and Brazil. In El Salvador, WEC is working with USAID, PA Consulting and local partners, such as the National Cleaner Production Centre and the Ministries of Economy and Environment to implement an 'Alliance for Private Sector Competitiveness' based on an integrated programme to improve competitiveness while reducing environmental impact.

## PENANG SKILLS DEVELOPMENT CENTRE, MALAYSIA (PSDC)

The Penang Skills Development Center (PSDC) is based on a longstanding public-private partnership model supported by major Malaysian companies, foreign investors, and the Malaysian government. It was established in 1989 as part of a comprehensive and integrated government strategy to upgrade and transform the State of Penang from an agri-based trading economy into a technology-based manufacturing region.

PSDC was established with the core objective of offering a more efficient, market-led and collective approach to skills development that would ensure a better match between labour force skills and industry needs. While the government has played a crucial role in providing facilities and grants to cover initial operating costs, it recognized from the outset the importance of working closely with and providing incentives to the business sector. In particular, corporate partners help to identify training needs, fund worker participation, contribute equipment and machinery, share experts, and support training and practical follow-up activities. They play a role not only in providing vital

resources for the center, but also in its governance and decision-making structures. PSDC has a management council, for example, that is composed of representatives from industry, as well as academia and government.

A key focus of the center's several hundred courses is to facilitate more effective business linkages between its member companies and their suppliers in order to improve overall productivity and global competitiveness. PSDC's Global Supplier Development Programme is one example that aims to upgrade the core competencies, technologies and systems of local small enterprises through a combination of training, coaching, mentoring and business linkages with large multinational corporations. Successful small enterprises then have the opportunity to enter global supply chains. The PSDC model illustrates the potential for governments, donors, academics and corporations to work together in a manner that draws on each sector's core resources and capabilities, and meets both business and economic development needs.

## ENABLIS

The Enablis Entrepreneurial Network was established as a nonprofit organization in response to the final recommendations of the Digital Opportunities Task Force. Established by the G8 Heads of State at their 2000 Summit, the task force focused on the role that information technology could play in narrowing social and economic inequality and supporting wealth creation. Several of the business leaders who had participated in this public-private sector task force joined forces with the Canadian Government to launch Enablis as networked initiative aimed at providing a combination of technology, financing, coaching,

information exchange, and networking and business linkage opportunities to entrepreneurs in South Africa. The global and local partners, Accenture, Hewlett Packard, Telesystem, First National Bank (FNB), Khula Enterprise Finance, and KPMG have provided a combination of funding, in-kind services, mentoring and other forms of support to the programme leverage their different competencies and resources. Although still at an early stage, this initiative offers another potentially useful model of a public-private approach that relies heavily on the use of information technology to deliver and scale up its services.

## PARTNERSHIP MODEL #6:

### Multi-stakeholder public policy structures

TYPE OF PARTNERSHIP OR COLLECTIVE ACTION MODEL	EXAMPLES
Joint structures to facilitate more organised and systemic engagement of the private sector and other non-governmental actors in public policy consultations aimed at supporting national poverty reduction strategies, good governance, pro-poor growth and investment, environmental goals and other broader development objectives beyond direct business or industry interests.	<ul style="list-style-type: none"><li>■ National public-private policy forums</li><li>■ Investor roundtables</li><li>■ National business councils for sustainable development</li><li>■ Industry charters</li><li>■ Sector, geographic or issue-based public advocacy groups</li></ul>

There is growing recognition of the importance of engaging the private sector and civil society organisations more proactively in national or sector-based dialogues to shape the development of public policy not only as it relates to private sector development, but also to poverty reduction, good governance and sustainable development more broadly.

An area of particular interest within the international development community is the development of effective mechanisms to increase the level and quality of private sector engagement in the design and implementation of national Poverty Reduction Strategy Papers (PRSPs). Regular reviews of these strategies by the IMF and World Bank show that more governments are actively soliciting the views of the private sector, but as of 2001 there had been private sector participation in only about one third of the countries with PRSPs.<sup>27</sup>

In its 2004 *World Industrial Report*, UNIDO concluded, “Interaction between government officials and donors on the one side, and private entrepreneurs on the other has been minimal. Consequently, the enormous detail, the minutiae of PRSP participation, construction, implementation, financing, monitoring and reporting contrasts starkly with the superficial treatment of the main actor in the process – the private sector.”<sup>28</sup> UNIDO points to the lack of incentives or effective structures to facilitate active private sector engagement, even in developing countries where there is an organised private sector in terms of chambers of commerce and business associations, let alone in countries where such institutions are weak or marginalised. It also makes the case that even when governments do consult with business, “it does not follow that private sector viewpoints are incorporated, nor indeed that agreed measures are implemented effectively.”<sup>29</sup>

Despite the challenges involved, it is increasingly in the interests of the private sector, especially large companies, to engage more proactively in such policy dialogues, both in terms of direct self-interest and in terms of creating a better enabling environment for competitive and responsible enterprise generally and a more level playing field in the areas of anti-corruption, environmental and labour standards.

This is an area, however, where there is still relatively little institutional innovation, beyond the advocacy and public policy consultation mechanisms of traditional trade and industry associations and chambers of commerce. Although these organised business associations play a crucial role in serving as the representative voice of the private sector to governments, there is potential for the creation of smaller leadership groups that may be multi-sector in their governance and composition and which focus on providing business input to and support for the achievement of broader national development goals.

One area where there are useful role models is in sustainable development. Over the past 15 years, the World Business Council for Sustainable Development, for example, has played an important leadership role in catalyzing the creation of national or regional Business Councils for Sustainable Development in some 50 countries around the world. These councils are business-led and funded. In addition to sharing good practices between companies and supporting collective corporate action on a variety of operational projects, in many cases they have also become an important advocate, sounding board, and even partner for government when it comes to tackling complex public challenges such as climate change, biodiversity and sustainable production and consumption.

## THE BUSINESS TRUST, SOUTH AFRICA

The Business Trust was created as a public-private partnership mechanism in 1999 to stimulate job creation and employment, build human capacity and build trust between business and government leaders. Its board of directors is jointly made up of cabinet ministers nominated by the President and by top business leaders, with a co-chair drawn from each group, who share overall governance of the Trust and shape its strategy. The secretariat is located within the National Business Initiative, and the Trust is funded by pro-rata contributions from over 140 of the country's major corporations. A key commitment at the outset was to demonstrate that for every Rand contributed more money would be leveraged and only a small percent would go to management costs.

Over a five year period the Trust has been able to leverage two Rand for every one Rand contributed by the private sector, with only five cents of the contribution going to management costs. The funds it has leveraged have supported focused job creation

and economic development projects, with the main emphasis on increasing tourism and its local business linkages, a programme to reduce crime and another to improve education. It is estimated that the Trust's operational activities have benefited over 3 million people during this period and created over 120,000 new jobs, assisted 2,000 small firms, trained 5,000 unemployed people and cut malaria rates (a major inhibitor of tourism and economic development) by 80% in some areas.<sup>30</sup>

Of particular relevance for this report, however, is the Big Business Working Group, which was also established under the auspices of the Trust. Chaired by the President, it provides a regular forum for an informal exchange of opinions and concerns between business and government leaders on issues of strategic relevance to the country, including, but not only economic development. The goals of the group have been to build mutual trust, developed a shared appreciation of challenging issues, and strengthen relationships.

The National Economic Development and Labour Council is another model in South Africa, which is a formal tripartite consultation mechanism that brings together organized business, government and the trade unions. Other leadership groups that bring together business and government to jointly discuss national development issues include initiatives such as the Viet Nam Business Forum and Tanzania's Investors Roundtable, profiled on pages 128 and 129. In Malaysia and Brazil successive governments have also created a variety of institutions and incentives to encourage greater private sector engagement in economic policy making and enterprise development programmes.

A crucial success factor in all of these examples has been the active engagement of the country's top business leaders and in some cases foreign investors, as well as senior commitment by government at the level of the President's or Prime Minister's office or cabinet.

## VI CONCLUSIONS AND RECOMMENDATIONS

The promotion of competitive and responsible entrepreneurship offers one of our best hopes for achieving sustained economic growth and reducing poverty in developing countries.

Millions of small enterprises are already creating jobs, generating wealth, expanding opportunity and lifting people out of poverty in low-income rural and urban communities throughout the world. In many cases they are succeeding against the odds. They are surviving in the face of unnecessary and avoidable market failures, governance gaps and institutional constraints. They are often operating in informal economies with limited access to affordable financial products, business development services and legal rights. They are un-connected to the markets and value chains that might enable them to increase their scale, quality and productivity. They are usually marginalized and excluded from political processes and the provision of public goods. While their contribution to development is essential, these small enterprises are constrained by numerous obstacles.

Many of these obstacles can be overcome if governments, large corporations, and non-profit organizations are willing to work together and with the poor themselves to build new types of partnership that support more efficient market mechanisms, more innovative financial instruments, more effective institutions, and more accountable governance structures. As examples throughout this report have illustrated, there is experimentation and innovation underway in all of these areas. At the same time, there is the need for much greater leadership on the part of all development actors if we are to achieve the scale and systemic impact that is required to expand economic opportunity to the level that will enable millions more people to transition out of poverty.

There are a wide variety of actions that leaders in government, non-profit organizations and business can take to support this goal. Many of them have been detailed in this report. Others have been explored at length by the UN Commission on the Private Sector and Development, which made eight core recommendations to public and private sector leaders that are summarized in Appendix II.

Central to the achievement of most of these recommendations is the creation of new types of alliance between large and small enterprises, between public and private actors, between foreign and domestic entities, and between commercial

and social investors. The report has focused on such alliances. It has identified six different models of collective corporate action and multi-sector partnership that offer potential to increase the scale and effectiveness of small enterprise development through a combination of market-driven and public policy approaches. These include:

- Direct, commercially-driven business linkages and ‘hybrid’ business models along individual corporate value chains;
- Collective business linkage initiatives that bring together groups of companies in the same industry sector or location;
- Efforts to extend the development impact and outreach of existing chambers of commerce and other representative business associations;
- Public-private and ‘blended value’ financing mechanisms that pursue both market-based and broader social returns;
- Enterprise support services that meet the needs of small enterprises in a demand-driven and market-oriented manner; and
- Multi-stakeholder public-policy structures focused on improving the overall enabling environment.

Many of the alliances profiled in this report, especially in the area of ‘hybrid’ or ‘blended value’ mechanisms that combine public and private resources and/or objectives, are still relatively new and untested. Yet, they offer serious potential for achieving more effective approaches to economic development. They need to be better understood and evaluated. Those that offer the greatest promise need to be supported, and where relevant replicated or scaled-up. The following pages highlight some actions that different development actors can take to support this process.

### **Developing country governments**

1. Support efforts to strengthen the capacity and voice of organised, representative business associations, especially those that have a large membership of small enterprises or have targeted programmes to support competitive and responsible entrepreneurship.
2. Establish new multi-stakeholder structures to encourage greater private sector and civil society participation in defining and implementing national development and poverty reduction strategies.
3. Partner with collective business initiatives and intermediary organizations to create innovative new public-private financing mechanisms and institutionalized enterprise support services.
4. Create incentives for large domestic and foreign corporations that undertake strategic efforts to build local business linkages and support small enterprise

development, either through their commercial value-chains or their community investment activities. Make such efforts a requirement in public procurement and tendering processes.

### **Donor agencies**

1. Establish dedicated ‘partnership’ units and train people in country offices to build greater understanding, trust and alliances with the private sector. Some of the most successful alliances and development outcomes profiled in this report have resulted from the work of such units in organisations such as UNDP, UNIDO, UNEP, GTZ, DFID and USAID.
2. Support programmes that enhance the local capacity and outreach of indigenous business associations and networks. Provide funding and technical assistance to create such associations and networks where they do not currently exist, especially in key industry sectors and in rural communities.
3. Fund innovative intermediary organizations in the non-profit sector that are adopting market-oriented and demand-driven approaches to poverty alleviation and supporting efforts to link small enterprises to larger markets and value chains.
4. Ensure better donor coordination and system-wide learning within the donor community in the areas of business linkage initiatives, public-private partnerships, and programmes to implement social, environmental and ethical good practices along global supply chains.
5. Convene key development actors from different sectors and countries to share lessons on the role of the private sector as a partner in development, explore practical options for joint projects on-the-ground, and serve as a collective voice aimed at encouraging governments to prioritise new approaches to pro-poor growth and small enterprise development.

In 2006, UNDP launched a major new initiative aimed at providing such a platform, with a focus on exploring innovative approaches to implementing the recommendations of the UN Commission on the Private Sector and Development. This ‘Growing Inclusive Markets’ Initiative is bringing together leading donors, intermediary organizations and academic institutions that operate at the interface of business and development. It is developing in-depth case studies that document and analyse new business models and private sector efforts to serve low-income markets, gathering empirical data to map ‘base of the pyramid’ market demands and opportunities, building capacity of southern based researchers, and undertaking extensive communications activities and outreach to the media, business leaders and policy-makers in donor and developing country governments.

## Academic and research institutions

1. Invest in more research to evaluate new business models, collective corporate initiatives and public-private partnerships that are aimed at promoting more competitive and responsible entrepreneurship, in order to develop sound empirical evidence on what works and what doesn't.
2. Undertake more education and training aimed at developing the new types of 'cross-boundary' leadership, management skills and partnership building capacities that are needed to create non-traditional alliances and effectively implement new approaches to development.
3. Increase school and college-level education and training in entrepreneurship – and in particular responsible entrepreneurship that encompasses social and environmental awareness and expertise as well as financial and technical skills.

## Companies

Expanding economic opportunity is one of the greatest contributions that large corporations can make to development and poverty reduction in the countries and communities where they operate. This report has described how large companies can achieve this individually, collectively or in partnership with other sectors through:

- The ways in which they manage their own core business activities, and especially the manner in which they source from, distribute through or sell to small enterprises along their value chains.
- Their philanthropic, community engagement and social investment activities, and the way they align these to core corporate competencies and efforts to support entrepreneurial training and small business development.
- Their engagement in public policy dialogue, advocacy and institution building.

Some specific ways that companies can increase the scale and systemic impact of their efforts to expand economic opportunity include the following:

1. Adopt a more strategic approach to implementing responsible business standards and practices along individual value chains in order to maximize the development impact of existing business linkages. Wherever possible increase the number of such linkages that have a pro-poor or environmentally beneficial impact.
2. Participate or take a lead in establishing collective business linkage initiatives that bring together larger groups of companies on either an industry-specific or location-specific basis.
3. Invest in more innovative 'blended value' financing mechanisms and in business linkage centres and small enterprise initiatives through core business

activities, corporate foundations, philanthropic funds, community engagement programmes, employee volunteering programmes or a combination of these.

4. Help to strengthen indigenous business associations and explore new types of public policy consultation mechanisms.
5. Play a public statesman role in speaking out on the importance of competitive and responsible entrepreneurship and in advocating for better investment climates, fairer trade regimes and more inclusive enabling environments that support small enterprises as well as larger companies.

The challenges of expanding economic opportunity and reducing poverty remain daunting, but there is a vital need to keep focused on experimenting with new approaches and assessing what works among the many encouraging initiatives already underway. The words of Professor David Landes in his book *The Wealth and Poverty of Nations* offer a useful message on which to conclude: “In this world, the optimists have it, not because they are always right, but because they are positive. Even when wrong, they are positive, and that is the way of achievement, correction, improvement, and success. Educated, eyes-open optimism pays; pessimism can only offer the empty consolation of being right. The one lesson that emerges is the need to keep trying. No miracles. No perfection. No millennium. No apocalypse. We must cultivate a sceptical faith, avoid dogma, listen and watch well, try to clarify and define ends, the better to chose means.”<sup>1</sup>

While the obstacles are great, there is much to be optimistic about. There are already numerous potential solutions. Ongoing efforts are needed to evaluate, replicate and scale those that are likely to be most effective. Better governance and accountability on the part of both donor and developing country governments will be absolutely essential to achieving this. Such governance and accountability will also be important on the part of corporations, trade unions and NGOs. At the same time, leaders in the public, private and civic sectors will need to become better innovators and risk-takers, willing to experiment with new models and approaches that span traditional boundaries. And all of these leaders will need to learn from and work with the millions of men, women and young people living and working in low-income urban and rural communities, many of them as self-employed entrepreneurs who are not asking for charity but rather seeking opportunity.



# ENDNOTES

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## EXECUTIVE SUMMARY

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## PART I: A GROWING CONSENSUS ON DEVELOPMENT AND POVERTY REDUCTION

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3. This section draws from:
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  - Nelson, Jane. Prescott, David. Held, Stefanie. *Partnering for Success: Business perspectives on Multistakeholder Partnerships*. World Economic Forum in cooperation with the International Business Leaders Forum and Kennedy School of Government, Harvard University, 2005.
4. Landes, David. S. *The Wealth and Poverty of Nations: Why some are so rich and some so poor*. New York and London: W.W. Norton & Company, 1999, 1998.
5. *Doing Business in 2004: Understanding regulation*. A co-publication of the World Bank, the International Finance Corporation, and Oxford University Press, 2004.
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## PART VI: CONCLUSIONS AND RECOMMENDATIONS

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## APPENDIX I: THE MILLENNIUM DEVELOPMENT GOALS

### GOAL 1 ERADICATE EXTREME POVERTY AND HUNGER

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**TARGET 1.** Halve, between 1990 and 2015, the proportion of people whose income is less than \$1 a day

• **Indicators**

1. Proportion of population below \$1 (1993 PPP) per day (World Bank)<sup>a</sup>
2. Poverty gap ratio [incidence x depth of poverty] (World Bank)
3. Share of poorest quintile in national consumption (World Bank)

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**TARGET 2.** Halve, between 1990 and 2015, the proportion of people who suffer from hunger

• **Indicators**

4. Prevalence of underweight children under five years of age (UNICEF-WHO)
5. Proportion of population below minimum level of dietary energy consumption (FAO)

### GOAL 2 ACHIEVE UNIVERSAL PRIMARY EDUCATION

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**TARGET 3.** Ensure that, by 2015, children everywhere, boys and girls alike, will be able to complete a full course of primary schooling

• **Indicators**

6. Net enrolment ratio in primary education (UNESCO)
7. Proportion of pupils starting grade 1 who reach grade 5 (UNESCO)<sup>b</sup>
8. Literacy rate of 15-24 year-olds (UNESCO)

### GOAL 3 PROMOTE GENDER EQUALITY AND EMPOWER WOMEN

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**TARGET 4.** Eliminate gender disparity in primary and secondary education, preferably by 2005, and in all levels of education no later than 2015

• **Indicators**

9. Ratio of girls to boys in primary, secondary and tertiary education (UNESCO)
10. Ratio of literate women to men, 15-24 years old (UNESCO)
11. Share of women in wage employment in the non-agricultural sector (ILO)
12. Proportion of seats held by women in national parliament (IPU)

## GOAL 4 REDUCE CHILD MORTALITY

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**TARGET 5. Reduce by two-thirds, between 1990 and 2015, the under-five mortality rate**

- **Indicators**

13. Under-five mortality rate (UNICEF-WHO)
14. Infant mortality rate (UNICEF-WHO)
15. Proportion of 1 year-old children immunised against measles (UNICEF-WHO)

## GOAL 5 IMPROVE MATERNAL HEALTH

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**TARGET 6. Reduce by three-quarters, between 1990 and 2015, the maternal mortality ratio**

- **Indicators**

16. Maternal mortality ratio (UNICEF-WHO)
17. Proportion of births attended by skilled health personnel (UNICEF-WHO)

## GOAL 6 COMBAT HIV/AIDS, MALARIA AND OTHER DISEASES

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**TARGET 7. Have halted by 2015 and begun to reverse the spread of HIV/AIDS**

- **Indicators**

18. HIV prevalence among pregnant women aged 15-24 years (UNAIDS-WHO-UNICEF)
19. Condom use rate of the contraceptive prevalence rate (UN Population Division)<sup>e</sup>
  - a. Condom use at last high-risk sex (UNICEF-WHO)
  - b. Percentage of population aged 15-24 years with comprehensive correct knowledge of HIV/AIDS (UNICEF-WHO)<sup>d</sup>
  - c. Contraceptive prevalence rate (UN Population Division)
20. Ratio of school attendance of orphans to school attendance of non-orphans aged 10-14 years (UNICEF-UNAIDS-WHO)

**TARGET 8. Have halted by 2015 and begun to reverse the incidence of malaria and other major diseases**

- **Indicators**

21. Prevalence and death rates associated with malaria (WHO)
22. Proportion of population in malaria-risk areas using effective malaria prevention and treatment measures (UNICEF-WHO)<sup>e</sup>
23. Prevalence and death rates associated with tuberculosis (WHO)
24. Proportion of tuberculosis cases detected and cured under DOTS (internationally recommended TB control strategy) (WHO)

## **GOAL 7 ENSURE ENVIRONMENTAL SUSTAINABILITY**

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**TARGET 9. Integrate the principles of sustainable development into country policies and programmes and reverse the loss of environmental resources**

- **Indicators**

25. Proportion of land area covered by forest (FAO)
26. Ratio of area protected to maintain biological diversity to surface area (UNEP-WCMC)
27. Energy use (kg oil equivalent) per \$1 GDP (PPP) (IEA, World Bank)
28. Carbon dioxide emissions per capita (UNFCCC, UNSD) and consumption of ozone-depleting CFCs (ODP tons) (UNEP-Ozone Secretariat)
29. Proportion of population using solid fuels (WHO)

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**TARGET 10. Halve, by 2015, the proportion of people without sustainable access to safe drinking water and basic sanitation**

- **Indicators**

30. Proportion of population with sustainable access to an improved water source, urban and rural (UNICEF-WHO)
31. Proportion of population with access to improved sanitation, urban and rural (UNICEF-WHO)

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**TARGET 11. Have achieved by 2020 a significant improvement in the lives of at least 100 million slum dwellers**

- **Indicators**

32. Proportion of households with access to secure tenure (UN-HABITAT)

## **GOAL 8 DEVELOP A GLOBAL PARTNERSHIP FOR DEVELOPMENT**

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**TARGET 12. Develop further an open, rule-based, predictable, non-discriminatory trading and financial system (includes a commitment to good governance, development, and poverty reduction- both nationally and internationally)**

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**TARGET 13. Address the special needs of the Least Developed Countries (includes tariff- and quota-free access for Least Developed Countries' exports, enhanced programme of debt relief for heavily indebted poor countries [HIPC] and cancellation of official bilateral debt, and more generous official development assistance for countries committed to poverty reduction)**

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**TARGET 14. Address the special needs of landlocked developing countries and small island developing states (through the Programme of Action for the Sustainable Development of Small Island Developing States and 22nd General Assembly provisions)**

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**TARGET 15. Deal comprehensively with the debt problems of developing countries through national and international measures in order to make debt sustainable in the long term**

\*Indicators for targets 12-15 are given below in a combined list.

- **Indicators**

#### **Official development assistance (ODA)**

33. Net ODA, total and to LDCs, as percentage of OECD/Development Assistance Committee (DAC) donors' gross national income (GNI)(OECD)
34. Proportion of total bilateral, sector-allocable ODA of OECD/DAC donors to basic social services (basic education, primary health care, nutrition, safe water and sanitation) (OECD)
35. Proportion of bilateral ODA of OECD/DAC donors that is untied (OECD)
36. ODA received in landlocked developing countries as a proportion of their GNIs (OECD)
37. ODA received in small island developing States as proportion of their GNIs (OECD)

#### **Market access**

38. Proportion of total developed country imports (by value and excluding arms) from developing countries and from LDCs, admitted free of duty (UNCTAD, WTO, WB)
39. Average tariffs imposed by developed countries on agricultural products and textiles and clothing from developing countries (UNCTAD, WTO, WB)
40. Agricultural support estimate for OECD countries as percentage of their GDP (OECD)
41. Proportion of ODA provided to help build trade capacity (OECD, WTO)

#### **Debt sustainability**

42. Total number of countries that have reached their Heavily Indebted Poor Countries Initiative (HIPC) decision points and number that have reached their HIPC completion points (cumulative) (IMF- World Bank)
43. Debt relief committed under HIPC initiative (IMF-World Bank)
44. Debt service as a percentage of exports of goods and services (IMF-World Bank)

*Some of the indicators listed below are monitored separately for the least developed countries, Africa, landlocked developing countries, and small island developing states*

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### **TARGET 16. In cooperation with developing countries, develop and implement strategies for decent and productive work for youth**

- **Indicators**

45. Unemployment rate of young people aged 15-24 years, each sex and total (ILO)

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### **TARGET 17. IN COOPERATION WITH PHARMACEUTICAL COMPANIES, PROVIDE ACCESS TO AFFORDABLE ESSENTIAL DRUGS IN DEVELOPING COUNTRIES**

- **Indicators**

46. Proportion of population with access to affordable essential drugs on a sustainable basis (WHO)

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### **TARGET 18. IN COOPERATION WITH THE PRIVATE SECTOR, MAKE AVAILABLE THE BENEFITS OF NEW TECHNOLOGIES, ESPECIALLY INFORMATION AND COMMUNICATIONS TECHNOLOGY**

- **Indicators**

47. Telephone lines and cellular subscribers per 100 population (ITU)
48. Personal computers in use per 100 population and Internet users per 100 population (ITU)

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**FOOTNOTES:**

- a** For monitoring country poverty trends, indicators based on national poverty lines should be used, where available.
- b** An alternative indicator under development is “primary completion rate”.
- c** Among contraceptive methods, only condoms are effective in preventing HIV transmission. Since the condom use rate is only measured amongst women in union, it is supplemented by an indicator on condom use in high-risk situations (indicator 19a) and an indicator on HIV/AIDS knowledge (indicator 19b). Indicator 19c (contraceptive prevalence rate) is also useful in tracking progress in other health, gender and poverty goals.
- d** This indicator is defined as the percentage of population aged 15-24 who correctly identify the two major ways of preventing the sexual transmission of HIV (using condoms and limiting sex to one faithful, uninfected partner), who reject the two most common local misconceptions about HIV transmission, and who know that a healthy-looking person can transmit HIV. However, since there are currently not a sufficient number of surveys to be able to calculate the indicator as defined above, UNICEF, in collaboration with UNAIDS and WHO, produced two proxy indicators that represent two components of the actual indicator. They are the following: (a) percentage of women and men 15-24 who know that a person can protect herself from HIV infection by “consistent use of condom”; (b) percentage of women and men 15-24 who know a healthy-looking person can transmit HIV.
- e** Prevention to be measured by the percentage of children under 5 sleeping under insecticide-treated bednets; treatment to be measured by percentage of children under 5 who are appropriately treated.
- f** An improved measure of the target for future years is under development by the International Labour Organisation (ILO).

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## APPENDIX II: RECOMMENDED ACTIONS OF THE UNITED NATIONS ‘COMMISSION ON THE PRIVATE SECTOR AND DEVELOPMENT’

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### ACTIONS IN THE PUBLIC SPHERE: CREATE AN ENABLING ENVIRONMENT

#### 1. Recommended actions by developing country governments

- i) Reform regulations and strengthen the rule of law
- ii) Formalize the economy
- iii) Engage the private sector in the policy process

#### 2. Recommended actions by developed country governments

- i) Facilitate a conducive international macroeconomic environment and trade regime
- ii) Redirect the operational strategies of multilateral and bilateral development institutions and agencies
- iii) Untie aid

#### 3. Recommended actions by multilateral development institutions

- i) Apply the Monterrey recommendations of specialization and partnerships to private sector development activities
- ii) Address informality in developing countries

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### ACTIONS IN THE PUBLIC-PRIVATE SPHERE: PARTNER AND INNOVATE

#### 1. Facilitate access to broader financing options

#### 2. Assist skill and knowledge development

#### 3. Make possible sustainable delivery of basic services, particularly energy and water

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### ACTIONS IN THE PRIVATE SPHERE: MOBILIZE CAPABILITIES AND RESOURCES

#### 1. Recommended actions by the private sector

- i) Channel private initiative into development efforts
- ii) Develop linkages with multinational and large domestic companies to nurture smaller companies
- iii) Pursue business opportunities in bottom-of-the-pyramid markets
- iv) Set standards

#### 2. Recommended actions by civil society and labour organizations

- i) Increase accountability in the system
- ii) Develop new partnerships and relationships to achieve common objectives

*Source:* United Nations Commission on the Private Sector and Development report to the UN Secretary-General – *Unleashing Entrepreneurship: Making markets work for the poor*, 2004

## APPENDIX III: OECD'S FIVE STAGE ANALYTICAL FRAMEWORK to assess whether the conditions are in place for the private sector to deliver growth, and to identify those changes to institutions and policies that would help make growth more pro-poor

<b>INSTITUTIONS AND POLICIES TO PROVIDE INCENTIVES FOR ENTREPRENEURSHIP AND INVESTMENT</b>	<ul style="list-style-type: none"> <li>• <b>Entry and Exit Barriers:</b> ease of business establishment; ease of bankruptcy procedures; less bureaucracy</li> <li>• <b>Predictable Rules of Exchange:</b> transparent decision-making; enforcement of contract; transferable property rights; level playing field with public sector and larger businesses.</li> <li>• <b>Macro stability:</b> political and social stability; monetary and fiscal discipline; wider tax base; redirecting public expenditure towards basic services for the poor and increasing the productivity of investment in them</li> <li>• <b>Governance:</b> law and order; access to justice; protection of human rights; lower corruption</li> <li>• <b>Factor Markets:</b> financial sector deepening; flexible labour markets with growing demand for labour; secure access to natural resources on a sustainable basis.</li> </ul>
<b>INSTITUTIONS AND POLICIES TO INCREASE PRODUCTIVITY: Competition and Innovation</b>	<ul style="list-style-type: none"> <li>• <b>Business services, structures &amp; Networks:</b> Disseminating knowledge; Business services; business linkages; clusters; business organisations.</li> <li>• <b>Research &amp; Technology Organisations. Academia:</b> Agricultural research &amp; extension; scientific research; innovation support</li> </ul>
<b>INSTITUTIONS AND POLICIES TO HARNESS INTERNATIONAL ECONOMIC LINKAGES</b>	<ul style="list-style-type: none"> <li>• <b>Trade Openness:</b> Tariff &amp; non-tariff policy; trade facilitation; domestic &amp; trade infrastructure, improving access for the poor; building domestic capability to trade &amp; compete, export diversification; competitive exchange rates; access to knowledge and productive resources, particularly for the poor; policies to help the poor take advantage of new opportunities and to protect the vulnerable</li> <li>• <b>Foreign Investment:</b> Conditions for entrepreneurship and investment; few regulatory restrictions applied transparently; FDI facilitation, particularly in sectors likely to benefit the poor; business linkages with domestic firms; Prudent borrowing from abroad.</li> </ul>
<b>INSTITUTIONS AND POLICIES TO IMPROVE MARKET ACCESS AND FUNCTIONING</b>	<ul style="list-style-type: none"> <li>• <b>Capital Markets:</b> Macro stability; interest rate liberalisation; reducing government interference in the lending decisions of the banks; financial codes &amp; standards; corporate governance; financial infrastructure; competitive banking system; increasing the integration of financial institutions serving the poor into the mainstream financial system.</li> <li>• <b>Labour Markets:</b> Core labour standards; health &amp; safety; realistic minimum wages; flexible labour markets; information on opportunities; education &amp; vocational training to reduce inequality for the poor.</li> <li>• <b>Natural Resource Markets:</b> Secure rights of access; equal access for the poor; sustainable natural resource use.</li> <li>• <b>Correcting Market Failures:</b> Monopolies and restrictive practices; aligning private and public benefits; private provision of public goods through; public-private partnerships; addressing inequality in access to information; developing linked markets.</li> <li>• <b>Pro-poor Value Chains:</b> Regulating &amp; promoting standards, quality; certification to reach the poor; competition to reduce the value captured by functions in the value chain; providing linked services.</li> <li>• <b>Social Cohesion &amp; Sustainable Development:</b> Institutions for gender, ethnic discrimination; mitigation conflict; building bridging and linking capital without excluding others; sustainable development.</li> </ul>
<b>INSTITUTIONS AND POLICIES TO MANAGE RISK AND VULNERABILITY</b>	<ul style="list-style-type: none"> <li>• <b>Macro Economic Stability:</b> Prudent fiscal, monetary policies; sound banking supervision; low currency and sovereign risk.</li> <li>• <b>Markets for Productive Resources:</b> Increased access to finance to support recovery from shocks; greater opportunity for diversifying livelihoods; greater access to natural resources.</li> <li>• <b>Markets for risk Insurance:</b> Drought insurance; livestock insurance; savings instruments to mitigate risk.</li> <li>• <b>Social Safety Nets &amp; Smart Transfers:</b> Food for work; smart transfers for health &amp; education; livelihood support after shocks; social insurance (disability, pensions).</li> <li>• <b>Investment in Disadvantaged Areas:</b> Increasing the incentive for entrepreneurship and investment; stimulating productivity growth; efficient public expenditure on health, education, water, other infrastructure, particularly in areas in which the poor live; area based programmes to improve market access and functioning.</li> </ul>

Source: Accelerating Pro-Poor Growth through Support for Private Sector Development, OECD's Development Assistance Committee (DAC) Network on Poverty Reduction, 2004

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## APPENDIX IV: THE PARIS DECLARATION ON AID EFFECTIVENESS

Endorsed on March 2, 2005

### Indicators of Progress

To be measured nationally and monitored internationally

#### OWNERSHIP

- 1 Partners have operational developmental strategies – Number of countries with national development strategies (including PRSs) that have clear strategic priorities linked to a medium-term expenditure framework and reflected in annual budgets.

#### ALIGNMENT

- 2 Reliable country systems – Number of partner countries that have procurement and public financial management systems that either (a) adhere to broadly accepted good practices or (b) have a reform programme in place to achieve these.
- 3 Aid flows are aligned on national priorities – Percent of aid flows to the government sector that is reported on partners' national budgets.
- 4 Strengthen capacity by coordinated support – Percent of donor capacity-development support provided through coordinated programmes consistent with partners' national development strategies.
- 5a Use of country public financial management systems – Percent of donors and of aid flows that use public financial management systems in partner countries, which either (a) adhere to broadly accepted good practices or (b) have a reform programme in place to achieve these.
- 5b Use of country procurement systems – Percent of donors and of aid flows that use partner country procurement systems which either (a) adhere to broadly accepted good practices or (b) have a reform programme in place to achieve these.
- 6 Strengthen capacity by avoiding parallel implementation structures – Number of parallel project implementation units (PIUs) per country.
- 7 Aid is more predictable – Percent of aid disbursements released according to agreed schedules in annual or multi-year frameworks.
- 8 Aid is united – Percent of Bilateral aid that is united.

#### HARMONISATION

- 9 Use of common arrangements or procedures – Percent of aid provided as programme-based approaches.
- 10 Encourage shared analysis – Percent of (a) field missions and/or (b) country analytic work, including diagnostic reviews that are joint.

#### MANAGING FOR RESULTS

- 11 Results-oriented frameworks – Number of countries with transparent and monitorable performance assessment frameworks to assess progress against (a) the national development strategies and (b) sector programmes.

#### MUTUAL ACCOUNTABILITY

- 12 Mutual accountability – Number of partner countries that undertake mutual assessments of progress in implementing agreed commitments on aid effectiveness including those in this Declaration.

*\* Note on Indicator 5: Scores for Indicator 5 are determined by the methodology used to measure quality of procurement and public financial management systems under Indicator 2 above.*

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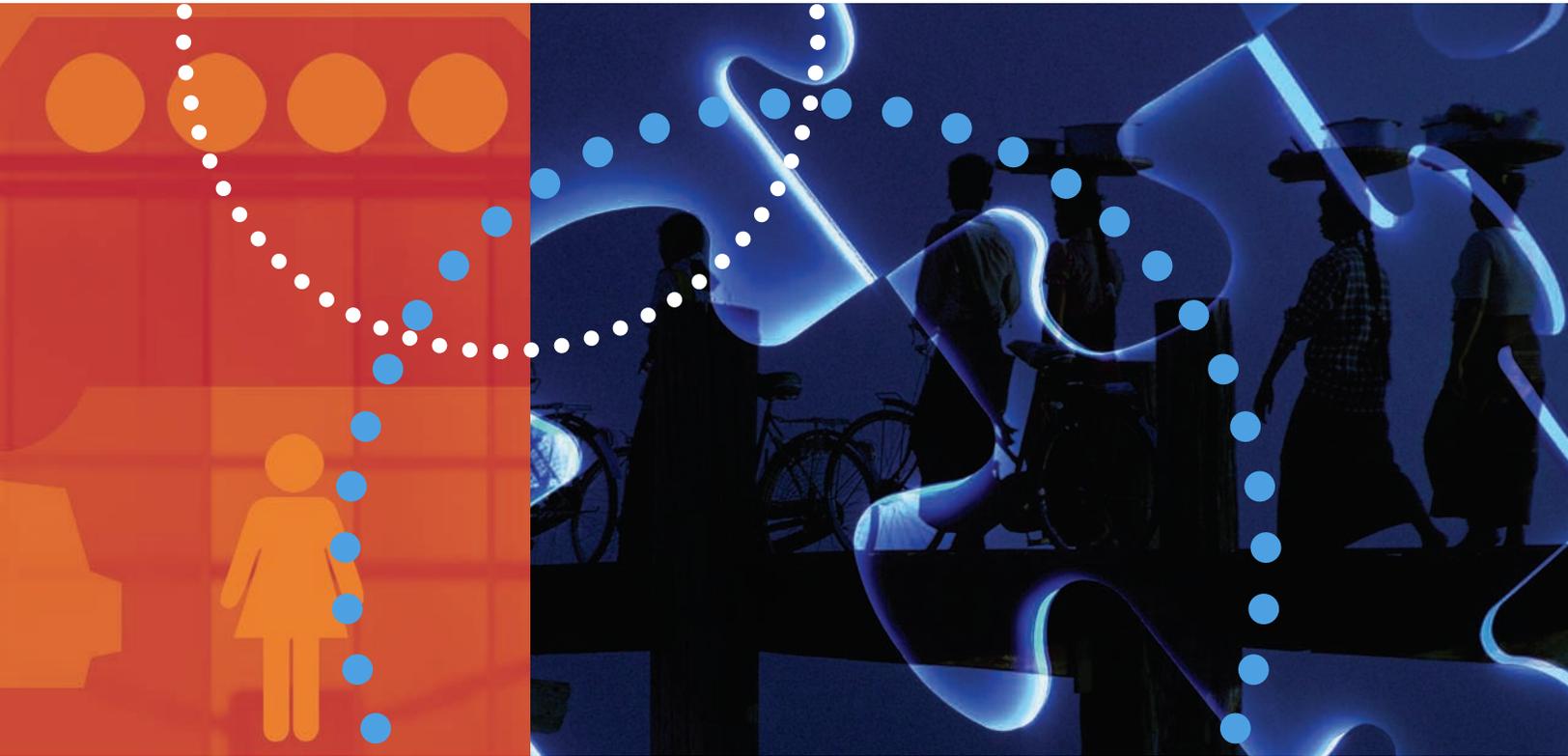
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### **UNIDO, CSR Programme**

*The United Nations Industrial Development Organization (UNIDO) is a Specialised United Nations Agency with a mandate to prevent the marginalisation of developing countries and to contribute to the eradication of poverty through the promotion of sustainable industrial development. The UNIDO CSR Programme is based on the Organization's business partnership approach that aims to upgrade the overall productivity and competitiveness of small enterprises and suppliers in order to facilitate their access to larger value chains and trade networks. This initiative is multi-disciplinary in character, integrating environmental and social issues into a productivity and quality upgrading programme. Thus, it promotes the broader concepts of good corporate citizenship and responsible competitiveness as prerequisites for sustainable industrial development. The UNIDO CSR Programme may be seen as a practical contribution to the ongoing CSR debate, developing interventions at the company and policy levels that support businesses, in particular small and medium enterprises, to successfully adhere to CSR-related principles and norms.*

### **Kennedy School of Government, Corporate Social Responsibility Initiative**

*The Corporate Social Responsibility Initiative at the Kennedy School of Government is a multi-disciplinary and multi-stakeholder program that seeks to study and enhance the public role of private enterprise. It explores the intersection of corporate responsibility, corporate governance and strategy, public policy, and the media. It bridges theory and practice, builds leadership skills, and supports constructive dialogue and collaboration among different sectors. It is a cooperative effort among the Kennedy School's Mossavar-Rahmani Center for Business and Government, Center for Public Leadership, Hauser Center for Non-Profit Organizations, and Joan Shorenstein Center on the Press, Politics, and Public Policy. It was founded in 2004 with the support of Chevron Corporation, The Coca-Cola Company, General Motors, and Walter H. Shorenstein.*



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