Chapter 1 Identifying the business case

Kunda Nordic Cement before changes

Many opportunities exist for businesses in emerging markets to benefit from actions which advance sustainable development.

Developing Value reaches this conclusion on the basis of the first large-scale study to analyze the extent and nature of the financial benefits that companies in emerging markets gain from sound environmental practice, social development and economic progress — which we describe as the 'business case' for sustainability. (For a definition of 'sustainability' see Box 1.) This study documents more than 240 real-life examples from over 60 emerging markets (see Box 2) which show how owners and managers of businesses of all sizes and types have enjoyed business success as a result of improved environmental, social or governance performance, despite some of the risks.

The evidence from 176 companies[3] shows that many emerging market businesses have been involved in areas such as social development or environmental improvements, and have achieved cost savings, revenue growth and other business benefits. The companies range from small businesses to multinational corporations in Africa, Latin America, Asia, the Middle East, and Central & Eastern Europe.

This is important because sustainability is rapidly moving up the business agenda globally, while the business environment has become significantly more competitive and volatile. The greater importance of the private sector in all regions and countries at all stages of economic development has fuelled concerns about globalization, the role of markets and global governance. Consumers, investors, policy-makers and NGOs have raised issues about worsening environmental and social problems, and the unequal distribution of benefits from globalization.[4]

Emerging markets context

The sustainability debate has been most visible in developed countries. But in emerging markets, too, public interest and the intensity of debate is rapidly increasing. A recent analysis[5] shows that through the second half of the 1990s, interest in globalization grew exponentially in Asia and Latin America, although it has declined in Latin America in the last couple of years. Events like the 2002 UN World Summit on Sustainable Development (WSSD) in Johannesburg help recharge the debate and ensure that sustainable development continues to increase in importance.

They also help focus attention on the needs of a world which will soon have to accommodate 8 billion people, where environmental resources will be under greater stress, while new health and security risks emerge, and issues of equity and access to resources, technology and markets will grow in importance.

Rafael Wong, executive vice president, **Reybancorp**, Ecuador, commented, 'When we first obtained financing from IFC, the environmental standards seemed like an obstacle, but we now realize that they have helped us to build a strong business. In five years, there will be no access to international markets for companies that do not show respect for the environment. It is becoming fundamental to international trade.'[6]

While the trajectory of sustainable development's profile is likely to continue rising, the subject will continue to be volatile. New issues are likely to emerge, often unpredictably. The challenges of three years hence will be very different from those three years ago.

These challenges will have to be met in a difficult political and economic environment, with falling commodity prices and weak global economic conditions. Companies continue to struggle against corruption, crime, lack of infrastructure and unrealistic regulation, and have had to face economic crises in major markets like Argentina and Turkey, political unrest in Central and Southern Asia, and concern in Southern Africa over Zimbabwe and the falling rand.

Net private capital flows to the major emerging markets fell from $169 billion[7] in 2000 to $132 billion in 2001.[8] The growth of trade slowed and the trend in real commodity prices relative to manufactured goods prices shows no sign of improving. As a result, growth of real gross domestic product (GDP) in developing countries was forecast to increase by 1.3% in 2001, down from 3.8% growth in 2000.[9]

Poverty remains endemic — almost a quarter of the population in emerging markets lived on less than $1 per day in 1999,[10] while 28% of the world's children under five years of age are malnourished. HIV/AIDS incidence is increasing — 36 million people were affected around the world in 2000, with the majority living in Southern Africa and South and East Asia. Over 1 billion people worldwide do not have access to safe water sources.[11]

However, there are some encouraging statistics. The economies of Central and Eastern Europe were spared most of the upheaval of 2001's global slowdown, with GDP growth rates averaging 5%.[12] Further, the situation for emerging markets as a whole is set to improve in 2002, with private capital flows expected to recover – rising to $160 billion.[13] Many developing countries are on track to achieve one of the Millennium Development Goals: universal primary education by 2015, and some are significantly reducing infant and under-five mortality.[14] It is against this background, and in the context of globalization and growing concerns over the role of private firms in addressing environmental and social issues, that we have undertaken this study.

Key audiences for the report

This report is aimed at helping business people in emerging markets who are struggling to find the right balance between financial pressures on the one hand, and growing sustainability challenges on the other. It analyzes the benefits derived from implementing better governance, social and environmental practices and provides a starting point for companies to develop their own sustainability path. The analysis is based not on model companies who got it all right, but on ordinary companies that have implemented some sustainability practices and found value. While many of these findings might be intuitive, e.g. cost savings from environmental efficiency, this analysis provides a hook and basis for the intuition. It also raises new ideas and opportunities that companies can tap into.

The main audience for the report is business managers who are relatively new to the debate around sustainability. The report covers many kinds of companies which operate in emerging markets, from local small and medium sized enterprises (SMEs) to multinationals based in developed countries. For those leading companies that have already integrated sustainability into their vision, we hope the opportunities and case studies highlighted in *Developing Value* may spark new ideas. It may also help 'sell' the business case to any skeptics remaining in the organization, or to business partners such as suppliers.

Box 1
What is sustainability?

'Sustainability' is about ensuring long-term business success while contributing towards economic and social development, a healthy environment and a stable society. We use the term in this report to refer to the private sector's contribution to sustainable development – generally defined as 'meeting the needs of the present generation without compromising the ability of the future generations to meet their needs'.[15]

There are three broad components of sustainability. They are sometimes described as 'people, planet and profits', or the 'social, economic and environmental' dimensions. The need for businesses to address all three has been encapsulated in the concept of the 'triple bottom line'.

As well as these three components, there is also a process element to sustainability, concerned with accountability, transparency and engagement with stakeholders.

Sustainability is sometimes known as 'corporate social responsibility' or 'corporate citizenship'. Though we use sustainability here, we accept that in many respects the terms are synonymous. They cover the same broad aspects of the business: good governance, treatment of employees, impact on the environment, impact on local communities and business relationships with suppliers and customers.

Company case studies

The companies highlighted in *Developing Value* have undertaken a wide range of actions, from the strategic to the opportunistic, from major investments to relatively small changes in the way the business is run. In many cases the owners or managers were not explicitly addressing sustainable development, but were simply implementing what they saw as good management practices and sound business decisions.

Kunda Nordic Cement in Estonia demonstrates a more significant impact on the company as well as the community. Previously, the plant emitted high levels of pollution, adversely impacting the health of people and livestock, degrading soil and water and reducing catches by local fishermen. The plant implemented highly effective pollution prevention measures, yielding environmental benefits for Kunda and the entire Baltic region.

Kunda Nordic Cement after changes

Emissions were reduced by more than 98% of the 1992 level and the benefits in improved air quality extended throughout Estonia and as far away as Belarus, Finland, Norway, Poland, Russia and Sweden. This also saved Kunda operating costs of almost $173,000 per year. In addition, if the Kunda facility had failed to change its operations in 1992, environmental and business concerns would probably have forced management to close the plant.

Kurzemes Piens, a Latvian dairy, is an example of a small company benefiting from the practical application of basic sustainability concepts. It saw the investment in preventing leaks from its refrigeration system pay back in just four months. It has avoided 12 tons/year of ammonia emissions, which has improved health and safety for workers while saving $9,300 a year.

Structure of report

The relationships between the sustainability activities and financial performance in the cases we have gathered have been compiled in a business case matrix which graphically demonstrates the links between specific sustainability activities and measures of business success — both financial indicators and drivers. Details of our analysis, the key opportunities we found and the matrix itself are in **Chapter 2**, where we also address the counter-arguments from those who believe these issues are at best a distraction and at worst an attempt to disadvantage developing countries.

The key opportunities we describe are also documented in many examples throughout the report, as well as in four in-depth case studies from Brazil, China, the Czech Republic and South Africa.

While there is a business case to be found across all regions and types of companies, its specific nature varies. In **Chapter 3** we examine these differences, and include three country perspectives from Brazil, South Africa and the Philippines.

The analysis highlights the dynamic nature of the business case. Risks and opportunities evolve rapidly — what was relevant some years ago is not relevant today. Companies need to keep a long-term perspective in mind as they plan sustainability activities, even if they start with short-term actions. **Chapter 4** provides practical guidance for businesses looking to mitigate risks and maximize opportunities from sustainability.

Finally, although the private sector is being asked to contribute to social and environmental development, other players such as governments, NGOs and citizens play an important role in achieving sustainable development. They can strengthen the business case by providing companies with the right incentives and frameworks, as we show in **Chapter 5**. **Chapter 6** wraps up the discussion and highlights the key messages.

Box 2
Defining emerging markets[16]

The term 'emerging market' was originally coined by IFC to describe a fairly narrow list of middle-to-higher income economies among the developing countries, with stock markets in which foreigners could buy securities.
The term's meaning has since been expanded to include more or less all developing countries. Developing countries are those with a Gross National Income (GNI) per capita of $9,265 or less.[17]

Box 3
Who are stakeholders?

A stakeholder is any individual or group which can affect or is affected by an organization's or a project's activities, either positively or negatively. 'Stakeholders' are increasingly self-legitimizing — in other words, those who judge themselves to have an interest in an organization's operations, value and performance are de facto 'stakeholders'.

These include employees, local communities, local elected officials and local and central governments, indigenous groups and their traditional leaders, project sponsors, non-profit organizations, customers, financiers, shareholders, business partners, competitors and regulators.

The Bank of Shanghai
China

Board meeting, Bank of Shanghai

The Bank of Shanghai (BoS) was established in 1995 through an amalgamation of 99 urban credit cooperatives. It has grown rapidly and remains the largest of about 110 'city commercial banks' in China. But it is still relatively small: 4,500 employees, 45 branches and 198 business offices. The total assets for BoS under Chinese accounting standards were US$14.7 billion at the end of 2001. It is a full-service commercial bank but most lending is currently to SMEs in the Shanghai region.

Promoting the private sector by lending to small enterprises is considered a social responsibility as well as a commercial opportunity. But the Bank remains selective about the businesses it backs, and has ensured that the loan portfolio is balanced with infrastructure finance and larger corporate customers. It also aims to expand in consumer credit and housing loans.

But all the city banks face international competition following China's entry into the World Trade Organization, as well as competing with the four state-owned banks that dominate the sector and are undergoing extensive commercial restructuring.

Corporate governance and management systems

Corporate governance has improved dramatically since investment from the IFC, accompanied by the appointment of John Langlois (a former managing director of JPMorgan) as a director.

Previously the board's function was mainly to approve annual business plans and dividend payments. It has now assumed an important role in its three core functions: strategy development, accountability and control, and management selection and remuneration. Board meetings have increased in frequency from twice a year to at least four times a year. The board has set up an audit committee, a compensation committee and a risk management committee. It is engaged in much more active discussions with management on the strategic development of the Bank.

Board meetings now include discussions on specific subjects relating to the Bank's management and special topic seminars to equip the directors with modern banking concepts and trends. The directors have fundamentally changed their thinking on dividend payments, and begun to emphasize the importance of increasing retained earnings to strengthen capital adequacy.

The management team has introduced improvements in all operational areas reflecting international best practice, particularly in credit risk management and internal controls.

Business benefits

Improved corporate governance and increased transparency helped to attract investment from HSBC and other foreign banks, and are likely to bring forward the date of a listing on the stock exchange. The Bank will need further capital to finance growth and to fund the necessary infrastructure improvements, e.g. IT systems.

There has also been a significant culture change, part of which is greater long-term thinking, prompted by the more professional board focusing on strategy. Employees are generally more motivated, especially by the transparency which now allows them to see the Bank's financial progress, but some have found it hard to adjust to international standards and senior managers feel under greater pressure to deliver. Staff training is critical to continued improvements and addressing weaknesses more quickly. The new corporate governance standards have also improved the Bank's standing with regulators. The People's Bank of China has included BoS in a pilot corporate governance project aimed at improving standards throughout the country.

Fu Jianhua, CEO of the Bank of Shanghai, said, 'The cooperation between BoS and IFC has been very successful and it has played a significant role in BoS moving towards international standards and best practices in banking. We look forward to continuing our long-term partnership.' Brand recognition by customers will benefit from greater openness. It is very important for BoS to have established its credibility and brand name to retain its niche in the face of competition from foreign banks and the state owned banks.

Key barriers, challenges or difficulties

The main difficulty has been the increased pressure on management to address weaknesses. The International Accounting Standards audits that are part of the new governance structure have created a sense of urgency which is not appreciated by all staff. Some prefer the previous lack of transparency which helped to hide problems.