

Motivating business to act in socially responsible ways

Kirsten Cheryll Williams

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Question

What evidence exists around why businesses adopt more responsible (e.g. socially, environmentally) or pro-poor business practices? How can this be encouraged and scaled up across industries most effectively (other than through legal / regulatory changes – looking for the carrot rather than the stick)?

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The K4D helpdesk service provides brief summaries of current research, evidence, and lessons learned. Helpdesk reports are not rigorous or systematic reviews; they are intended to provide an introduction to the most important evidence related to a research question. They draw on a rapid desk-based review of published literature and consultation with subject specialists.

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1. Overview

Businesses, both large multinational companies (MNCs) and Small and Medium sized enterprises (SMEs), have paid considerable attention to the surge in inclusive innovation and socially responsible business practice. At the new frontiers of doing socially responsible business, companies pursue social and environmental aims, insofar as there are financial gains. However, the way that businesses relate to these social and environmental elements is shifting. There are increasingly more examples of businesses pursuing intrinsic value creation by integrating simultaneously social/environmental and growth objectives in their business model. These new frontiers, most vividly captured in the innovation literature, attract businesses to see new possibilities at Bottom of the Pyramid (BOP) markets. The successful ventures in this kind of innovation targeted to lower income markets - also referred to as 'frugal innovation' - are characterized by well-thought through multi-stakeholder partnerships and business models that have been entirely re-conceived.

This report draws out the key incentives to social responsible business practices, reviewing how such practices can be encouraged and scaled.

The first section reviews some of the main incentives to adopting socially responsible business practices. This includes: a desirable corporate image, the personal preferences of managers and shareholders and the opportunity of tapping into markets at the bottom of the pyramid (BOP).

Socially responsible behaviours take place within an ecosystem of other actors and multi-stakeholder approaches. Development partners and governments appreciate the private sector as a key ally in achieving sustainable development goals. The second section of this report explores the ways in which CSR can be encouraged. Corporate Social Responsibility (CSR) can be promoted through four strategies: partnering, facilitating, endorsing and mandating (Carroll and Shabana, 2010). As this report is more concerned with the carrot, rather than the stick of encouraging sustainable business practices, only the first three strategies are reviewed.

The final section surfaces some of the strategies that are being used to scale-up socially responsible business. Given that the field of frugal innovation and BOP is relatively young and poorly measured, the literature provides a limited understanding of how to scale up sustainable practices. Even so, the report abstracts a few salient approaches with regards to scaling up: expanding reach, measuring beyond compliance, facilitating access to finance, and designing appropriate products.

Overall, the academic literature around socially responsible businesses is ample, yet the notion of what is meant by CSR has been evolving. There is a significant amount of literature that associates CSR to more traditional philanthropic practices. Some authors criticize this approach to CSR for being too narrow and extrinsic from the firm's business model. Others have re-conceptualized the term. Meanwhile, an even larger body of literature is decisively distinguishing itself from the concept CSR by introducing new concepts; for example, creating shared value (CSV) and inclusive innovation have emerged in this new space. Although many authors point to the invariable overlap between the CSR, Creating Shared Value and Inclusive Innovation fields (among others), most studies insist on their differences. As such, this report will use 'socially

responsible practices' or 'inclusive business' to more broadly refer to companies integrating a social and environmental lens into their operations.

The literature also offers several examples of socially responsible business, but these accounts tend to be anecdotal and lack external peer-review. Moreover, most cited cases are of Western MNCs, mostly in the trade and industry sectors, operating in the Global South. Among Southern examples, the vast majority of studies concentrate around examples of frugal innovations in emerging economies in India and China. Many studies point to the weak evaluation mechanisms of socially responsible businesses, and the subsequent gap in knowledge in terms of real impact in the community and on the firm. There are also far less studies on SMEs who, alongside social entrepreneurs, play a pivotal role in frugal innovations.

This report is interested in exploring some of the more recent tendencies while underscoring that which many authors have stated: universal principles around socially responsible business can come to the detriment of truly meeting local challenges and opportunities.

2. Incentives to adopt more responsible business practices

Corporate Image and Legitimacy

Maintaining a positive corporate image remains one of the most salient motivators for companies to employ inclusive business practices. Ever since consumers and stakeholders began to hold Western MNCs accountable for their activities in developing countries, corporate image has grown in importance (Wójcik, 2016). For MNCs, especially those in the most contested sectors including oil and gas, investing in public-facing social and environmental projects helps mitigate for negative externalities produced by these industries. Seen this way, MNCs engage in socially responsible activities to bolster their corporate image and subsequently obtain a 'social licence to operate' (Lamb et al, 2017; Idemudia, 2011).

Indeed, creating extrinsic social value to bolster the image of the business represents a traditional model of CSR that has been heavily criticized. Consumers and stakeholders are increasingly dubious of the authenticity of these efforts. As such there are a growing number of businesses that are creating shared value (CSV). This means reimagining business models so that economic value is generated alongside value for society (FSG, 2011). Businesses engaged in CSV create a corporate identity with a strong vision and set of values. This proves to be an effective strategy in the Global North where consumers and investors alike expect more from their companies (Edi, 2015). Maintaining a good reputation before stakeholders is what incentivizes businesses to uphold a positive corporate image (Schaltegger and Burritt, 2018).

The personal preferences of managers and shareholders

The case for altruism as a motivator of socially responsible business remains a highly contested point in management literature. Yet there is a growing body of socio-economic studies supporting the notion that shareholders and managers take decisions also guided by their values, emotions and judgements and not simply by profit-motivated self-interest (Wójcik, 2016; Graafland & Mazereeuw-Van der Duijn Schouten, 2012). Thus, the personal inclination of managers or

shareholders with social and/or environmental preferences can place pressure to generate inclusive business practices (Lambertini & Tampieri, 2015).

Indeed, Schaltegger and Burrit (2016) argue that one of the motivations to pursue sustainable business models stems from managers who are ethically motivated to mainstream sustainability in the business. By striving for organizational excellence, these corporations are constantly learning and innovating to become more resource efficient, create products and services that are environmentally and socially sound and cost-saving, and upholding the highest international standards. The likelihood of managers being favourable towards sustainability models can depend on the environment they are embedded in. Social capital is offered as one explanation as to why companies in countries of 'high social capital' engage in more socially responsible business practices compared to other sites (Jha & Cox, 2015). It is unclear how the individual preferences of managers and shareholders influence businesses in developing countries where there exists a different culture around socially responsible practices all together. Authors from the Global South argue that local perspectives have not been sufficiently captured in the literature and that they may have their own unique interpretations of inclusive businesses (Idemudia, 2011).

Within SMEs the instance for altruism and seeking out a more sustainable business model appears to be greater. Due to the size of these companies, the personal preferences of managers have more weight than might occur in MNCs (Graafland & Mazereeuw-Van der Duijn Schouten, 2012).

This type of 'sustainability management' is most common in high-tech industries; it remains unclear from the literature if a sustainability mind set can be applied across every industry. Currently, the strategic management literature is making a strong case that incorporating social and ecological activities can make business sense. However, there is not an automatic relationship between the personal inclination of managers or shareholders towards deeper sustainability and successful business models (Schaltegger & Burritt, 2018). As the next section will illustrate, numerous interventions are needed for this kind of integrated bottom line to work.

Expanding reach to bottom of the pyramid markets

While growth in developed markets stagnates, economic growth in emerging markets is booming at 5-8%. For businesses of every size, this presents a new opportunity (Indigo Policy, 2016) – that of reaching to over four billion historically neglected consumers (Sharma, 2015). An emerging body of literature in BOP and inclusive innovation, propounds the opportunity of tapping into the BOP and emerging markets. Ever since C.K Prahalad put pro-poor innovation on the map through his book 'The Fortune at the Bottom of the Pyramid', companies of all sizes have been keenly looking to tap into these 'mega-markets' of 'micro-consumers' at the BOP (Knorringa, Peša, Leliveld & van Beers, 2016). Prahalad and others argue that by addressing these poor markets companies can grow their global market share, increase profits, energize developing economies, and empower the world's most vulnerable citizens (Sharma, 2015).

Different models of social innovation are inviting businesses to re-engineer products, services and systems to generate profits while simultaneously alleviating poverty. The proposal is attractive because it plays into businesses' long-term self-interests (Graafland & Mazereeuw-Van der Duijn Schouten, 2012). There are countless examples of businesses that employed inclusive

innovation models to successfully make accessible to developing markets consumer goods, mobile telecommunications, and medical imaging (Chataway, Hanlin & Kaplinsky, 2014).

The term inclusive innovation is often associated with Western MNCs rolling out low-end disruptive innovations for BOP markets. Meanwhile, 'frugal innovation', is the more southern originating concept of innovation, born in India. The concept refers to the idea of providing no-frills and non-luxury products and services at a low-cost (Chataway, Hanlin & Kaplinsky, 2014). Haier, the Chinese home appliance firm, is cited as an example of effectively understanding and penetrating the BOP market in China. They designed the Mini Magical Child, a low-cost washing machine apt for small daily loads which better suited the needs of low-income families (Zeschky, Widenmayer & Gassmann, 2011). Given that low-income consumers in emerging economies are expected to grow into higher-consumer groups in the future, this market segment is of high interest for businesses (OECD, 2015).

Western MNCs have also launched their own frugal innovations in these markets. Their initiatives have been met with mixed success as illustrated by P&G's PUR-water and Unilever's Shakti which are briefly described in figure 1.

Figure 1: Western MNC-led Frugal Innovation

P&G's PUR-water	Unilever Shakti
Proctor and Gamble (P&G), alongside the Center for Disease Control and Prevention (CDC) jointly developed a powder-based packet to purify water. Although P&G identified access to potable water as a basic need, they failed to understand how to create a market around this product in slums and village settings. Because of this, the venture failed and was eventually turned into a non-profit (Calton, Werhane, Hartman & Bevan, 2013).	In 2000, Unilever launched the Shakti project – an initiative to train female entrepreneurs in villages to sell Unilever products. The project fused together educational programs, entrepreneurship training, and microfinance. Shakti entrepreneurs would take out small loans to buy into the project. They would then go to remote villages and organize informative sessions on basic health and hygiene. This made it easier to generate interest and know-how around the proposed products. By 2013, Shakti had formed over 65,000 female entrepreneurs and reached over 50,000 villages (Sharma 2015).

Financial gains in new markets doesn't appear to be the only incentive to pursuing BOP. One of the unexpected developments of MNC ventures in these markets is that they discovered products and services that could appeal to consumers back home. For example, General Electric (GE), a US MNC, illustrates one effective example with the launch of their no-frills ultrasound machine. Originally destined for rural areas in China, this product soon found new markets in under-resourced clinics worldwide (Zeschky, Widenmayer & Gassmann, 2011). As such, frugal innovation is also a source of new knowledge and it promotes knowledge flow.

3. Encouraging more responsible business practices

Partnering

Most of the successful case studies cited in the literature, strongly suggest that a multi-stakeholder approach is essential to enabling the impact of socially responsible businesses. The ability for said businesses to reach markets depends on the participation of government, development partners, civil society and communities (Calton, Werhane, Hartman & Bevan, 2013). In a study on public policies that spur CSR, the World Bank (2002) identified four policies pursued by government and development partners to spur socially responsible business: partnering, facilitating, endorsing, and mandating. These strategies have also attracted the interest of development partners and donors as illustrated in the Dutch Ministry of Foreign Affairs' (2013) most recent study. The report reviews the first three strategies.

Partnering consists of bringing together public and private efforts, and resources, to generate favourable socially responsible business practices. Governments and development partners utilize public-private partnerships (PPPs), stakeholder dialogues, and sector-wide agreements and covenants (DMFA, 2013). This approach is the most emphasized in the literature, albeit with mixed success.

Beyond convening opportunities for different actors to work together, development partners must keep in mind how to balance the different needs of key stakeholders in the partnership. On the one hand, socially responsible business must learn to work *with* BOP consumers in a more participatory way as opposed to treating them like the typical client (Calton, Werhane, Hartman & Bevan, 2013).

As detailed in the 2015 winter edition of the Stanford Social Innovation Review (2015) choosing the right partners is paramount. Stepping into a partnership with international NGOs and government organizations may backfire if communities have negative perceptions of them. Instead partnerships with local community members, NGOs, and burgeoning entrepreneurs is regarded as more effective. Unilever Shakti is one successful example of stakeholder engagement.

Yet, some businesses are hesitant to adopt more time-consuming and costly approaches; they seek 'profitable partnerships' that make social and business sense (Calton, Werhane, Hartman & Bevan, 2013). Businesses are ultimately accountable to their shareholders who often focus on profit maximization (Davies, 2011). As such development partners and governments have an important mediating role to play between the sustainable development agenda and business interests. Successful partnerships will also require stable and capable country-level governance – less common in fragile states (Fayyaz, Lindgreen & Lund-Thomsen, 2015).

Composed correctly, public-private partnerships can be essential mechanisms to help overcome the difficulties of scaling up and effectively expanding local markets to other communities (Calton, Werhane, Hartman & Bevan, 2013). SMEs make for interesting partners because of their local knowledge and access to resources in BOP markets in rural areas and smaller industrial cities (Indigo Policy, 2016). Partnering is also beneficial for SMEs that struggle to grow and survive on their own in highly competitive markets. Accessing global markets is appealing for these businesses, yet they might find it challenging to comply to CSR International Accountability Standards (IAS) (Jamali, Lund-Thomsen & Khara, 2017). They simply don't have the same

capacity and resources as their large MNC counterparts. Davies (2011) points to the power imbalances in the global supply chain pre-dominantly dictated by Western MNCs and Western institutions.

Although most management literature speaks about the accountability of MNCs, an increasing number of studies are indicating the need to hold SMEs more accountable. These authors surface the tendency for symbolic CSR efforts by these companies that don't have the same resources as large MNCs to divert into activities. This may lead to malpractice including the engagement of the informal economy and the lack of human rights protections that come with it (Jamali, Lund-Thomsen & Khara, 2017). Establishing partnerships is thus an inevitable balance between providing businesses incentives to operate in inclusive ways and expand such efforts, while also holding them accountable (Davies, 2011).

Facilitating

Through facilitating interventions, development partners and governments can help create a culture around socially responsible business practices. This includes actions such as awareness raising campaigns, procurement policies, incentives, tax rebates, subsidies, benchmarks, guidelines for reporting, and enabling the dissemination and adoption of labels and certificates (DMFA, 2013; World Bank, 2012).

FSG (2011), a global non-profit consulting firm, explains how international standards and certification schemes for sustainability assist businesses in becoming more aware of their impact on society. Such schemes provide benchmarks for further improvement. As socially responsible business practices become a norm, there are increased instances of companies voluntarily adopting codes of conduct in favour of good social and ecological practice (Jha & Cox, 2015). Since the Global Reporting Initiative (GRI) launched its voluntary sustainability standards to capture environmental, social, and governance (ESG) performance, over 3,500 organizations in over 60 countries have employed the tool.

Endorsing

Development partners and governments can also lend their political support behind socially responsible practices. Interventions including the endorsement of CSR label schemes, heralding best practices and supporting civil society transparency initiatives help create an enabling culture (DMFA, 2013).

By profiling best practices, governments and donors alike can highlight promising examples of inclusive business instead of perpetuating outdated models. Doing so sends signals to the industry about what kind of socially responsible practices have more social impact and are appealing from a business perspective (World Bank, 2002).

In fact, one of the main criticism that business receive in their attempts to be socially responsible is the lack of depth. For example, critics point out to the ineffectiveness of investing in projects over too short a period that doesn't allow to measure real impact (Fayyaz, Lindgreen & Lund-Thomsen, 2015). The lack of evaluation means that businesses are unable to maximize their

learning to improve future performance. Indeed, the development literature stresses that businesses need to be part of a broader structural solution to poverty alleviation. Efforts that meet material needs of low-income communities, do not necessarily address the structural causes of poverty (Knorringa, Peša, Leliveld & van Beers, 2016; Lamb et al, 2017).

For this reason, frugal innovation is a source of interest as entire business models are re-engineered to better work with and serve low-income consumers. While the frugal innovation discourse is growing in appeal, academics also caution about the possible inequality-inducing effect of such approaches. Critics point out that this business-led development creates dependency on products that are exogenous to communities and might create divisions by emphasizing the gap between those who can afford the new products and those who cannot (Sandra Schillo and M. Robinson, 2017).

4. Scaling up across industries

Expanding Reach

Achieving scale is essential for socially responsible businesses to succeed, especially those pursuing frugal innovations. Given that the unit costs of products and services are low, businesses need to sell high volumes and reach new customer bases to generate profit (Indigo Policy, 2016). To deepen channels to new markets often means improving physical infrastructure including IT networks, utilities, public transportation and health care facilities (SSIR, 2015), but also identifying alternative distribution channels.

To overcome the challenge of penetrating new markets, businesses can be supported through acceleration services that help grow the innovation quickly by offering a series of entrepreneurial support services (Indigo Policy, 2016). Many in the innovation literature also point to the value of investing in new technologies. The OECD (2015) articulates the need to incentivize research institutions to develop frugal innovations.

SMEs alone struggle to get their innovations to commercialise beyond a single market (Chataway, Hanlin & Kaplinsky, 2014). From this perspective, MNCs are still the best suited to scale frugal innovation given their access to resources, internal R&D capacity, and their ability to set up partnerships to gain more know-how (Indigo Policy, 2016).

Measuring beyond compliance

If businesses are in fact linking the social and economic to create value, then having a measurement mechanism that helps capture this is invaluable to the business' growth. In an issue on 'The Hidden Pitfalls to Inclusive Innovation' by the Stanford Social Innovation Review (SSIR) (2015), the authors argue that relying exclusively on the usual business metrics won't work for inclusive businesses looking to scale-up (SSIR, 2015). A CSV measurement, as proposed by FSG (2011) differs from sustainability, compliance and reputation indicators as it is the only one that measures the value that socially responsible practices creates for the business.

Data yielded from such CSV measurements is instrumental to secure further investments. More than for the mere purpose of reporting, such metrics provide business with key information to scale up. This asks businesses to go beyond compliance indicators and towards a more holistic

perspective. The information gathered is indispensable not only for the business but for its community of current and potential investors (FSG, 2011).

Facilitating access to finance

To facilitate expansion into new markets, businesses can be supported with venture capital funding, loans, and grants (Indigo Policy, 2016). Since low-income consumers will take time to respond to new markets, micro-saving and microcredit institutions can provide financial support. These intermediaries help to steady consumers' consumption patterns while they adapt to the new market. This also inevitably serves business ventures that are susceptible to market failures early on (OECD, 2015).

Facilitating access to finance is also a controversial proposal. Critics that argue companies, especially MNCs, proposing supposed inclusive business practices often resist, assuming growing social costs of compliance (Jamali, Lund-Thomsen & Khara, 2017).

Businesses themselves have financial capital they can invest to help scale-up. However, they are not likely to do so if top managers feel the venture is too risky and the environment is not suitable (SSIR, 2015). In effect, building a stable and transparent financial environment for socially responsible business ventures is essential to encouraging further investments (World Bank, 2002).

Designing appropriate products and services for the BOP market

Although frugal innovation at the BOP remains a source of interest, the business proposal has proved far more challenging than expected. Numerous studies of MNCs with frugal innovation affirm that understanding the local market, user behaviour, and their needs is critical to scaling effectively (Zeschky, Widenmayer & Gassmann, 2011).

For Western MNCs wishing to carry out inclusive business practices in developing countries, the learning curve is steeper. As P&G's case demonstrates, a lack of appropriate involvement of local knowledge and community member participation in the process can adversely affect the absorption of the product or service (Calton, Werhane, Hartman & Bevan, 2013). Indeed, a study on frugal innovations in emerging markets underscores the value of having local people in the Research and Development (R&D) teams (Zeschky, Widenmayer & Gassmann, 2011).

While expanding business activity into the low-cost segment appeals to companies, successful implementation requires far more research, development investments, and closer ties to local subsidiaries. Some businesses are moving in this direction, and many are certainly talking about it, but the vast majority have not taken this step (SSIR, 2015).

Locally-based SME's have also demonstrated a strong interest and aptitude for tapping into the BOP markets. They leverage their local knowledge of the market and the available resources in the environment to design appropriate and easily accessible products and services (Indigo Policy, 2016). MNCs are bringing in local SMEs into global value chain models (Fayyaz, Lindgreen & Lund-Thomsen, 2015). Combining forces, there are greater odds for these socially

responsible business practices to deliver goods and services that meet the evolving needs of low-income consumer in developing countries.

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